PACIFIC ASSOCIATION OF SUPREME AUDIT INSTITUTIONS

PASAI

"Pacific Auditors Working Together"

REGIONAL FINANCIAL AUDIT MANUAL

2020

FOREWORD

This manual is the first of PASAI's suite of Regional Audit Manuals. The other components of this suite are the manuals for Performance Audits and Compliance Audits. These manuals are a critical component of PASAI's support to developing SAIs in the region to assist them to complete high-quality audits. These manuals are part of the support and services PASAI offers to the SAIs of the region to enable the achievement of Strategic Priority 3 (SP3) of PASAI's Strategic Plan 2014-2024, which is aimed at achieving high-quality audits. These manuals alone will, however, not result in high-quality audits. It is essential that each SAI takes this manual and develops their own customised audit manual to ensure compliance with the International Standards of Auditing, whether that be ISSAIs, ISA, or GAGAS, that is relevant to their SAI. This manual has two components:

- PASAI Regional Audit Manual; and
- Case Study materials - including templates.

In the Pacific, most developing SAIs, due to a lack of resources and expertise, find it difficult to keep their audit manuals aligned with auditing standards, particularly given the rapid pace of change in recent years. The objective of the manuals in this suite is to provide guidance to help SAIs develop an approach to firstly customise the audit manuals so that they align to the requirements and realities of the SAI's unique operating environment. This will make the manuals more useful to the specific situation and needs of each SAI. PASAI is planning to provide support to SAIs through a workshop and SAI level support to ensure this important customisation phase is achieved and that the effectiveness of the regional manual is maximised.

The next and crucial step is to provide ongoing support to ensure the SAI manual remains consistent with SAI's implementation of the audit methodology as it used in conducting the related audits. PASAI will also ensure that SAIs are informed of changes to Standards so that their customised manuals remain aligned to the latest updates to auditing standards.

In addition, to assist with making the manuals useful and relevant, they incorporate templates, checklists, examples, and case studies intended to serve as useful aids to understanding the standards and approaches. Each of these components and PASAI's ongoing support is intended to result in a more sustainable outcome.

PASAI is encouraged by the commitment of SAIs to raise standards. The PASAI Governing Board has clearly heard from SAIs across the region the utmost dedication to raising SAI standards because of the SAIs commitment to providing high quality audit so that governance and accountability systems in their countries can be improved and the lives of citizens positively impacted

We take this opportunity to express our appreciation to the reviewers and experts working in SAIs within the Pacific region and Internationally (IDI) for their contributions and comments in the development of these manuals. They are acknowledged specifically within each Audit Manual.

John Ryan

Secretary-General of PASAI

Controller and Auditor-General of New Zealand

Acknowledgements

Martin Grimwood was PASAI's consultant engaged to develop the Audit manuals. He has worked extensively throughout the region being a former Auditor-General of Tuvalu and Deputy Auditor-General of Solomon Islands. He has also been Adviser and Mentor to the Office of the Auditor-General of Vanuatu and has just (December 2019) concluded a similar role in Solomon Islands.

Martin holds a joint honours degree in Accounting and Law from the University of Southampton and was awarded his Masters degree by the University of Bath for his pioneering research into the use of Qualitative Methods in Performance Auditing. He holds professional accounting qualifications with the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Association of Certified Accountants (CACA); he is also a qualified Company Secretary (ICSA).

He was a founder member of the original South Pacific Association of Supreme Audit Institutions (SPASAI) which was part of the Commonwealth Training Initiative (CTI) which arose from the 1986 Commonwealth Auditors-General conference in Ottawa under the chairmanship of Ken Dye. He was also involved developing the three-volume audit manual which was also part of the CTI.

In addition to his work in the Pacific Region, Martin has worked with Supreme Audit Institutions (SAI) in many countries including establishing the SAI in Bosnia-Hercegovina and Afghanistan.

The following are also to be acknowledge for reviewing the draft manual and providing feedback to PASAI's Consultant:

- Mrs. Sarah Markley, PASAI Deputy Secretary-General, SAI New Zealand
- Mr. Tiofilusi Tiueti, PASAI Specialist Advisor
- A'eau Agnes Aruwafu, former PASAI Director Technical Support
- Mrs. Sinaroseta Palamo-Iosefo, PASAI Director Practice Development

Also, to thank the Communication Unit of SAI New Zealand for making the manuals more user friendly through the formatting of the manuals to brand them as PASAIs.

Finally, PASAI Acknowledges the support of development partners in making it possible for the development of these Regional Audit Manuals

Australian Aid

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Copyright statement

Disclaimer statements

This manual has been developed by PASAI as a resource for SAIs in the Pacific region to help customise their own audit manuals.

The use of the manual is the responsibility of each individual SAI, having regard to its mandate, capacity and country circumstances. PASAI disclaims any responsibility or liability, where direct or indirect as a consequence of the use or application of this manual.

Version updates

It is important that records are kept of any major updates to the PASAI Regional Financial Audit manual:

Version	Details of updates made	Revised version issued	Signed off through GB approval (GB paper reference, dates, details)

ACRONYMS

AFROSAI-E	African Organisation of Supreme Audit Institutions – English Speaking
AFS	Annual Financial Statements
ANAO	Australian National Audit Office
AR	Audit Risk
CAAT	Computer Assisted Audit Technique
CACA	Chartered Association of Certified Accountants
CBP	Corporate Business Plan
CIPFA	Chartered Institute of Public Finance and Accountancy
CNMI	Commonwealth of the Northern Marianas Islands
CTI	Commonwealth Training Initiative
COFOG	Classification of Expenditure by Function of Government
COSO	Committee of Sponsoring Organizations
CR	Control Risk
DR	Detection Risk
DST	Direct Substantive Testing
FRF	Financial Reporting Framework
FSM	Federated States of Micronesia
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GAGAS	Generally Accepted Government Auditing Standards
GASB	Government Accounting Standards Board
GFM	Government Financial Management
GFS	Government Finance Statistics
GNA	Government National Accounts
GPFS	General Purpose Financial Statements
IAS	International Accounting Standard(s)
IASB	International Accounting Standards Board
ICQ	Internal Control Questionnaire
ICSA	Institute of Chartered Secretaries and Administrators
IDI	INTOSAI Development Initiative
IFAC	International Federation of Accountants
IFPP	INTOSAI Framework of Professional Pronouncements
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
INTOSAI	International Organisation of Supreme Audit Institutions
INTOSAI – P	INTOSAI - Principles
INTOSAI GUID	INTOSAI - Guidelines
IPSAS	International Public Sector Accounting Standards
IPSASB	IPSAS Board
IR	Inherent Risk

IS	Information Systems
ISA	International Standard on Auditing
ISSAI	International Standards for Supreme Audit Institutions
MPE	Maximum Potential Error
MPER	Maximum Potential Error Rate
NAO	National Audit Office
NDP	National Development Plan
NSW	New South Wales
NZ	New Zealand
PASAI	Pacific Association of Supreme Audit Institutions
PEFA	Public Expenditure and Financial Accountability Assessment
PFM	Public Financial Management
PN	Practice Notes
QA	Quality Assurance
QAO	Queensland Audit Office
QARC	Quality Assurance Review Committee
QC	Quality Control
QLD	Queensland
SAI	Supreme Audit Institution
SAI PMF	SAI Performance Measurement Framework
SAP	Strategic Audit Plan
SBA	Systems Based Approach
SEC	Security and Exchange Commission
SIC	Standards Interpretation Committee
SOE	State-Owned Enterprise
TA	Technical Assistance
TER	Tolerable Error Rate
TPS	Third Party Statements
VIC	Victoria
WGA	Whole of Government Accounts
WP	Working Papers
WPF	Working Papers Files

PART ONE: INTRODUCTION

Chapter 1: Introduction

1.1 The New Series of PASAI Manuals

Previous Pacific Association of Supreme Audit Institutions (PASAI) manual and guidelines were produced by committees drawn from member countries including reliance on other regional audit manuals.

This process provided valuable capacity development for those involved in the development process. During the process a valuable partnership with AFROSAI-E was developed which continued during the drafting of this new manual.

PASAI faces ongoing challenges to facilitate Supreme Audit Institute (SAI) engagement with materials provided as resources to the region. The second half of the current PASAI strategy was identified as the right time to refresh the initial manual work and to seek to use approaches that may, more successfully, ensure the wealth of guidance contained in the manuals is used to best effect

Furthermore, PASAI's aim to become a Learning and Knowledge institution has led to the decision to enhance and develop the regional manuals for all streams of audit - Financial Audit, Compliance Audit and Performance Audit.

Accordingly, an audit expert was selected, after an open tender process, to develop these PASAI audit manuals and to work with the PASAI Secretariat to ensure this manual reflects what is relevant for our PASAI region and its members. Details of the consultant and those involved in reviewing and providing input into these manuals are included in the Acknowledgements Section**.**

In support of the manual there is also a separate volume containing case study materials.

As we make clear below, the target is for every SAI to customise this manual for their own unique environment in order to maximise the effectiveness of the content.

These manuals are designed for use by developing countries. However, the manuals should be of use to developed countries to complement their own systems and processes. It is PASAI's expectation that developed SAI would draw on the customised versions of this material when working to support their twinning partners.

The manuals do not describe the various judicial systems as these are very country-specific; however, PASAI may develop such manuals in future. This is due to only two of our member SAIs under such system and they already have an established guidelines. However, the manuals sit outside and complement a local understanding of specific jurisdictional frameworks which can be recognised through the customisation of the manual materials.

1.2 PASAI Region

The PASAI region covers the island states of Oceania together with New Zealand, Australia and some Australian states (see map).

Table 1 below provides more details of PASAI membership together with a further link to each member.

Table 1: PASAI Membership

	Member	PASAI Link	SAI Website
1	American Samoa	www.pasai.org/american-samoa	www.americansamoa.gov/territorial-audit-office
2	Australia - NAO	www.pasai.org/australia	www.anao.gov.au
3	Australia - NSW	www.pasai.org/new-south-wales	www.audit.nsw.gov.au/
4	Australia - QLD	www.pasai.org/queensland	www.qao.qld.gov.au
5	Australia - VIC	www.pasai.org/victoria	www.audit.vic.gov.au
6	Cook Islands	www.pasai.org/cook-islands	www.auditoffice.gov.ck

7	Federated States of Micronesia (FSM) – National Office	www.pasai.org/federated-states-of-micronesia-national-office	www.fsmopa.fm/
8	FSM - Chuuk	www.pasai.org/federated-states-of-micronesia-chuuk	No website
9	FSM - Kosrae	www.pasai.org/kosrae	No website
10	FSM - Pohnpei	www.pasai.org/pohnpei	www.opapni.fm
11	FSM - Yap	www.pasai.org/yap	www.audityap.org
12	French Polynesia	www.pasai.org/french-polynesia	www.ccomptes.fr/polynesie-francaise
13	Guam	www.pasai.org/guam	www.opaguam.org
14	Kiribati	www.pasai.org/kiribati	kao.gov.ki
15	Marshall Islands	www.pasai.org/marshall-islands	www.rmioag.com/
16	Nauru	www.pasai.org/nauru	No website
17	New Caledonia	www.pasai.org/new-caledonia	See footnote[1]
18	New Zealand	www.pasai.org/new-zealand	www.oag.govt.nz
19	Commonwealth of the Northern Marianas Islands	www.pasai.org/northern-mariana-islands	www.opacnmi.com
20	Palau	www.pasai.org/palau	www.palauopa.org
21	Papua New Guinea	www.pasai.org/papua-new-guinea	www.ago.gov.pg
22	Republic of Fiji	www.pasai.org/fiji-islands	www.oag.gov.fj
23	Samoa	www.pasai.org/samoa	www.audit.gov.ws
24	Solomon Islands	www.pasai.org/solomon-islands	www.oag.gov.sb
25	Tonga	www.pasai.org/tonga	www.audit.gov.to
26	Tuvalu	www.pasai.org/tuvalu	www.tuvaluaudit.tv
27	Vanuatu	www.pasai.org/vanuatu	www.nao.gov.vu

SAI in the PASAI region operate under three distinct models:

- **Legislative-Parliamentary (Commonwealth System):** under this system the work of the SAI is linked closely with that of parliamentary accountability with reports presented to the Speaker for tabling before the House. It is usual to have a (Public Accounts) Committee of parliament to review the reports and to issue their own report to the House. Such SAI are called “Office of the Auditor-General” or “National Audit Office” and are usually headed by a single person (often the Auditor-General) and are primarily staffed by accountants and auditors. They focus primarily of financial and performance audits.

1 http://www.ccomptes.fr/fr/CTC01/Accueil.htmlhttp://www.ccomptes.fr/index.php/Nos-activites/Chambres-territoriales-des-comptes-CTC/Nouvelle-Caledonie

The countries using this system comprise: Australia (and states); Cook Islands, Fiji, Kiribati, Nauru, New Zealand, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu;

- **Legislative-Congressional Model (United States System):** the SAI's work is closely related to the legislative obligations of government with reports presented to the Speaker, Governor and relevant agencies. Typically, the SAI is called "the Office of the Public Auditor" and is headed by the "Public Auditor" who is appointed by the Governor with the legislature's support. The SAI focuses mainly on performance and forensic audit work with the financial audits contracted out to the private sector. Staff tend to have investigative and generalist background rather than being professional accountants. The SAI report either to the legislature or public oversight body.

  The countries using this system comprise: American Samoa, Commonwealth of the Northern Marianas Islands, Federated States of Micronesia and each of its states (Chuuk, Kosrae, Pohnpei and Yap), Guam, Marshall Islands and Palau.

- **Judicial Model (French System):** The SAI is an integral part of the judicial system, operating independently from the executive and legislative branches. The SAI is usually known as the Court of Accounts (or Audit) and its members are judges, typically appointed for an unlimited time. The work focuses on financial and performance audits with specific attention being paid to the legality of the transactions. Staff have legal or generalist backgrounds. There is not usually any parliamentary committee to which the court reports. The court itself holds officials to account and can impose penalties on audited officials.

  The countries using this system: French Polynesia and New Caledonia.

The different models give rise to different accounting and auditing standards used in the different jurisdictions.

These are discussed in the detail in Chapter #4 (Accounting Standards) and Chapter #5 (Auditing Standards).

The differing **Accounting Standards** give rise to different formats for the "general purpose financial statements" (GPFS) – the Annual Financial Statements (AFS) (see 4.1.3).

However, whilst there are different **Auditing Standards** all PASAI members are also members of the International Organisation of Supreme Audit Institutions (INTOSAI) – either as full members (the majority); as an affiliate (Guam) or through the "colonial power": France (French Polynesia and New Caledonia) and the United States (American Samoa and Commonwealth of the Northern Marianas Islands). This means that they are encouraged to comply with the International Standards of Supreme Audit Institutions (ISSAI), if they do not have an authoritative body that sets the auditing standards for the government.

Those countries following the **Legislative-Congressional Model** also have to be compliant with the Generally Accepted Government Auditing Standards (GAGAS) (the "Yellow Book"). These standards are not significantly different from the IPSAS.

Given that all PASAI members are encouraged to follow ISSAI they will be the prime reference in this manual. However, where indicated, the appropriate countries will need to customise the manual by adding the reference to GAGAS or other applicable local standards.

1.3 Customisation

Whilst in the past every manual and guideline produced by PASAI was intended to be customised by individual Supreme Audit Institutions (SAI), we are aware that detailed customisation did not occur. Therefore PASAI has with this redevelopment of our regional manuals specifically provided for assistance to be given to SAIs so that, together with a regional workshop to assist SAIs to customise manuals, we will provide guidance in this manual on how customisation should be done to maximise the effectiveness of this material.

It is clear that, given the different models of auditing followed by PASAI members, customisation is essential. The idea of a "one size fits all" manual is outdated and we want to ensure that the investment in these new manuals maximises their usefulness to our members.

The three new manuals and templates seek to solve this problem in three main ways:

- **Manuals and Templates:** the manuals make it very clear where sections should be subject to customisation;
- **Training:** we will be providing training to our SAIs on the content of each manual; and
- **Pilot Audits:** we will coordinate development and support individual customisation of manuals by encouraging SAIs to conduct pilot audits to 'test' the manuals before finalising it.

1.4 SAI Overall Approach to Capacity Building

In December 2016, INTOSAI endorsed the Supreme Audit Institutions Performance Measurement Framework[2] (SAI PMF) as an approved tool for use by its members.

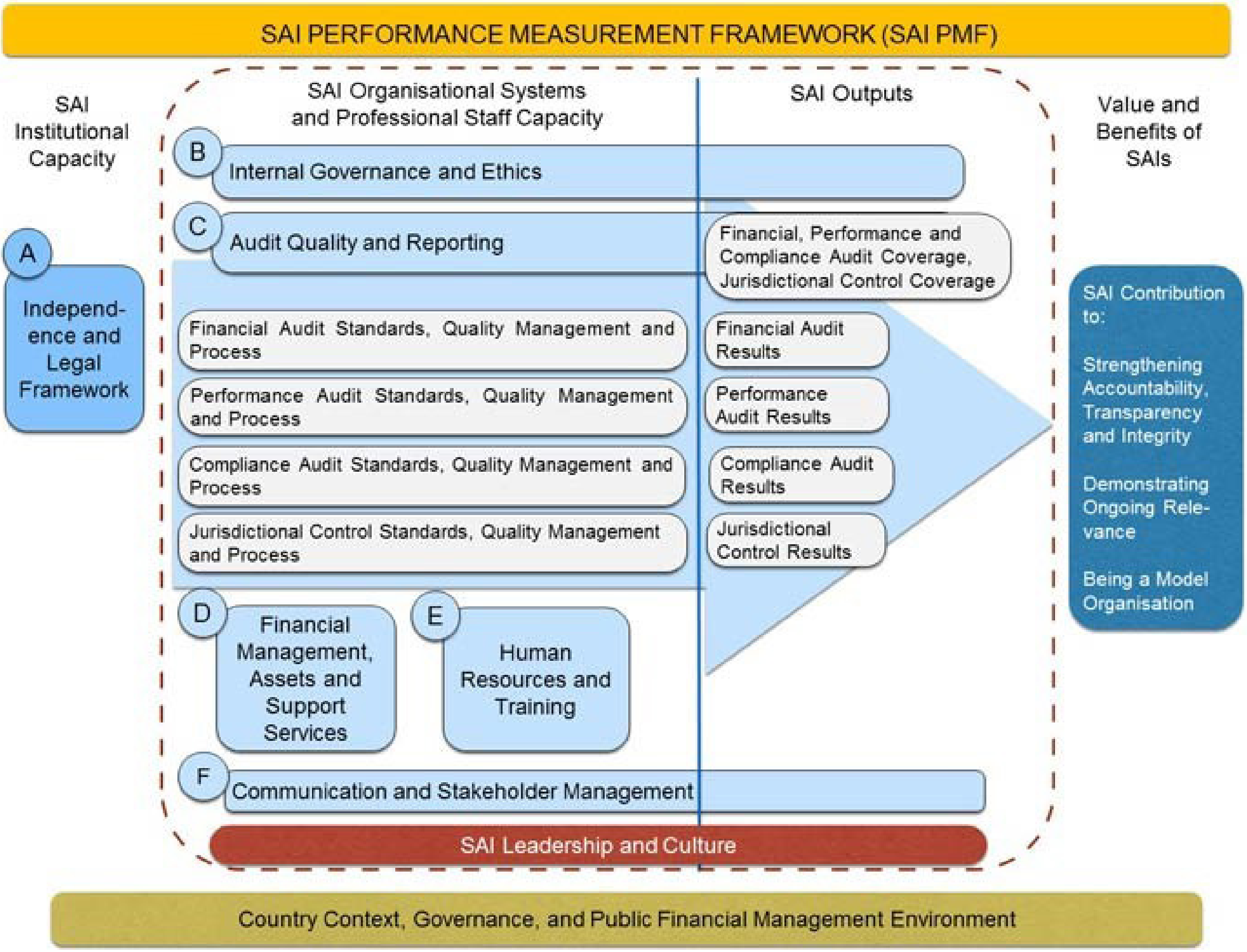
Our approach is to use SAI PMF results to inform all three areas of capacity building: institutional, organisational and staff capacity.

The SAI PMF provides SAI with a framework for voluntary assessments of their performance against the International Standards for Supreme Audit Institutions (ISSAIs) and other established international good practices for external public auditing.

SAI PMF is a multi-purpose, universal framework, and can be applied in all types of SAI, regardless of governance structure, mandate, national context and development level and, thus, has been used by PASAI across its members. The SAI PMF programme kick-started in 2015 and through a multi-phased approach over the years, PASAI has coordinated the completion of SAI PMF assessments of almost all Pacific SAIs.

2 See: https://www.idi.no/en/idi-cpd/sai-pmf

Figure 1: SAI Performance Measurement Framework



The table below indicates the numbers of Domains, Performance Indicators, Dimensions and Tests.

Table 2: Analysis of Domains, Performance Indicators, Dimensions and Criteria

Area	Number of Items
Domain	6
Performance Indicators	25[3]
Dimensions	804
Criteria	560

Domain "C" covers Audit Quality and Reporting. The table below indicates the key performance indicators and dimensions for Financial Audits.

3 Performance Indicators 18, 19 and 20 only related to SAI with judicial functions.

Table 3: Extract from SAI PMF Domain "C"

Performance Indicator	Dimension
SAI-8: Audit Coverage	(i) Financial Audit Coverage
SAI-9: Financial Audit Standards and Quality Management	(i) Financial Audit Standards and Policies (ii) Financial Audit Team Management and Skills (iii) Quality Control in Financial Audit
SAI-10: Financial Audit Process	(i) Planning Financial Audits (ii) Implementing Financial Audits (iii) Evaluating Audit Evidence, Concluding and Reporting in Financial Audits
SAI-11: Financial Audit Results	(i) Timely Submission of Financial Audit Results (ii) Timely Publication of Financial Audit Results (iii) SAI Follow-up on Implementation of Financial Audit Observations and Recommendations

This manual is intended to ensure that any SAI following it in its entirety will score very highly when answering the associated SAI PMF test questions.

1.5 Public Expenditure and Financial Accountability Assessment[4]

The Public Expenditure and Financial Accountability (PEFA) programme was initiated in 2001 by seven international development partners: The European Commission, International Monetary Fund, World Bank, and the governments of France, Norway, Switzerland, and the United Kingdom.

PEFA began as a means to harmonise assessment of Public Financial Management (PFM) across the partner organisations. It subsequently established a standard methodology for PFM diagnostic assessments, the PEFA framework. Since 2001 PEFA has become the acknowledged standard for PFM assessments.

The PEFA programme provides a framework for assessing and reporting on the strengths and weaknesses of public financial management (PFM) using quantitative indicators to measure performance. PEFA is designed to provide a snapshot of PFM performance at specific points in time using a methodology that can be replicated in successive assessments, giving a summary of changes over time.

PEFA is a methodology for assessing public financial management performance. It identifies 94 characteristics (dimensions) across 31 key components of public financial management (indicators) in seven broad areas of activity (pillars).

As such it is a valuable tool for auditors and any new PEFA assessment should build into the strategic planning for the SAI. This will be both from the point of view of topics which require audit attention but also from the point of view of internal changes as the SAI itself is the subject of the assessment.

4 https://www.pefa.org

1.6 Finalisation of Audit Manuals

For each SAI the final draft manuals which arise from the Capacity Building training sessions, will be subject to rigorous testing before being finally adopted.

"Pilot audits" will use the draft manuals as the basis for undertaking actual audit work. The methodology laid down in the manuals will be tested for its practicality and any problems identified. The draft manuals will then be updated and finalised on the basis of such feedback.

We **recommend** at least three pilot audits be used in each SAI to test each manual.

PASAI will co-ordinate the process of ensuring technical support is provided to each member to enable the pilot audits to be undertaken. This will be in the form of a blended approach which can be either a regional workshop, SAI level support or engaging a TA.

1.7 Keeping Audit Manuals Relevant

PASAI will provide each SAI with regular bulletins setting out developments which affect the effectiveness of the manual. This will be done by both e-mails and social media.

This will include not only the results of our own research but also relevant material produced by the International Organisation of Supreme Audit Institutions (INTOSAI); other regional SAI bodies; the INTOSAI Development Initiative (IDI); International Federation of Accountants (IFAC); national SAI; and any other relevant sources

These bulletins will indicate areas where the individual members manuals need reviewing and, where appropriate, will provide new text which can be used for the updating process.

Any significant changes to the PASAI Audit manual will be submitted to the PASAI Governing Board (meet bi-annually) for approval and then included in a revised version of the manual. This will be recorded as per the table on page 4.

1.8 Structure of this Manual

The main part of the manual comprises three parts:

- Part Two: The Background to Financial Audit**:** this part examines the framework and standards within which the Financial Audit takes place;
- Part Three: The Financial Audit Process**:** this part covers the actual Financial Audit work from planning through to reporting; and
- Part Four: Follow Up and Quality Assurance**:** covers the steps which need to be taken to ensure that any recommendations made are implemented and that the work undertaken is of a consistently high standard.

The final part provides a summary of how to customise this manual for your individual use and how to ensure its continued relevance.

At the start of each main chapter there are three text boxes:

Key Points: This box will indicate the key points in the chapter and provide hyperlinks thereto.

Internet Links: This box will indicate the key internet links contained in the chapter.

Customisation: This box will provide advice on customising the chapter.

PART TWO: BACKGROUND TO FINANCIAL AUDIT

Chapter 2: Introduction

This chapter provides a brief overview to: Government Financial Management; Accounting Standards; Auditing Standards; and Key Audit Concepts.

There are no specific internet links in this chapter.

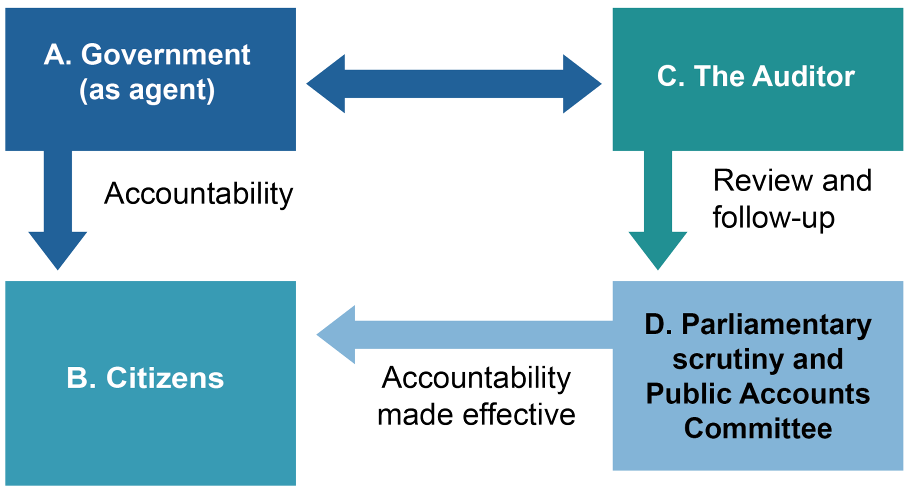
This Chapter should be customised to describe your country PFM framework including if there is a PFM Roadmap, Government structure and overall national priorities document name, PEFA assessments (if applicable) and your audit universe and Financial Reporting Frameworks used (IPSAS, IFRS) This may be good to also include Country Overview (map, economy, currency, culture etc).

2.1 Overview

This part provides the framework within which Financial Audit takes place. We first examine the overall Public Financial Management (PFM) framework and external audits role therein (Chapter 3); we then look at the Accounting Standards which must be followed when producing Annual Financial Statements (AFS) as part of GFM (Chapter 4) and, then, the Auditing Standards which we must follow when auditing the AFS (Chapter 5).

The relationship between auditing and accountability is expressed in Figure 2.

Figure 2: Audit and Accountability



2.2 Public Financial Management (PFM)

Governments are responsible for the management of public money and public assets on behalf of the citizens of a country. This is summarised in Figure 3, which provides an overview of PFM Framework.

Figure 3: Overview of PFM

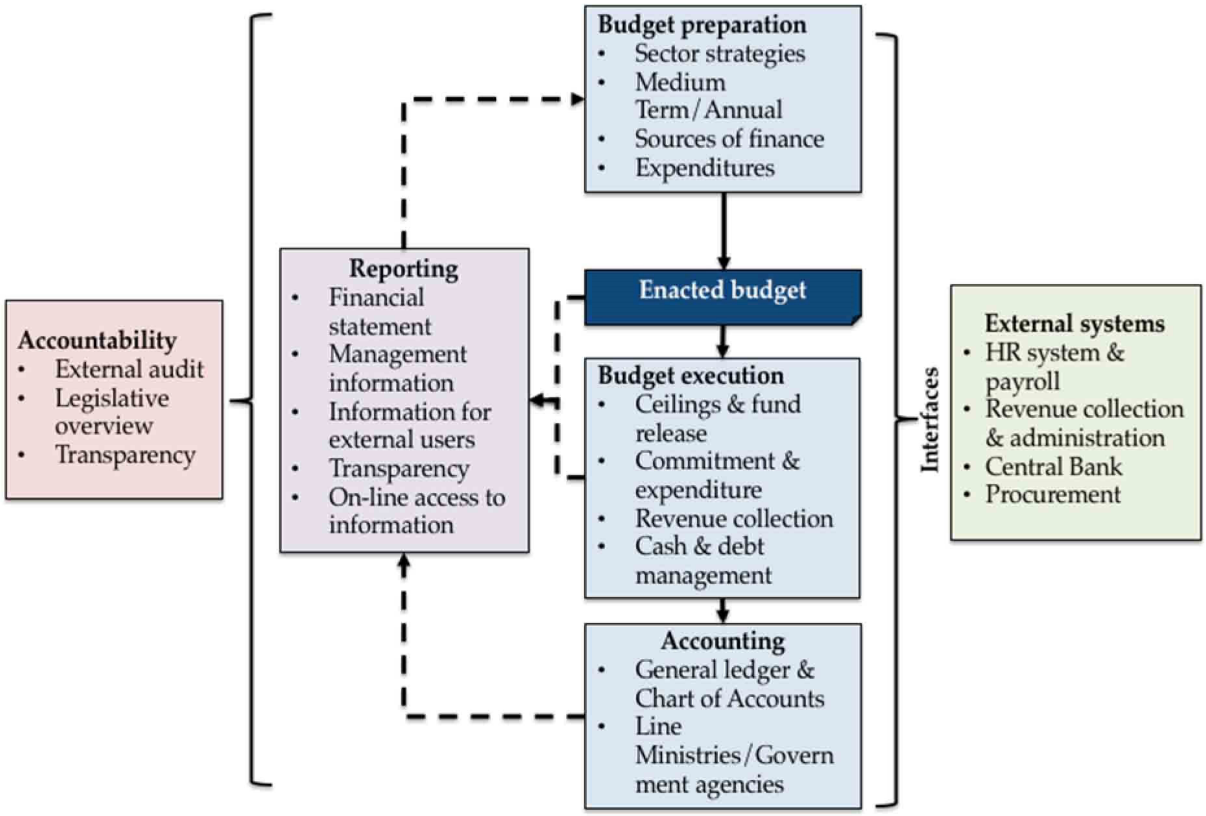


Figure 3 indicates where external audit fits into the process.

2.3 Accounting Standards

In order to be able to do this effectively we (the SAI) must know how the accounts should look in order for them to comply with international accounting standards. As we will see below, this is a key part of the audit process.

This depends on the legislative framework and mandate of the SAI.

Of the three regimes within the PASAI Region,

- **International Public Sector Accounting Standards (IPSAS)** for public sector organisations and the **International Financial Reporting Standards (IFRS)** for commercial organisations are followed by countries using the Commonwealth and French Systems; and
- **Generally Accepted Accounting Principles (GAAP)** are followed by the countries using the United States System.

Although these are gradually merging, there are still difference of which the auditor must be aware. Chapter 4 details the three systems and their use throughout PASAI. As part of the customisation process, you will delete those not relevant to your SAI.

2.4 Auditing Standards

To ensure consistency of the audit process, we have to comply with auditing standards.

INTOSAI's ISSAI are a great option for countries that do not have the capacity or desire to prepare their own standards.

If the SAI legislation requires adherence to other standards, the SAI should endeavour to ensure that these are at least as detailed as the ISSAI. Accordingly, these will be the prime standards referred to through this manual.

Countries following the US System also have to comply with the Yellow Book or Generally Accepted Government Auditing Standards which is developed by the Government Accountability Office (GAO).

Again, whilst they are not significant, there still are differences between the two sets of standards. Chapter 5 details the two systems and there use throughout PASAI.

As part of the customisation process, you will need to select the system relevant to your mandate and delete anything not relevant.

2.5 Key Audit Concepts

The role of these is described more fully at the appropriate part of the manual; this section provides a brief overview. The key concepts comprise:

- **Code of Ethics:** auditors must be above suspicion. INTOSAI regards this as so important that it has its own standard (#140);
- **Independence:** for the auditor's report and opinion on the Annual Financial Statements (AFS) to be believed and trusted, the SAI must be clearly independent of the organisations which it is auditing;
- **Reasonable Assurance:** auditing is not an exact science; we must undertake audits to provide only reasonable assurance not 100% certainty;
- **Audit Evidence:** in order to form our opinions on the AFS we must obtain sufficient, reliable evidence on which to base that opinion. We must also ensure that it is fully documented;
- **Assertions:** during the audit we will need to rely on assertions from management on various aspects of the AFS. We must test that these assertions are valid;
- **Professional Scepticism:** we do this by making use of professional scepticism which basically means we need to see evidence which convinces us that the assertion or statement is accurate;
- **Materiality:** this is an area where many SAI fall down. We must ensure that the time and resources we put into an audit are worth any potential errors that we might find. For the audit of AFS, an item is material only if it will affect the views of a person reading the accounts. For governments, this figure will usually be millions of dollars;
- **Audit Engagement Risk:** this is risk that may adversely affect our capability to do the audit. To reduce this, we must plan and perform the audit engagements to reduce audit risk to an acceptably low level; and
- **Audit Risk:** From the auditors' point of view, Audit Risk is the level of risk that we are willing to accept when issuing an unqualified opinion on a set of financial statements that are materially in error.

Chapter 3: Government Financial Management

This chapter Defines Government Financial Management; Relates Public and Private Sector Financial Management; Examines the Goals of the Annual Financial Statements; Examines the Whole Systems Approach to PFM.

The key internet links of this chapter are:

Definition of FM: (Wikipedia, Financial Management)

Four Dimensions of PFM: www.icgfm.org/publications/journal/

Whole Systems Approach: www.cipfa.org/policy-and-guidance/reports/whole-system-approach-volume-1

This Chapter should be customised to describe your country PFM framework including if there is a PFM Roadmap, Government structure and overall national priorities document name, PEFA assessments (if applicable) and your audit universe and Financial Reporting Frameworks used (IPSAS, IFRS) This may be good to also include Country Overview (map, economy, currency, culture etc).

3.1 Definitions

3.1.1 Overview

As indicated below, there is a difference between Public Financial Management (PFM) and Government Financial Management (GFM). Basically, GFM can be regarded as a sub-set of Public Financial Management (PFM).

The audit treatment of Annual Financial Statements produced as part of GFM may differ from that used on AFS produced in the wider PFM.

The purpose of this chapter is to illustrate the relationship between the elements of PFM.

3.1.2 Financial Management

Wikipedia defines Financial Management in general as:

> *... the efficient and effective management of money (funds) in such a manner as to accomplish the objectives of the organization. (Wikipedia, Financial Management)*

3.1.3 Public Financial Management

The Chartered Institute of Public Finance and Accountancy (CIPFA) (2010[5]) define Public Financial Management as:

> *Public Financial Management (PFM) is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective delivery of public service goals.*

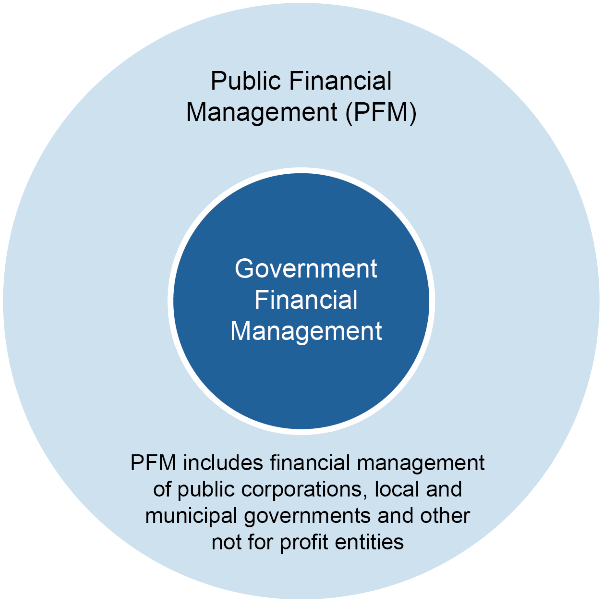
PFM by definition includes the financial management of the whole of the public sector, including the financial management of public corporations, not for profit entities within the public sector, local and municipal governments.

5 CIPFA (2010; 2017 Update), "Public Financial Management: A Whole System Approach", Volume 1, The Approach & Volume 2, Additional Material, London, CIPFA

3.1.4 Government Financial Management

Government Financial Management (GFM) can be regarded as a sub-set of PFM being applied specifically to sovereign governments. This is illustrated in Figure 4.

Figure 4: Government Financial Management



3.2 Relationship between Public and Private Sector Financial Management

Most SAI will be responsible for a mix of clients – some being purely public sector organisations and other being quasi-private sector; notably the State-Owned Enterprises (SOE).

Public and private sector financial management are both built on common concepts (e.g., the economic entity, the management of money, the accounting model, and the requirements for control). However, despite the similarities, a comparison of the public to private sector financial management shows important differences, as summarised in Table 4.

Table 4: Differences between the Private Sector and PFM

Context	PFM	Private Sector Financial Management
Power	Governments control the country and can make, amend or repeal laws.	Private sector entities cannot change laws.
Accountability	Governments are accountable to the citizens of the country.	Private sector entities are accountable to the owners of the entity.
Legal	Public sector entities, including the national government, must operate according to the constitution and laws governing the public sector.	Private sector entities must operate according to laws, made by the government or governing private sector commercial entities.
Coverage	Public sector required to deliver all government services.	Private entities choose which services and goods to provide.
Role of budget	The budget is a law defining how public money should be raised and spent.	Budgets are a planning and forecasting tool.
Goals	Efficient and effective delivery of public goods and services.	Profit maximisation.

3.3 Goals of Annual Financial Statements (AFS)

3.3.1 Introduction

As part of the audit of AFS, we will be endeavouring to ascertain whether the organisation has achieved the goals it needs to achieve in the statements. This section indicates what these goals should be. We will need to tailor our audit approach to be able to give an opinion on whether or not these goals have been achieved.

3.3.2 International Public Sector Accounting Standards (IPSAS) Conceptual Framework Approach to Goals

We will be looking at the International Public Sector Accounting Standards (IPSAS) in detail in the following chapter.

The IPSAS Board approaches goals from the perspective of the goals of published financial reports. The IPSAS Conceptual Framework on financial reporting (IPSASB, 2018 Update[6]) identifies two objectives for financial statements:

- Accountability; and
- Resource Allocation.

The IPSAS Conceptual Framework does not consider the broader goals of GFM, as discussed in the section below.

3.3.3 A Four-Dimensional Approach to the Goals of GFM

An alternative approach is that GFM can be viewed as having multiple dimensions (Parry, 2010[7]):

- **Dimension 1: Fiscal Management:**
  - Fiscal sustainability;
  - Managing fiscal risk; and
  - Appropriate fiscal balance.
- **Dimension 2: Resource Allocation:**
  - Resource allocation in accordance with government policy priorities; and
  - Effective resource allocation.
- **Dimension 3: Fiduciary Risk Management:**
  - Public resources used for stated purpose;
  - Compliance with rules and regulations; and
  - Controls over the use of public assets and liabilities.
- **Dimension 4: Governance:**
  - Accountability and transparency;
  - Citizen participation in PFM processes; and
  - Analysis of assets and flows to enable impact on social groups to be identified.

This approach is consistent with a broader view of both public and government financial management.

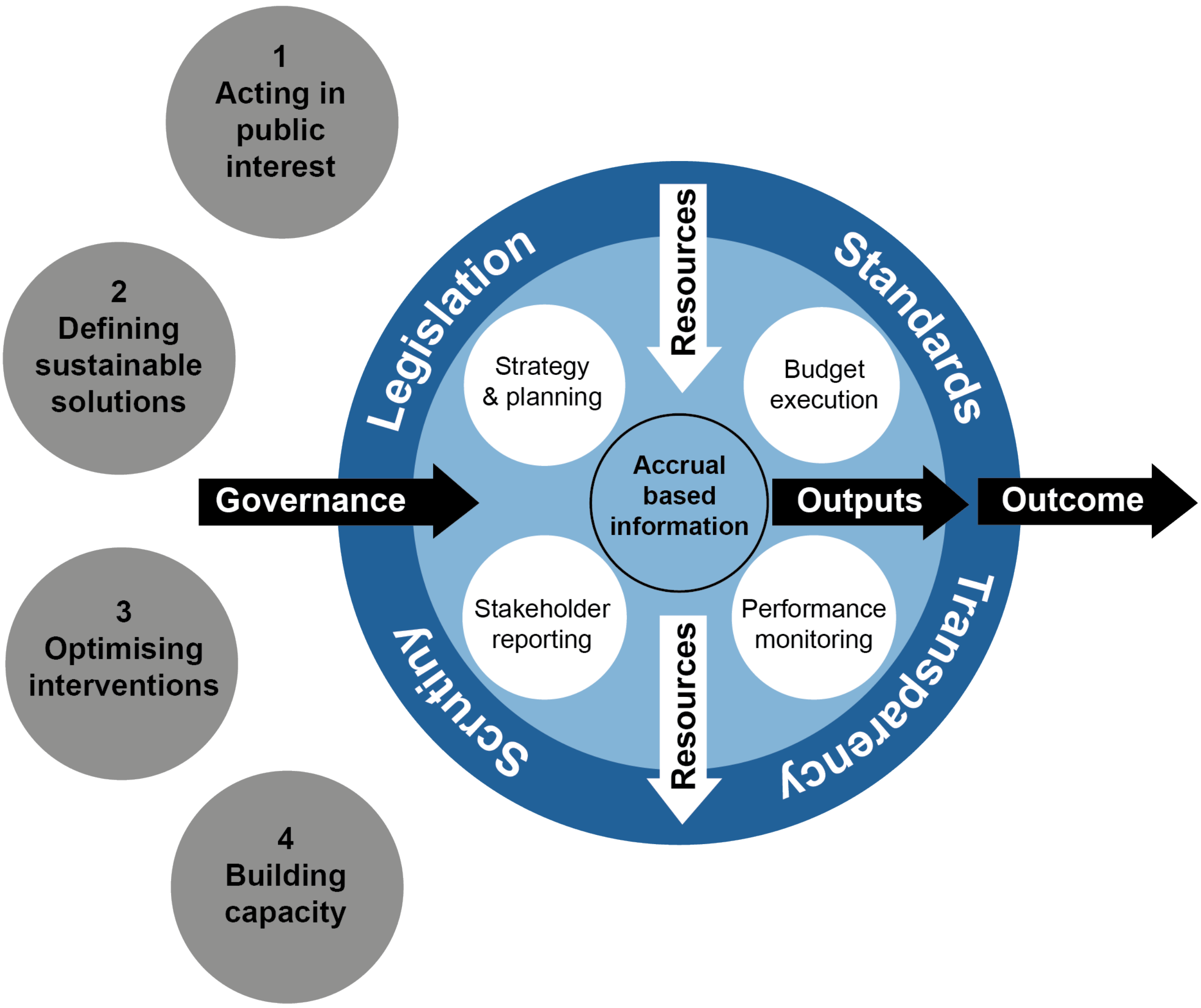
6 IPSASB (2018 Update), Handbook of International Public Sector Accounting Pronouncements, Vol 1, 2 and 3 New York, IFAC (Online)

7 PARRY, M. (2010), "The Four Dimensions of PFM", The International Journal on Governmental Financial Management (Online) vol. 10, no. 1, pp. 98-106 ICGFM, Available: http://www.icgfm.org

3.4 Whole Systems Approach to PFM

The Chartered Institute of Public Finance and Accountancy (CIPFA) developed "A Whole Systems Approach" to PFM (CIPFA, 2010[8]). As the name implies this takes a holistic approach to PFM and seeks to integrate all aspects into a single framework, as illustrated below.

Figure 5: A Whole Systems Approach to Government

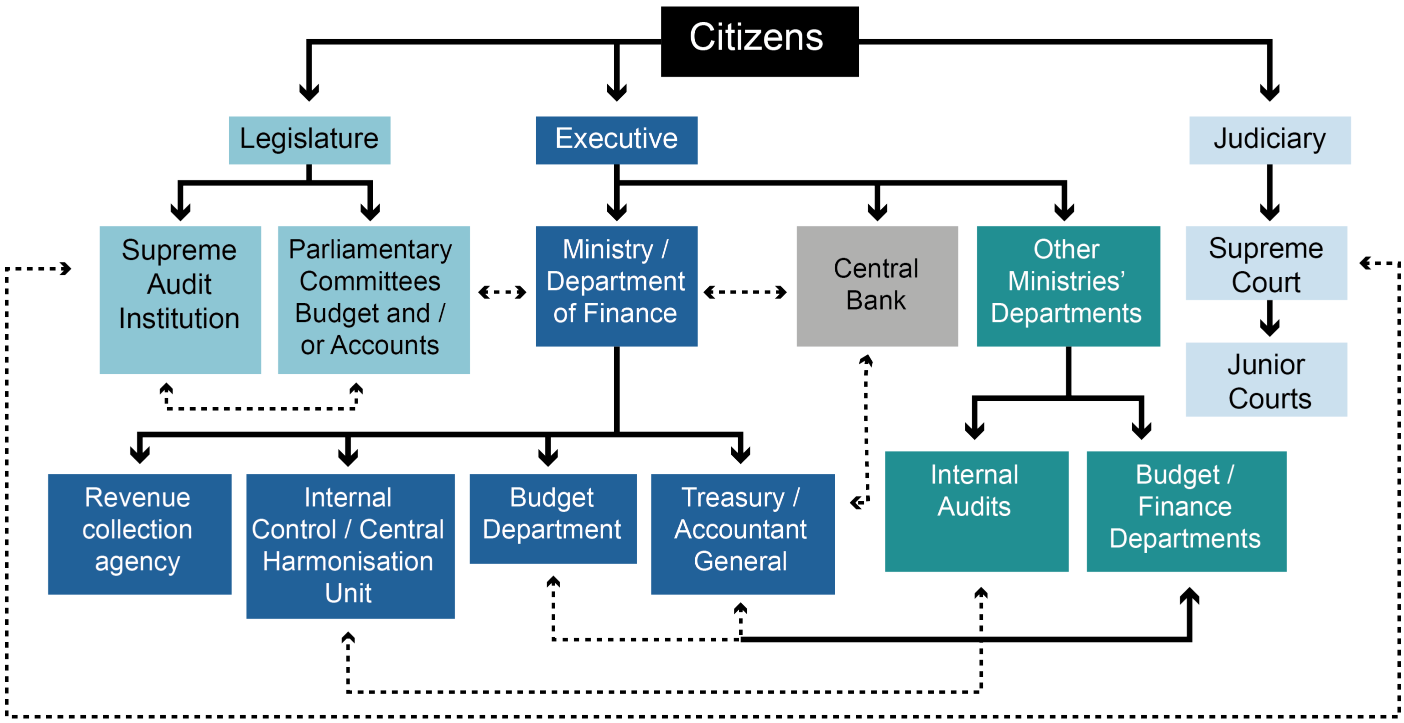


This illustration indicates the likely future direction which government reporting will take. As auditors, we must be aware of this to ensure that we are prepared to audit, and offer our opinions on, AFS produced under this methodology.

Variety makes it impossible to specify a single organisational structure for GFM. However, there are certain key functions and relationships which are generic and are summarised in the illustration below which indicates where the SAI fits into the overall process.

8 CIPFA (2010; 2017 Update), "Public Financial Management: A Whole System Approach", Volume 1, The Approach & Volume 2, Additional Material, London, CIPFA

Figure 6: A Whole Systems Approach to Government[9]



3.5 Whole of Government Accounts

Related to this is the "Whole of Government Accounts" (WGA).

WGA are a consolidated set of financial statements for the whole of the public sector.

They should consolidate **the audited accounts** of all **material public sector bodies**. This should include central government departments, local authorities, devolved administrations, the health service, academies and public corporations, in order to produce a comprehensive, accounts-based picture of the fiscal position in any one year.

WGA complement the **National Accounts** figures, by providing a set of financial statements based on standards familiar to users of private sector accounts. Thus, those countries producing them tend to use the **International Financial Reporting Standards (IFRS)** rather than the International Public Sector Accounting Standards (IPSAS).

The **aim** of WGA is to enable Parliament and the public to better understand and scrutinise how taxpayers' money is spent. By presenting the public finances in a framework familiar to the commercial and accountancy professions, WGA increases transparency and accessibility of information about public finances.

WGA should not be considered merely as an academic exercise as it makes a **big contribution to accountability and transparency**. The fact that it is prepared according to accounting standards, and **independently audited by the SAI**, means that users can have confidence in the numbers.

The WGA should be considered by the Public Accounts Committee (PAC) – or equivalent - each year and it should be used as a tool for accountability across government. WGA is the only publication where all significant public sector contingent liabilities are brought together in one place.

9 Accounting for Governments: Parry and Hughes (2018)

A big source of strength in the WGA is in the scale of the underlying dataset and the emerging trend analysis. This can be used by the Treasury (Ministry of Finance) as a tool to support or challenge government decision making. As the process matures and data collection procedures improve, this becomes a more robust base to develop policy and, just as important, to see the effects of past decisions.

In this manner, WGA can be used as a driver to improve financial management across the public sector, supporting the objectives of the government. Fiscal transparency should be at the centre of WGA.

WGA highlights some of the **longer-term risk** on the government's balance sheet, complementing traditional spending-focused financial risk management. This information can then be fed into stronger decision making.

WGA data has been used to look at the public sector asset base and to challenge how assets are used. There is progress to be made in analysing public sector assets building on wider WGA data such as future capital commitments.

In terms of auditing WGA, if the government produces WGA then they have to be audited by the relevant Supreme Audit Institution.

3.6 Government Finance Statistics

The International Monetary Fund (IMF) developed the Government Finance Statistics (GFS)[10] as means of comparing financial data between countries and within countries over time. The current data set is developed based on the GFS Manual (2014).

GFS data are compiled either on a cash or accruals basis – according to the methodology in use in the country assessed.

GFS contains detailed data on revenue, expense, transactions in assets and liabilities and stock positions in assets and liabilities of general government and its sub-sectors.

GFS is divided into seven databases:

- Main Aggregates and Balances;
- Revenue;
- Expense;
- Classification of Expenditure by Function of Government (COFOG);
- Integrated Balance Sheet (Stock Positions and Flows in Assets and Liabilities;
- Financial Assets and Liabilities by Counterpart Sector; and
- Statement of Sources and Uses of Cash.

Whilst not of great use for Financial Auditing – although the SAI can check that the GFS and government data is coherent – GFS is probably of greater use in Performance Audits where international comparisons (e.g. on spending on health) could be useful.

10 https://data.imf.org

Chapter 4: Accounting Standards

This chapter covers International Public Sector Accounting Standards (IPSAS); Accounting Bases; General Purpose Financial Statements; Cash-Based IPSAS; Accruals-Based IPSAS; International Accounting Standards; International Financial Reporting Standards; and Generally Accepted Accounting Principles.

The key internet links of this chapter are:

Cash-Based IPSAS: www.ipsasb.org/publications/revised-cash-basis-ipsas

Accruals-Based IPSAS: www.iasplus.com/en/standards/ipsas

IFRS Standards: www.iasplus.com/en/resources/ifrs-topics/use-of-ifrs

IFRS Jurisdictional Profiles: www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx

Model IFRS Statements: www.ifrspublicationsonline.com/p-171-illustrative-ifrs-consolidated-financial-statements-for-2019-year-ends-global.aspx

GAAP: www.gasb.org/home

IFRS Training: www.iasplus.com/en/tag-types/e-learning

Government Accounting Standards: www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1176160042391#gasbs25

Delete the sections and annexes which do not apply to your mandate.

4.1 International Public Sector Accounting Standards (IPSAS)

4.1.1 Overview

All public sector bodies should prepare financial data in accordance with international standards to ensure its comprehensiveness and for comparability both externally and internally over time.

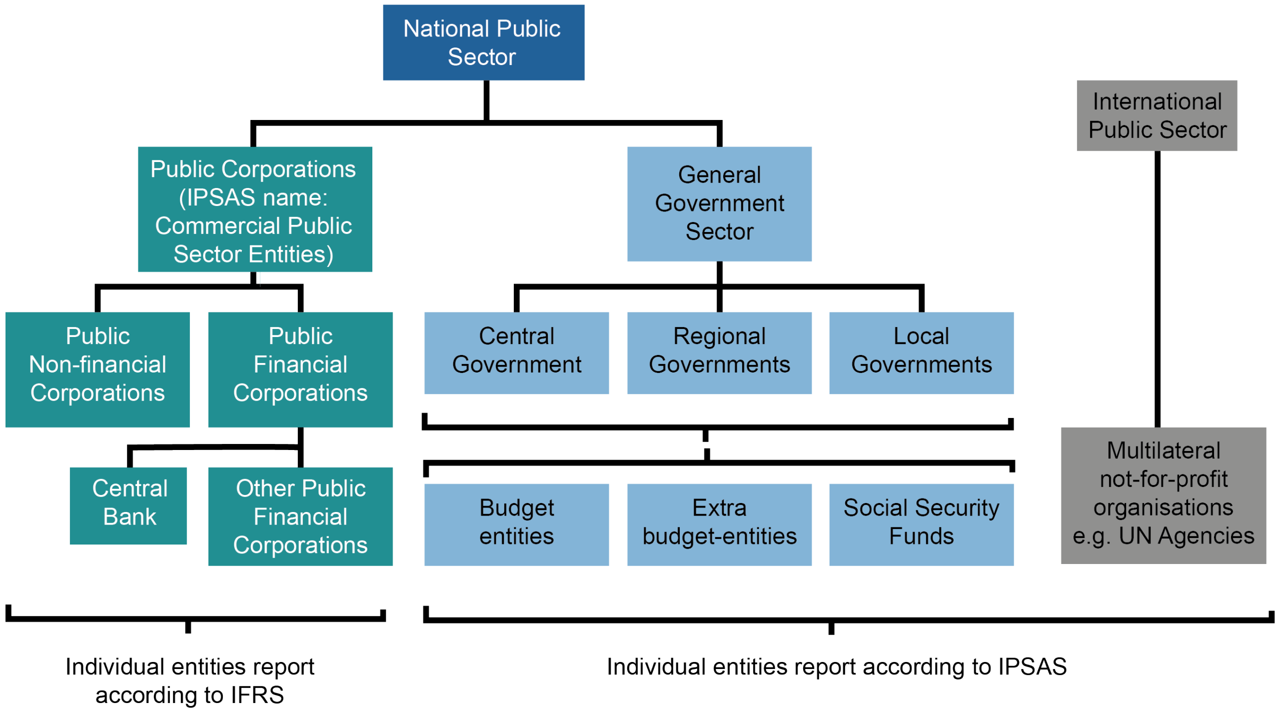
The International Public Sector Accounting Standards (IPSAS) are developed and managed by the International Federation of Accountants' (IFAC) International Public Sector Accounting Standards Board (IPSASB).[11]

The IPSASB issues IPSAS dealing with financial reporting under the **cash basis** of accounting and the **accrual basis** of accounting. The accrual basis IPSAS are based on the International Financial Reporting Standards (IFRS)(see 4.2 below), issued by the International Accounting Standards Board (IASB) where the requirements of those standards are applicable to the public sector.

Figure 7 indicates where the different standards apply.

11 IPSASBCommunications@ipsasb.org

Figure 7: Applicability of IPSAS

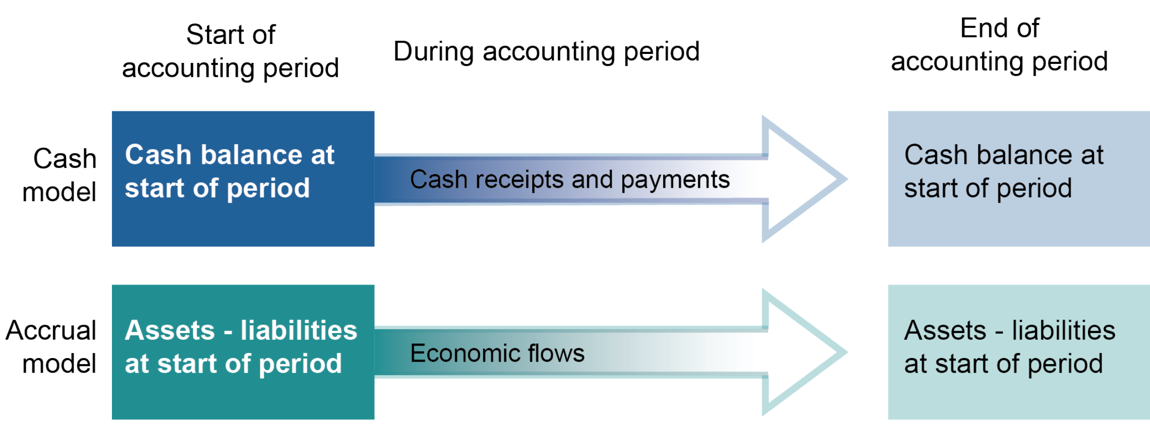


4.1.2 Basis of Accounting which determines Financial Reporting Framework[12]

IPSAS only recognises two choices of **Accounting Basis**:

- **Cash Based Model:** currently comprising a single standard[13]. This was revised in 2017 and came into force from 1 January 2019; or
- **Accruals Based Model**: where there are currently 42 standards[14].

Figure 8: Accounting Bases



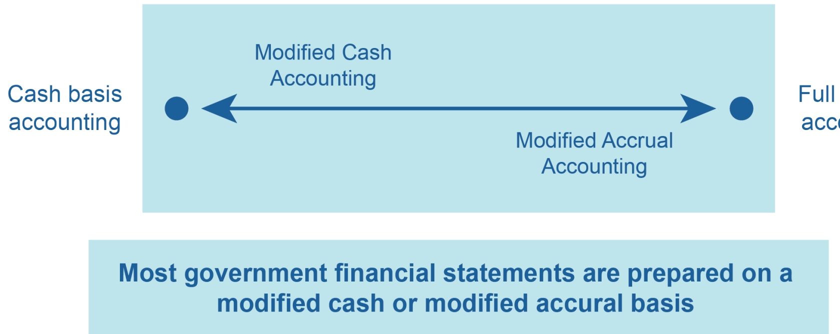
The basis of accounting refers to the body of accounting principles that determine when the effects of transactions or events should be recognised for financial reporting purposes. It relates to the timing of the measurements made, regardless of the nature of the measurement. Common bases of accounting are the **cash basis** of accounting (i.e. effects

12 This is an important aspect of the pre-engagement phase and is discussed in more detail below.
13 https://www.ipsasb.org/publications/revised-cash-basis-ipsas
14 https://www.iasplus.com/en/standards/ipsas

of transactions and events are recognised when cash is paid or received) and the **accrual basis** of accounting (i.e. the effects of transactions and events are recognised when they take place).

There are many variations of both bases. These can be regarded as forming a “continuum” or “spectrum” with cash-based accounting at one end and full accruals-based accounting at the other. The intermediate points are called modified cash and modified accruals – although there are many different “modifications”.

Figure 9: The Accounting Continuum



The **cash basis of accounting** recognises transactions and events only when cash has been received or paid. Consistent with the cash basis, a statement of receipts and payments (or expenditure) is usually prepared to disclose information about cash flows during a period and cash balances at the end of that period.

The **full accrual basis of accounting** is geared towards recognising the financial effects of transactions and events in the periods in which they occur, irrespective of whether or not cash has been received or paid in the periods in which they occur, irrespective of whether or not cash has been received or paid and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate (matching principle). The full accrual basis of accounting reports on the economic resources or services potentials (assets) and obligations (liabilities) of the entity and changes therein. It requires the capitalisation of expenditure on the acquisition of all capital assets and the depreciation of those assets as their service potential is consumed.

The **modified accrual or modified cash bases** of accounting can approximate the accrual basis of accounting or the cash basis of accounting. Just where the model lies on the “continuum” or “spectrum” between cash and full accrual accounting and, therefore, the nature of the elements which are reported, will depend on the nature and extent of the “modifications”.

A common modification at the accrual end of the spectrum involves the treatment of physical assets. Options used by different organisations include:

- the initial exclusion of physical assets from the financial statements (as illustrated in the table below);
- the inclusion only of new fixed assets – the accounting treatment which conforms to IPSAS; or
- the inclusion of both new fixed assets and existing fixed assets (as different classes of assets until a full revaluation is possible).

A common modification at the cash end of the spectrum is to include in the financial statements information about those transactions and events which will result in cash receipts or disbursements within a short period, typically one month, immediately following the year end.

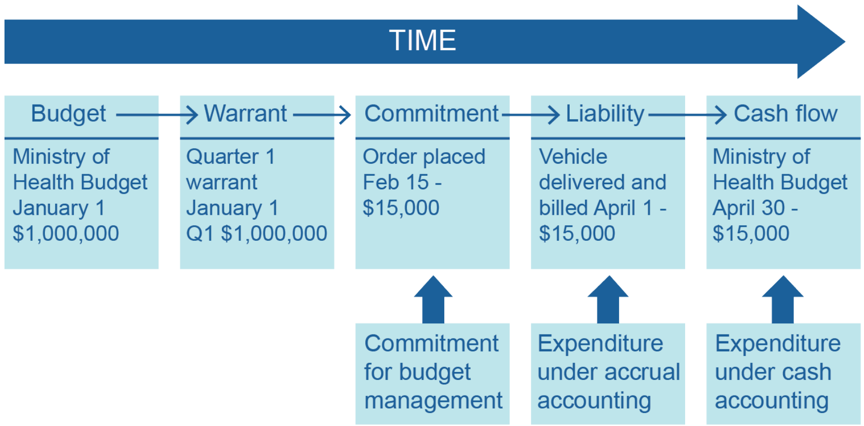
Table 5 indicates the differences in reporting of Assets and Liabilities under the four bases although, there are, of course, many variations to this general “theme”.

Table 5: Asset and Liability Reporting under different Bases of Accounting

	Cash Basis	Modified Cash	Modified Accrual	Full Accrual
Assets	**Cash Balances**	**Cash Balances** **Accounts Receivable** (within X days)	**Cash Balances** **Financial Assets:** • Investments • Inventories for Sale • Loans • Outstanding • Revenues Receivable • Other Receivables	**Cash Balances** **Financial Assets:** • Investments • Loans • Outstanding • Revenues receivable • Other aeceivables **Physical Assets:** • Plant and Equipment • Infrastructure Assets • Other Assets
Liabilities	None	Accounts Payable (within X days) Transfer Payments (within X days) Borrowings	Accounts Payable Transfer Payments Borrowings Accrued Liabilities (e.g. employee pension obligations and accrued interest)	Accounts Payable Transfer Payments Borrowings Accrued Liabilities (e.g. employee pension obligations and accrued interest)

A further approach to understanding the difference between cash and accrual is to view the different stages in the expenditure process as illustrated below. Accrual accounting records expenditures at the point where the goods or services are delivered and billed. Cash accounting records expenditures when payment is made for the goods or services.

Figure 10: Expenditure Stages and Bases of Accounting



As we will see below, we need to know what method of accounting the organisation that we are auditing intends following, which should be made clear, in the Notes to the Accounts, and ensure that the accounts it produces are consistent with this methodology.

4.1.3 General Purpose Financial Statements

Financial statements issued for users that are unable to demand financial information to meet their specific information needs are **"general purpose financial statements" (GPFS).**

Examples of such users are citizens, voters, their representatives and other members of the public. The term "financial statements" used here and in the standards covers all statements and explanatory material which are identified as being part of the GPFS.

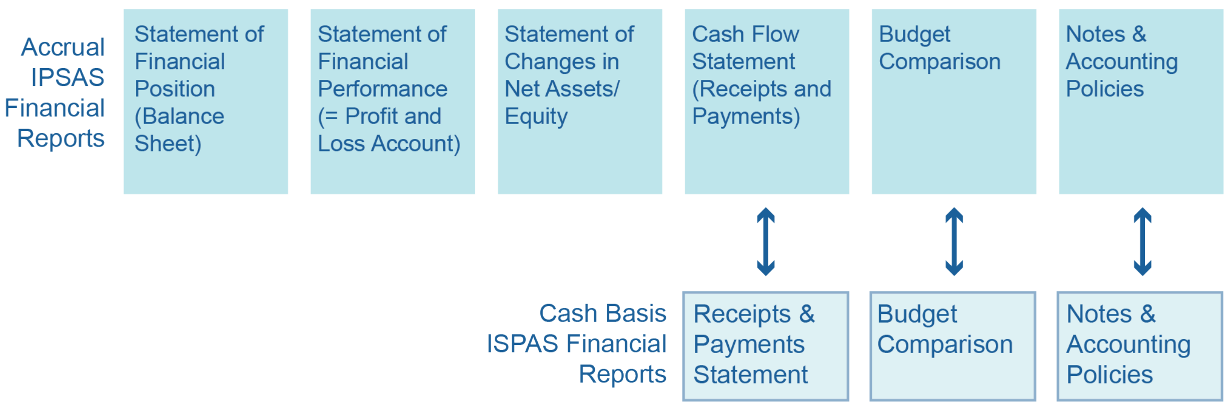
When the **cash basis of accounting** underlies the preparation of the financial statements, the primary financial statement is the statement of cash receipts and payments. The illustration below provides an overview of the reporting requirements; Annex 1 provides a more detailed example of the Receipts and Payments Statement.

Alternatively, the Cash Basis IPSAS (IPSASB, 2017 version: Para. 2.2.1) states that

> *An entity which intends to migrate to the accrual basis of accounting is encouraged to present a statement of cash receipts and payments in the same format as that required by International Public Sector Accounting Standard (IPSAS #2), 'Cash Flow Statements'.*

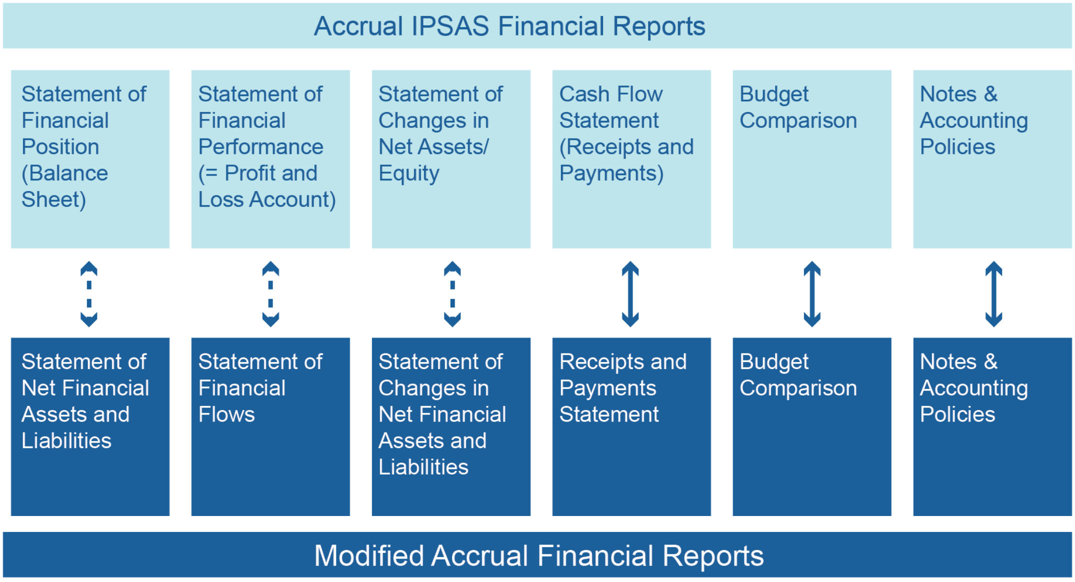
An example of the format here also appears in **Annex 1**.

Figure 11: Cash Basis Financial Reports



Where the **modified accrual basis of accounting** is used, the following financial reports will be prepared.

Figure 12: Modified Accrual Basis Financial Reports



When the **accrual basis of accounting** underlies the preparation of the financial statements, the following statements are recommended:

- **Statement 1:** Statement of Consolidated Assets and Liabilities;
- **Statement 2a:** Statement of Consolidated Revenue and Expenditure (Expenses classified by nature);
- **Statement 2b:** Statement of Consolidated Revenue and Expenditure (Expenses classified by function);
- **Statement 2c:** Statement of Consolidated Fund;
- **Statement 3:** Statements of Changes in Net Assets/Equity;
- **Statement 4:** Statement of Consolidated Cash Flow; and
- **Statement 5:** Statement of Accounting Policies and Notes to the Financial Statements.

See Annex 2 for detailed examples.

4.1.4 Cash-Based Accounting IPSAS

The required format for the financial statements under International Public Sector Accounting Standards (IPSAS) is contained in the Standard **Financial Reporting Under Cash Based Accounting,** which was issued in January 2003, revised in 2006 and re-published in January 2007. The latest version was issued in 2017.

Unlike under the accrual accounting basis there is only one standard[15].

4.1.5 Accrual-Based Accounting IPSAS

There are currently 42 IPSAS relating to accruals bases accounting. These are listed in Table 6.

Table 6: IPSAS under Accruals Based Accounting

IPSAS	Title	Based On
1	Presentation of Financial Statements	IAS[16] #1
2	Cash Flow Statements	IAS #7
3	Accounting Policies, Changes in Estimates and Errors	IAS #8
4	The Effect of Changes in Foreign Exchange Rates	IAS #21
5	Borrowing Costs	IAS #23
6	Consolidated Financial Statements and Accounting for Controlled Entities	IAS #27
7	Accounting for Investments in Associates	IAS #28
8	Financial Reporting in Interests in Joint Ventures	IAS #31
9	Revenue from Exchange Transactions	IAS #18
10	Financial Reporting in Hyperinflationary Economies	IAS #29
11	Construction Contracts	IAS #11
12	Inventories	IAS #2
13	Leases	IAS #17
14	Events after the Reporting Date	IAS #10
15	Financial Instruments: Disclosure and Presentation (Superseded)	
16	Investment Property	IAS #40
17	Property, Plant and Equipment	IAS #16
18	Segment Reporting	IAS #14
19	Provisions, Contingent Liabilities and Contingent Assets	IAS #37
20	Related Party Contracts	IAS #24
21	Impairment of Non-cash Generating Assets	IAS #36
22	Disclosure of Financial Information about the General Government Sector	N/a
23	Revenue from Non-exchange Transactions (Taxes and Transfers)	N/a
24	Presentation of Budget Information in Financial Statements	N/a
25	Employees Benefits	IAS #19
26	Impairment of Cash-generating Assets	IAS #36
27	Agriculture	IAS #41
28	Financial Instruments Presentation	IAS #32
29	Financial Instruments Recognition and Measurement	IAS #39
30	Financial Instruments Disclosure	IFRS #7
31	Intangible Assets	IAS #38
32	Service Concession Arrangements Grantor	IFRIC #12
33	First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSAS)	N/a
34	Separate Financial Statements	IAS #27
35	Consolidated Financial Statements	IFRS #10
36	Investments in Associates and Joint Ventures	IAS #28
37	Joint Arrangements	IFRS #11
38	Disclosure of Interests in Other Entities	IFRS #12
39	Employee Benefits	IAS #19
40	Public Sector Combinations	N/a
41	Financial Instruments	IFRS #9
42	Social Benefits	

15 IPSASBCommunications@ipsasb.org
16 International Accounting Standards

If any government wishes to be fully IPSAS compliant, it must move to a full accruals' basis of accounting, and **all** IPSAS will need to be followed. However, most governments have opted for a modified accruals basis, and few operate a full accruals basis.

Summary

When auditing financial statements stated to have been produced under IPSAS, we must ensure both that all relevant standards have been adopted and that the financial statements themselves are produced in accordance with the government's prescribed Financial Reporting Framework.

4.2 International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS)

4.2.1 Overview

These standards are aimed more for use by commercial or quasi-commercial organisations. Although the British Government uses them instead of IPSAS.

International Accounting Standards (IAS) were issued by the International Accounting Standards Council (IASC) and endorsed or amended by the International Accounting Standards Board (IASB). The IASB will reissue standards in this series where it considers it appropriate.

The International Financial Reporting Standards (IFRS) are also issued by the International Accounting Standards Board (IASB).

The International Financial Reporting Interpretations Committee (IFRIC) and the Standards Interpretation Committee (SIC) offer guidance as to how the standards should be applied.

Most jurisdictions have reporting requirements for listed and other types of entities that include presenting financial statements that are prepared in accordance with a set of generally accepted accounting principles. IFRS Standards are increasingly that prescribed set of principles and are used extensively around the world.

A very useful annual publication for SAI auditing under IFRS is the "IFRS in Your Pocket" series published by Deloittes[17].

Deloittes maintain an up-to-date summary of the adoption of IFRS Standards around the world on IAS Plus at: http://www.iasplus.com/en/resources/ifrs-topics/use-of-ifrs

The IFRS Foundation publishes individual jurisdictional profiles which can be found in: http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx

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17 https://www.iasplus.com/en/publications/global/ifrs-in-your-pocket/2019

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4.2.2 International Accounting Standards

The standards are summarised in Annex 3 but, as these are frequently updated, users of this manual should check on the IASB website[18] for any updated information; standards which have been superseded do not appear to avoid wasting space.

4.2.3 International Financial Reporting Standards

The standards are summarised in Annex 4 but, as these are frequently updated, users of this manual should check on the IASB website[19] for any updated information.

4.2.4 Examples of Financial Statement Under IFRS

Deloittes issue an annual volume illustrating the current format for accounts prepared under IFRS entitled: *"Model Financial Statements for IFRS Preparers".*

This can be found and downloaded at: https://www.ifrspublicationsonline.com/p-171-illustrative-ifrs-consolidated-financial-statements-for-2019-year-ends-global.aspx

4.2.5 IFRS Training

Over the years, PASAI has engaged USP Fiji to provide training to our members, which has been subject to available funding. However, Deloitte provides a series of free e-learning modules covering most of the IAS and IFRS. These can be accessed and downloaded at: https://www.iasplus.com/en/tag-types/e-learning

4.2.6 Summary

When auditing financial statements stated to have been produced under IFRS, we must ensure both that all relevant standards have been adopted and that the statement themselves are produced in accordance with the prescribed structure.

4.3 Generally Accepted Accounting Principles (GAAP)

4.3.1 Introduction

Generally Accepted Accounting Principles (**GAAP**)[20] is the accounting standard adopted by the U.S. Securities and Exchange Commission (SEC). While the SEC previously stated that it intends to move from U.S. GAAP to the International Financial Reporting Standards (IFRS), the latter differ considerably from GAAP, and progress has been slow and uncertain. More recently, the SEC has acknowledged that there is no longer a push to move more U.S. companies to IFRS, so the two sets of standards will "continue to coexist" for the foreseeable future.

18 https://www.ifrs.org/groups/international-accounting-standards-board/
19 https://www.ifrs.org/groups/international-accounting-standards-board/
20 Website: https://www.gasb.org/home

4.3.2 Basic Characteristics

GAAP indicate that Financial Reporting should provide information that is:

- Useful to present to potential investors and creditors and other users in making rational investment, credit, and other financial decisions;
- Helpful to present to potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts about economic resources, the claims to those resources, and the changes in them;
- Helpful for making financial decisions;
- Helpful in making long-term decisions;
- Helpful in improving the performance of the business; and
- Useful in maintaining records.

To achieve basic objectives and implement fundamental qualities GAAP has three basic assumptions, four basic principles, and five basic constraints.

- Assumptions
  - **Business Entity:** The business is separate from its owners and other businesses. Revenue and expense should be kept separate from personal Expense;
  - **Monetary Unit:** A stable currency is the unit of record. The FASB accepts the nominal value of the U.S. dollar as the monetary unit of record, unadjusted for inflation;
  - **Periodicity:** The economic activities of an enterprise can be divided into artificial time periods; and
  - **Going Concern:** Continuation of an entity as a going concern is presumed.
- Principles
  - **Historical Cost Principle:** Companies account for and report the acquisition costs of assets and liabilities rather than their fair market value. This principle provides information that is reliable (removing the opportunity to provide subjective and potentially biased market values), but not very relevant. Thus, there is a trend toward the use of fair values. Most debts and securities are now reported at market values;
  - **Revenue Recognition Principle:** Companies should record revenue when earned but not when received. The flow of cash does not have any bearing on the recognition of revenue. This is the essence of accrual basis accounting. Conversely, however, losses must be recognised when their occurrence becomes probable, whether or not it has actually occurred. This comports with the constraint of **conservatism** yet brings it into conflict with the constraint of **consistency**, in that reflecting revenues/gains is inconsistent with the way in which losses are reflected;
  - **Matching Principle:** Expenses have to be matched with revenues as long as it is reasonable to do so. Expenses are recognised not when the work is performed, or when a product is produced, but when the work or the product actually makes its contribution to revenue. Only if no connection with revenue can be established, cost may be charged as expenses to the current period (e.g., office salaries and other administrative expenses). This principle allows greater evaluation of actual profitability and performance (shows how much was spent to earn revenue). Depreciation and Cost of Goods Sold are good examples of application of this principle; and
  - **Full Disclosure Principle:** The amount and kinds of information disclosed should be decided based on trade-off analysis as a larger amount of information costs more to prepare and use. Information disclosed should be enough to make a judgment while keeping costs reasonable. Information is presented in the main

body of financial statements, in the notes or as supplementary information.

- Constraints
  - **Objectivity principle**: the company financial statements provided by the accountants should be based on objective evidence;
  - **Materiality principle**: the significance of an item should be considered when it is reported. An item is considered significant when it would affect the decision of a reasonable individual;
  - **Consistency principle**: It means that the company uses the same accounting principles and methods from period to period;
  - **Conservatism principle**: when choosing between two solutions, the one which has the less favourable outcome is the solution which should be chosen (see convention of conservatism); and
  - **Cost Constraint**: The benefits of reporting financial information should justify and be greater than the costs imposed on supplying it.

4.3.3 Statements of Government Accounting Standards

There are 91 standards forming the GAAP which are developed by the Government Accounting Standards Board (GASB) and which may be viewed on https://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1176160042391#gasbs25

The current standards also appear as Annex 5, with links to each standard; standards which have been superseded do not appear to avoid wasting space.

4.4 Current Position of PASAI Member Countries

The different legal and administrative frameworks within which PASAI member countries operate have given rise to the use of different accounting standards. The current position (excluding French Polynesia and New Caledonia) is summarised in Table 7.

Table 7: Accounting Basis used by PASAI Member Countries

SAI	Accounting Basis
Cook Islands	IPSAS Accrual
Nauru	IPSAS Cash
Samoa	IPSAS Cash
Tonga	IPSAS Cash
Australia - NAO	Accrual
Australia - NSW	Accrual
Australia - QLD	Accrual
Australia Victoria	Accrual
New Zealand	Accrual
American Samoa, FSM (National and States), Guam, Marshall Islands, CNMI and Palau	GAAP(GASB) Accrual
Republic of Fiji	IPSAS Cash Basis
Kiribati	Cash Basis
Papua New Guinea	Cash Basis
Solomon Islands	IPSAS Cash Basis
Tuvalu	IPSAS Accrual
Vanuatu	IPSAS Accrual

In summary, seven countries use some form of cash basis (IPSAS, GAAP (GASB) or Modified Cash) and the other eighteen use some form of accruals basis (IPSAS, GAAP (GASB)).

Chapter 5: Auditing Standards

The key points are:

INTOSAI Framework of Professional Pronouncements; INTOSAI Founding Principles; INTOSAI Core Principles; International Standards of Supreme Audit Institutions; INTOSAI Guidance; and Generally Accepted Government Auditing Standards.

The key internet links of this chapter are:

INTOSAI Auditing Standards: www.issai.org/professional-pronouncements/?n=0-1000000000

Beijing Declaration

GAGAS (Yellow Book): www.gao.gov/yellowbook/overview

Delete the sections and annexes which do not apply to your mandate.

5.1 INTOSAI Framework of Professional Pronouncements (IFPP)

5.1.1 Introduction

This section examines INTOSAI auditing standards[21]. It illustrated the key points involved, but there is no substitute of reading the standards and explanatory notes themselves.

This section makes reference to all of the INTOSAI pronouncements and is not limited merely to those connected with Financial Auditing. The Compliance and Performance Auditing Manuals will only contain the standards specific to those audits.

INTOSAI Professional Pronouncements are the formal and authoritative announcements or declarations of the INTOSAI Community. They draw on the collective professional expertise of INTOSAI's members and provide INTOSAI's official statements on audit-related matters. All the pronouncements are organised and numbered according to their status and purpose in a single framework.[22]

This framework – **The INTOSAI Framework of Professional Pronouncements (IFPP) –** contains three categories of professional pronouncements:

- **The INTOSAI Principles (INTOSAI-P):** these consist of founding principles and core principles. The founding principles have historical significance and specify the role and functions, which SAI should aspire to. These principles may be informative to Governments and Parliaments, as well as SAI and the wider public and may be used as reference in establishing national mandates for SAI. The core principles support the founding principles for an SAI, clarifying the SAI's role in society as well as high level prerequisites for its proper functioning and professional conduct.
- **The International Standards of Supreme Audit Institutions (ISSAI):** these are the authoritative international standards on public sector auditing. The purpose of the ISSAI is to:
  - ensure the quality of the audits conducted;
  - strengthen the credibility of the audit reports for users;
  - enhance transparency of the audit process;
  - specify the auditor's responsibility in relation to the other parties involved; and

21 All can be accessed and most downloaded at: https://www.issai.org/professional-pronouncements/?n=0-1000000000
22 https://www.intosai.org/focus-areas/audit-standards#&gid=lightbox-group-1255&pid=0

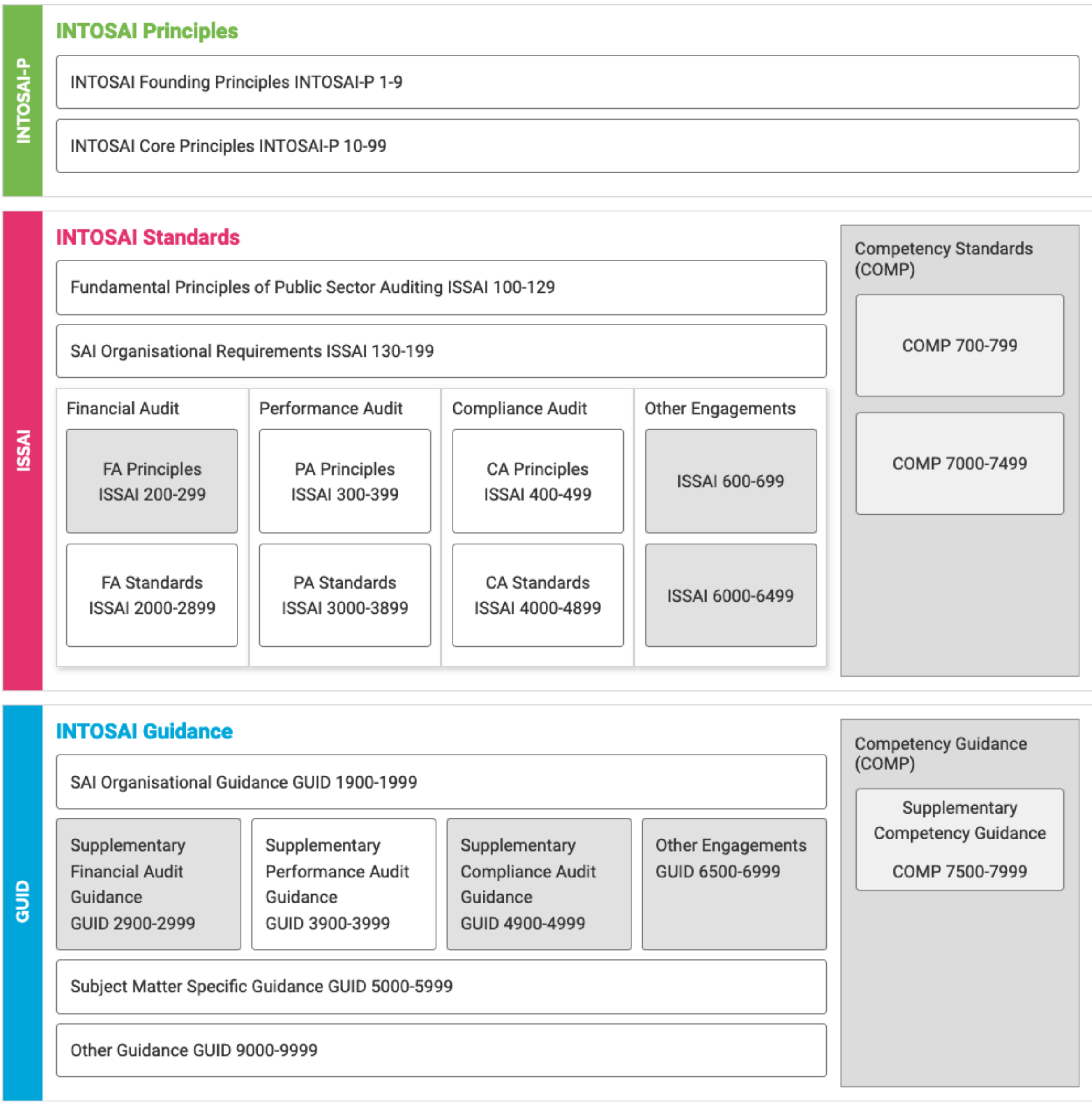
  - define the different types of audit engagements and the related set of concepts that provides a common language for public sector auditing.

  The full set of ISSAI is based on a basic set of concepts and principles that defines public sector auditing and the different types of engagements supported by the ISSAI.

- **The INTOSAI Guidance (GUID):** the guidance is developed by INTOSAI in order to support the SAI and individual auditors in:
  - How to apply the ISSAI in practice in the financial, performance or compliance audit processes;
  - How to apply the ISSAI in practice in other engagements; and
  - Understanding a specific subject matter and the application of the relevant ISSAI.

The IFPP replaces the former ISSAI framework as indicated in Figure 13.

Figure 13: The INTOSAI Framework of Professional Pronouncements (IFPP)



5.1.2 INTOSAI Founding Principles (INTOSAI-P) (1–9)

The **INTOSAI-P #1 (ex ISSAI #1) – The Lima Declaration** (from INCOSAI IX of 1977) calls for the establishment of effective Supreme Audit Institutions and provides guidelines on auditing precepts. The full set of ISSAI draw and elaborate on this historical document.

The chief aim of the Lima Declaration is to call for independent government auditing.

Rule of law and democracy are essential premises for independent government auditing.

The Lima Declaration is equally significant for all Supreme Audit Institutions, no matter to what region they belong, what development they have undergone, how they are integrated into the system of government, or how they are organised.

The Lima Declaration has seven parts and 25 sections. Table 8 shows the structure of the declaration.

Table 8: The Structure of the Lima Declaration

Part	Section
I. General	1. Purpose of audit
	2. Pre-audit and post-audit
	3. Internal audit and external audit
	4. Legality audit, regularity audit and performance audit
II. Independence	5. Independence of Supreme Audit Institutions
	6. Independence of the members and officials of Supreme Audit Institutions
	7. Financial Independence of Supreme Audit Institutions
III. Relationship to Parliament, Government and the Administration	8. Relationship to Parliament
	9. Relationship to government and the administration
IV. Powers of Supreme Audit Institutions	10. Powers of Investigation
	11. Enforcement of Supreme Audit Institution findings
	12. Expert opinions and rights of consultation
V. Audit Methods, Audit Staff, International Exchange of Experiences	13. Audit methods and procedures
	14. Audit staff
	15. International exchange of experiences
VI. Reporting	16. Reporting to Parliament and to the general public
	17. Method of reporting
VII. Audit Powers of Supreme Audit Institutions	18. Constitutional basis of audit powers; audit of public financial management
	19. Audit of public authorities and other institutions abroad
	20. Tax audits
	21. Public contracts and public works
	22. Audit of electronic data processing facilities
	23. Commercial enterprises with public participation
	24. Audit of subsidised institutions
	25. Audit of international and supranational organisations

5.1.3 INTOSAI Core Principles (INTOSAI-P) (10–99)

These currently comprise four items:

- **INTOSAI P #10 (ex ISSAI #10):** The Mexico Declaration on SAI Independence;
- **INTOSAI P #12 (ex ISSAI #12):** Value and Benefits of SAI;
- **INTOSAI P #20 (ex ISSAI #20):** Principles of Transparency and Accountability; and
- **INTOSAI P #50 (New):** Principles of Jurisdictional Activities of SAI.

INTOSAI P #10 (ex ISSAI #10)

The **Mexico Declaration** of 2007 defines the requirements of the Lima Declaration in more concrete terms and identifies eight principles for the independence of external government auditing. Table 9 summarises the eight principles.

Table 9: Mexico Declaration Principles

Principle
Principle 1: The existence of an appropriate and effective constitutional/ statutory/legal framework and of *de facto* application of the provisions of this framework: Legislation that spells out, in detail, the extent of SAI independence is required;
Principle 2: The independence of SAI heads including security of tenure and legal immunity in the normal discharge of their duties: the applicable legislation specifies the conditions for appointments, re-appointments, employment, removal and retirement of the head of the SAI;
Principle 3: A sufficiently broad mandate and full discretion in the discharge of SAI functions: SAI should be empowered to audit the: - Use of public monies, resources, or assets, by a recipient or beneficiary regardless of its legal nature; - Collection of revenues owed to the government or public entities; - Legality and regularity of government or public entities accounts; - Quality of financial management and reporting; and - Economy, efficiency, and effectiveness of government or public entities operations.
Principle 4: Unrestricted access to information: SAI should have adequate powers to obtain timely, unfettered, direct, and free access to all the necessary documents and information, for the proper discharge of their statutory responsibilities;
Principle 5: The right and obligation to report on their work: SAI should not be restricted from reporting the results of their audit work. They should be required by law to report at least once a year on the results of their audit work;
Principle 6: The freedom to decide the content and timing of audit reports and to publish and disseminate them: SAI are free to decide the content of their audit reports. SAI are free to make observations and recommendations in their audit reports, taking into consideration, as appropriate, the views of the audited entity;
Principle 7: The existence of effective follow-up mechanisms on SAI Recommendations: SAI submit their reports to the Legislature, one of its commissions, or an auditee's governing board, as appropriate, for review and follow-up on specific recommendations for corrective action; and
Principle 8: Financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources: SAI should have available necessary and reasonable human, material, and monetary resources – the Executive should not control or direct the access to these resources. The SAI manages its own budget and allocates it appropriately. The Legislature or one of its commissions is responsible for ensuring that SAI have the proper resources to fulfil their mandate. SAI have the right of direct appeal to the Legislature if the resources provided are insufficient to allow them to fulfil their mandate.

INTOSAI P #12 (ex ISSAI #12)

The Value and Benefits of SAI – Making a Difference to the Lives of Citizens is a short (13-page standard) which is structured as follows:

- Preamble;
- Strengthening the Accountability, Transparency, and Integrity of Government and Public Sector Entities;
- Demonstrating Ongoing Relevance to Citizens, Parliament, and Other Stakeholders; and
- Being a Model Organisation Though Leading by Example.

Figure 14 indicates three objectives by which an SAI is able to make a difference to the lives of its citizens.

Figure 14: Objectives by which an SAI is able to make a difference to the lives of its citizens

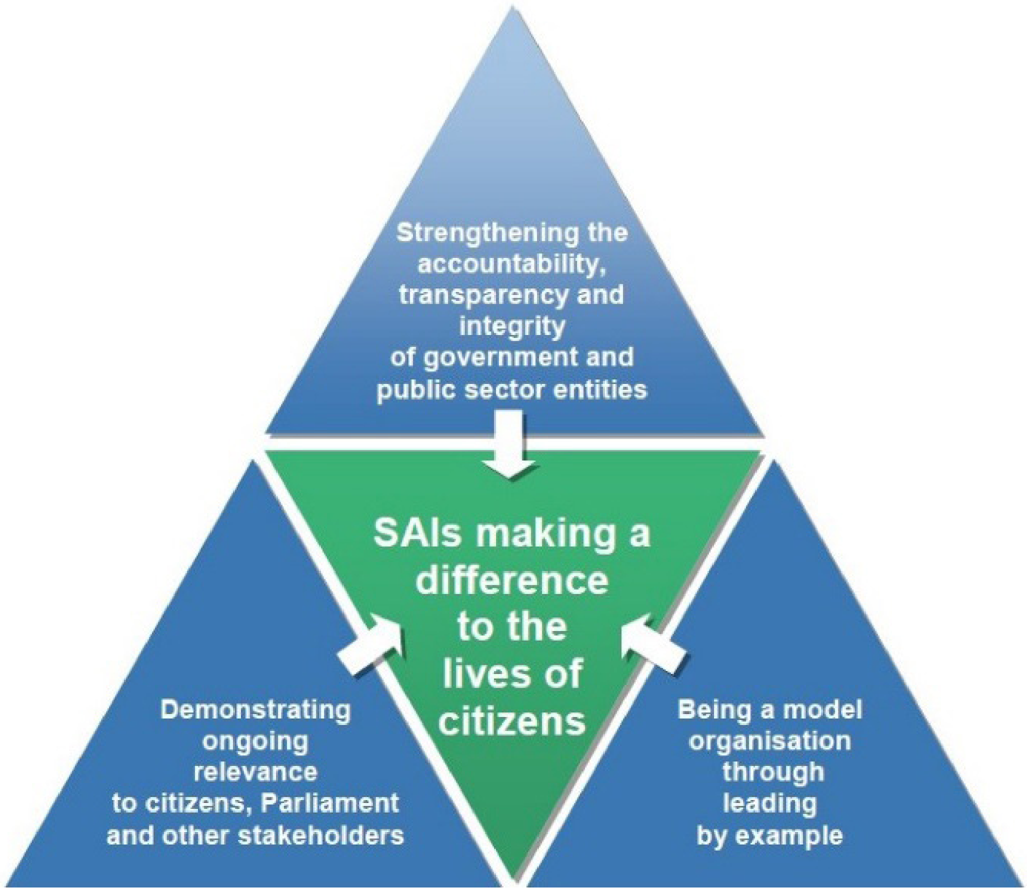
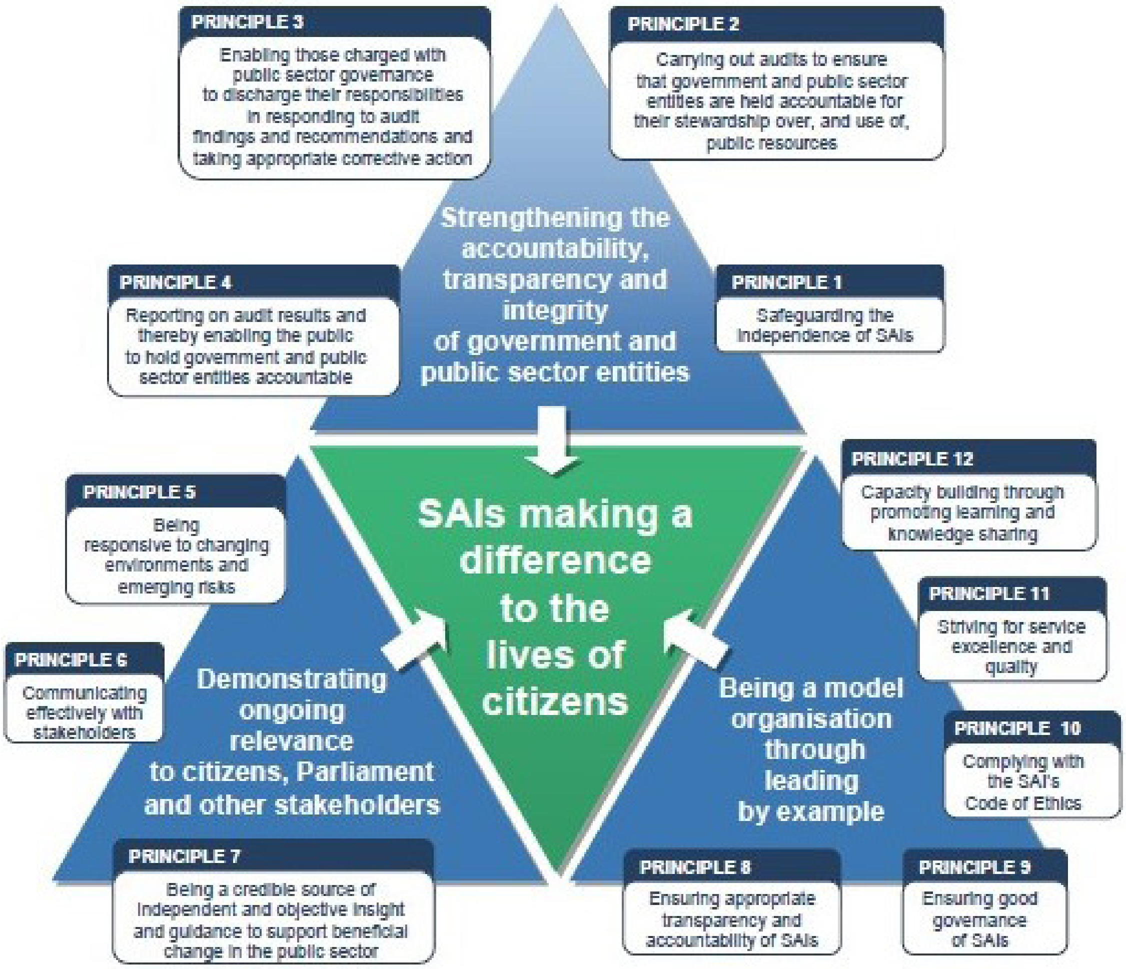


Figure 15 links the 12 values of the standard to the three objectives by which an SAI is able to make a difference to the lives of its citizens.

Figure 15: Values and Benefits of SAI



INTOSAI P #20 (ex ISSAI #20)

Principles of Transparency and Accountability comprises nine pages and is structured as follows:

- **Purpose and Objectives;**
- **Concepts of Accountability and Transparency;**
- **Principles:** see Table 10:

Table 10: Transparency and Accountability Principles

Principle
Principle 1: SAI perform their duties under a legal framework that provides for accountability and transparency;
Principle 2: SAI make public their mandate, responsibilities, mission, and strategy;
Principle 3: SAI adopt audit standards, processes and methods that are objective and transparent;
Principle 4: SAI apply high standards of integrity and ethics for staff of all levels;
Principle 5: SAI ensure that these accountability and transparency principles are not compromised when they outsource their activities;
Principle 6: SAI manage their operations economically, efficiently, effectively and in accordance with laws and regulations and reports publicly on these matters;
Principle 7: SAI report publicly on the results of their audits and on their conclusions regarding overall government activities;
Principle 8: SAI communicate timely and widely on their activities and audit results through the media, websites and by other means; and
Principle 9: SAI make use of external and independent advice to enhance the quality and credibility of their work.

INTOSAI P #50 (New)[23]

This Principle only applies to SAI that have a jurisdictional function. Principles of jurisdictional activities of SAIs develops twelve principles to suit the specific context of jurisdictional activities of the SAI empowered with those missions.

Table 11: Transparency and Accountability Principles

Principle
Principle 1: The law should define the liability and sanction regime applicable to persons accountable by law before the SAI.
Principle 2: The member(s) of the SAI, involved in the jurisdictional activities, should benefit from guarantees legally spelled out, which explicitly ensure their independence toward the public authorities.
Principle 3: The SAI should have legal powers or rights guaranteeing its access to information.
Principle 4: An irregular fact may be prosecuted or sanctioned only before the expiry of a reasonable time from the moment it was committed or discovered.
Principle 5: Any judgement of the SAI must be open to be objected and reconsidered and is subject to appeal or annulment in accordance with the national regulation.
Principle 6: The SAI must ensure that the persons accountable before it undergo a fair trial guaranteed by the legal procedures.
Principle 7: The impartiality of the judgment process must be guaranteed by regulations governing the activities of the jurisdictional SAIs and the resulting proceedings.
Principle 8: The SAI must ensure that the exercise of the jurisdictional activities leads to notified and implemented judgement. The sanction of the personal liability of the litigant must be effective.
Principle 9: A person accountable by law cannot be condemned for the same irregularity to several sanctions of the same nature imposed by the SAI. A person accountable by law can only be condemned for the same irregularity to sanctions of a different nature imposed by the SAI and other courts if the law so permits.
Principle 10: The SAI must guarantee the quality of jurisdictional procedures through an efficient and systematic quality control.
Principle 11: The SAI must complete the jurisdictional procedure within a reasonable time.
Principle 12: The SAI must ensure that judgements, as any judicial decision, are made publicly, respecting the secrecy and restrictions linked to confidentiality that are legally mandatory as well as the protection of personal data.

5.1.4 International Standards of Supreme Audit Institutions (ISSAI)

The ISSAI are grouped into ten categories:

- **ISSAI #100 to #129:** Fundamental Principles of Public-Sector Auditing;
- **ISSAI #130 to #199:** SAI Organisational Requirements;
- **ISSAI #200 to #299:** Financial Audit Principles;
- **ISSAI #300 to #399:** Performance Auditing Principles;
- **ISSAI #400 to #499:** Compliance Auditing Principles;
- **ISSAI #600 to #699:** Other Engagements;
- **ISSAI #2000 to #2899:** Financial Auditing Standards;
- **ISSAI #3000 to #3899:** Performance Audit Standards;
- **ISSAI #4000 to #4899:** Compliance Audit Standards;
- **ISSAI #6000 to #6499:** Other Engagement Standards.

23 https://www.intosai.org/fileadmin/downloads/documents/open_access/INTOSAI_P_11__INTOSAI_P_99/INTOSAI_P_50/INTOSAI-P-50_en.pdf

Fundamental Principles of Public-Sector Auditing

There is a single standard here – ISSAI #100 - it comprises 19 pages and is structured as follows:

- Purpose and Authority of the ISSAI;
- Framework for Public Sector Auditing;
- Elements of Public Sector Auditing; and
- Principles of Public Sector Auditing.
- SAI Organisational Requirements

There are currently two standards here:

- **ISSAI #130 (ex ISSAI #30):** Code of Ethics; and
- **ISSAI #140 (ex ISSAI #40):** Quality Control for SAI.

ISSAI #130 comprises 7 pages and is structured as follows:

- Introduction;
- Integrity;
- Independence, Objectivity and Impartiality;
- Professional Secrecy; and
- Competence.

ISSAI #140 comprises 15 pages and is structured as follows:

- Scope;
- Overview of International Standard on Quality Control (ISCQ) 1;
- What is the System of Quality Control;
- Structure of ISSAI #140;
- Framework of a System of Quality Control; and
- Interpretation of Terms
- Financial Audit Principles and Financial Auditing Standards

The Financial Audit Principles are contained in **ISSAI #200** and the Standards in **ISSAI#2000 to #2899 (ex #1000 to #2999).**

ISSAI #200 constitutes the basis for financial auditing standards in accordance with INTOSAI standards.

The main purpose of the ISSAI on financial audit is to provide INTOSAI members with a comprehensive set of principles, standards and guidelines for the audit of financial statements of public-sector entities.

ISSAI #200 is explained in detail in Annex 6.

ISSAI#2000 to #2899 provide the standards for the performance of and reporting on audits carried out by Supreme Audit Institutions. However, by utilising the detail of the International Standard on Auditing (ISA) insofar as it is relevant to financial audits conducted by Supreme Audit Institutions, and by developing Practice Notes (PN) that deal with special considerations for financial audits of public sector entities, INTOSAI provides a comprehensive set of Financial Audit Guidelines that can be drawn upon by all Supreme

Audit Institutions in all institutional settings and audit environments.

The objective of the INTOSAI Financial Audit Standards is to provide guidance for audits of financial statements in the public sector, including general guidance on additional auditing and reporting objectives related to the public sector audit of financial statements.

ISSAI#2000 to #2899 are explained in detail in Annex 7**.**

- Compliance Auditing, Performance Auditing and Other Engagements

The fundamental principles and guidelines for these are discussed in the appropriate manual. This will include, in the Compliance Audit Manual, a section on the Controllership role of the SAI which, currently applies only to Samoa and New Zealand within the PASAI region.

5.1.5 INTOSAI Guidance (GUID)

As indicated above, INTOSAI adopted the Lima Declaration as early as 1977 and stipulated the principle of independence of external government auditing in methodological and professional terms in the Mexico Declaration in 2007.

INTOSAI also adopted a series of ISSAIs and INTOSAI Guidance for Good Governance (INTOSAI GOVs), which also contribute to the promotion of good governance.

As the Beijing Declaration[24] of 2013 states:

> *"INTOSAI has promoted good governance by enabling SAIs to help their respective governments improve performance, enhance transparency, ensure accountability, maintain credibility, fight corruption, promote public trust, and protect the interests of their citizens."*

The new **INTOSAI Framework of Professional Pronouncements (IFPP)** groups the Guidance Notes into eight categories:

- **GUID #1900 to #1999:** SAI Organisational Guidance;
- **GUID #2900 to #2999:** Supplementary Financial Audit Guidance;
- **GUID #3900 to #3999:** Supplementary Performance Audit Guidance
- **GUID #4900 to #4999:** Supplementary Compliance Audit Guidance;
- **GUID #5000 to 5999:** Subject Matter Specific Guidance;
- **GUID #6500 to #6999:** Other Engagements; and
- **GUID #9000 to #9999:** Other Guidance.

Although, at present there are only a limited number of Guidance Notes:

- **GUID #1900 (ex ISSAI #5600):** Peer Reviews;
- **GUID #3910 (ex ISSAI #3100):** Concepts for Performance Audits;
- **GUID #3920 (ex ISSAI #3200):** Performance Audit Process;
- **GUID #5090 (ex ISSAI #5000):** Audit of International Institutions;
- **GUID #5091 (ex INTOSAI GOV #9300):** Arrangements for the Audit of International Institutions;
- **GUID #5100 (ex ISSAI #5300):** Audit of Information Systems;
- **GUID #5200 (ex ISSAI #5110):** Environmental Audit;
- **GUID #5201 (ex ISSAI #5120):** Environmental Audit in the Context of Financial and

24 https://www.google.com/search?q=intosai+guidance+for+good+governance&oq=INTOSAI+Guidance&aqs=-chrome.1.69i57j0.4464j0j8&sourceid=chrome&ie=UTF-8

Compliance Audits;

- **GUID #5202 (ex ISSAI #5130):** The Role of the SAI;
- **GUID #5203 (ex ISSAI #5140):** Audit of International Environmental Accords;
- **GUID #5259 (ex ISSAI #5450):** Public Debt Information System;
- **GUID #5260 (ex INTOSAI GOV #9160):** Governance of Public Assets;
- **GUID #5270 (ex ISSAI #5700):** Audit of Corruption Prevention;
- **GUID #5290 (new):** Development and Use of Key National Indicators;
- **GUID #9000 (ex ISSAI #5800):** Co-operation between SAI;
- **GUID #9010 (ex INTOSAI GOV #9200):** Importance of Independent Standard Setting;
- **GUID #9020 (ex INTOSAI GOV #9400):** Evaluation of Public Policies;
- **GUID #9030 (ex ISSAI #11):** Good Practices Relating to SAI Independence; and
- **GUID #9040 (ex ISSAI #21):** Good Practices Relating to SAI Transparency.

5.2 Generally Accepted Government Auditing Standards (GAGAS)

5.2.1 Introduction

The **Generally Accepted Government Auditing Standards** (**GAGAS**), commonly referred to as the "**Yellow Book**", are produced in the United States by the Government Accountability Office (**GAO**).

The standards apply to both financial and performance audits of government agencies.

The Yellow Book standards are used by auditors who examine the federal government, including the Government Accountability Office, various offices of Inspectors General, and others.

In addition to financial audits, the Yellow Book standards cover Performance Audits, which evaluate the performance of a programme or project against defined objectives, such as objectives for efficiency and effectiveness.

The latest version of the Yellow Book as published in July 2018 and maybe accessed here: https://www.gao.gov/yellowbook/overview

As ever, there is no substitute for reading the original document. There, in this manual we only refer to the key topics; inviting readers to access the appropriate section of the Yellow Book for the full detail.

5.2.2 GAGAS and Financial Audit

These are detailed in Section 1.17 of the Yellow Book. The requirement is that financial audits provide independent assessments as to whether entities' reported financial information is presently fairly, in all material respects, in accordance with recognised criteria. When undertaking financial statement audits the auditor has to provide an opinion on this.

5.2.3 General Requirements

Chapter 2 of the Yellow Book covers the general requirements which auditors must follow in order to be compliant with GAGAS. These are divided into:

- **Unconditional Requirements:** which must be followed – and to be stated that they have been followed – in all assignments; and
- **Presumptively Mandatory Requirements:** which must be followed where relevant.

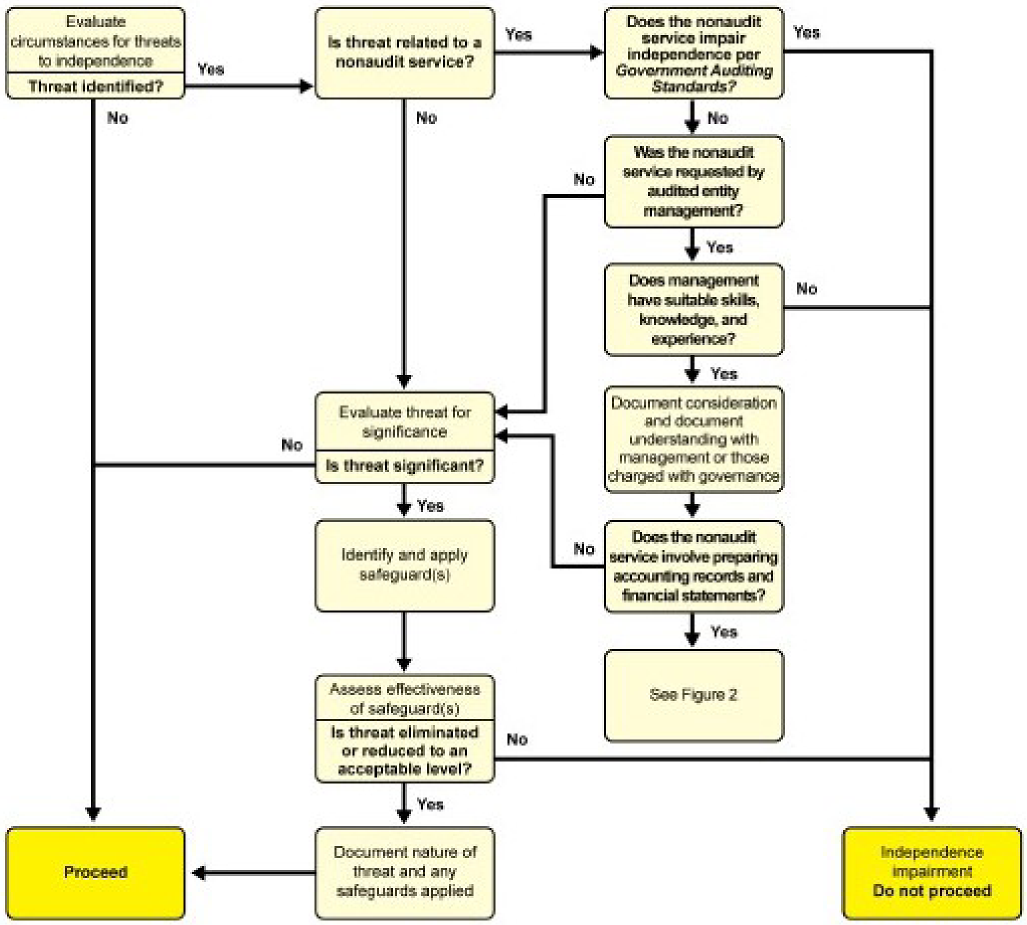
5.2.4 Ethics, Independence and Professional Judgement

Chapter 3 of the Yellow Book deals with these topics.

- **Ethics:** this includes the public interest, integrity, objectivity, proper use of data and professional behaviour;
- **Independence:** this includes a conceptual framework, provision of non-audit services and documentation;
- **Professional Judgement:** covers professional judgement.

The Independence conceptual framework can be illustrated as in Figure 16.

Figure 16: GAGAS Conceptual Framework for Independence



5.2.5 Competence and Continuing Professional Education

These are coved in **Chapter 4** of the Yellow Book.

5.2.6 Quality Control and Peer Review

These are covered in **Chapter 5** of the Yellow Book.

- **Quality Control:** this covers systems, leadership, independence, legal and ethical requirements, initiation, acceptance and continuance of engagements, human resources, engagement performance and quality of monitoring; and

- **Peer Review:** including additional requirement for non-recognised organisations.

5.2.7 Financial Audits

These are covered in **Chapters 6 and 7** of the Yellow Book.

Chapter 6 covers the **standards** for Conducting and Reporting on Financial Audits.

For **Conducting the Audit,** they include: Compliance with Standards; Licencing and Certification; Auditor Communication; Results of Previous Engagements' Investigations of Legal Proceedings; Non-compliance; Findings; Audit Documentation and Availability of Individuals and Documentation.

With regards **Reporting on the Audit**, they include reporting compliance with GAGAS; reporting on Internal Control; Presenting Findings in the Audit Report; Reporting Directly to parties outside of the audited entity; Obtaining and Reporting the Views of Responsible Officials; Reporting Confidential or Sensitive Information; and Distributing Reports.

Chapter 7 covers the **standards** for Attestation Engagements and Reviews of Financial Statements.

This covers Examination Engagements; Review Engagements; Agreed-Upon Procedures Engagement and Reviews of Financial Statements.

5.2.8 Performance Audits

These are covered in Chapters 8 and 9 of the Yellow Book with **Chapter 8** dealing with Fieldwork Standards and **Chapter 9** Reporting Standards.

These will be examined in more detail in the Performance Audit Manual.

5.3 Current Position of PASAI Member Countries

The table below summarises the current position with regards PASAI members.

Table 12: Use of Auditing Standards by PASAI Members

Numbers of SAI	SAI	Auditing Standard	%
10	All North SAI	GAGAS	40
7	Nauru, Tuvalu, Kiribati, Vanuatu, Solomon Islands, Cook Islands and Tonga	ISSAI	28
3	Samoa, PNG, Fiji[25]	ISA	12
2	Australia - NSW, VIC	Australian Auditing Standards	8
1	Australian - ANO	Jurisdictional Auditing Standards (ANAO)	4
1	Australia - QLD	Jurisdictional Auditing Standards (QAO)	4
1	New Zealand (NZ)	NZ Auditing Standards	4

Thus, in terms of independent audit opinions, seven countries currently state that they conduct audits according to ISSAI; with a further three striving to move to full compliance. PASAI is working towards providing support, according to the SAI needs, to assist all SAI to become fully ISSAI compliant.

25 Moving towards ISSAI

Chapter 6: Audit Planning

The key points are: Strategic Audit Plan and Annual Audit Plan.

There are no specific internet links in this chapter.

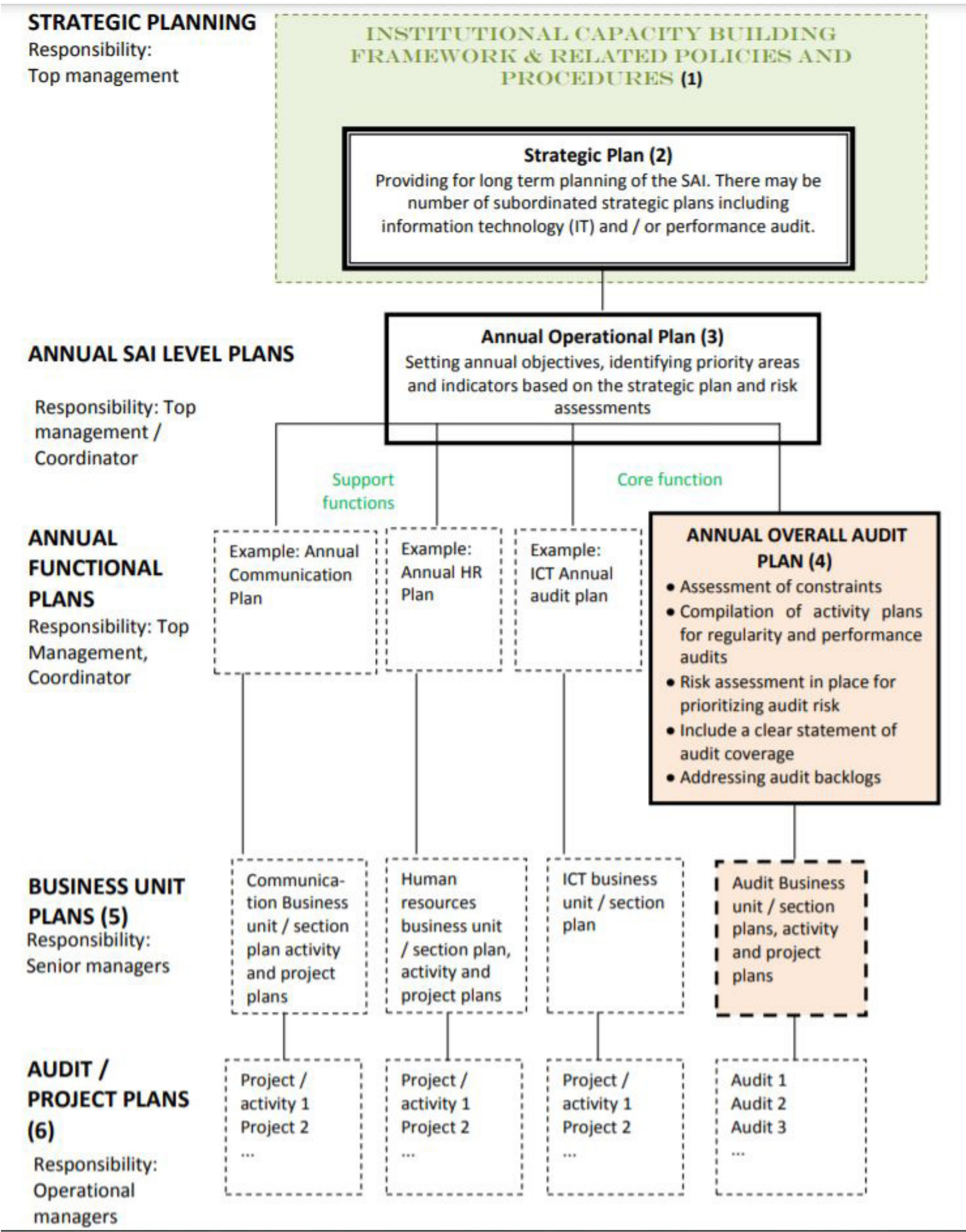
Whilst the steps to be undertaken are similar, customisation may be necessary to cite the appropriate audit standards.

6.1 Introduction

This Chapter examines only the high-level audit planning – Strategic and Annual Plans. The planning of the detailed audit work itself appears in Chapter 9 below. The illustration covers both the levels of planning discussed here and those in Chapter 9.

There should be a strong link between the plans; provisions of the Strategic Plan should cascade down into the Annual Operational and Functional Plans.

Figure 17: Levels of Planning



6.2 Strategic Audit Plan

It is important to understand the differences and linkages between a **Strategic Plan** and a **Strategic Audit Plan** (SAP). To avoid confusion, many SAI now call their Strategic Plans **Corporate Business Plans** (CBP) instead.

This terminology also makes the functions of the two plans much clearer.

The **CBP** is intended primarily for **external use** and can include:

- **Current State Assessment:** an overview of the current staffing levels and resources of the SAI;
- **Relationship with the National Development Plan (NDP):** usually the NDP will include the need to develop good governance, accountability and transparency on government actions. This section of the CBP indicates the contribution that the SAI will be making to this;
- **Corporate Issues and Goals:**
  - Staffing and Logistical Issues;
  - Executive Services Issues;
  - Professional Services Issues;
  - Monitoring and Evaluation Issues; and
  - Legislative and Administrative Framework Issues.
- **Strategic Initiatives and Implementation Matrix**:
  - **Goal Reference Number:** for each goal – typically around 20;
  - **Goal:** the title of the goal;
  - **Activities/Strategies:** to achieve the goal;
  - **Verifiable Output:** proof that the goal has been achieved;
  - **Risks:** to prevent the goal being achieved;
  - **Response to Risk:** steps to be taken to minimise risk;
  - **Milestones:** target dates for achieving the goals;
  - **Costs:** indicative costs; and
  - **External Technical Assistance:** required donor assistance.
- **External Technical Assistance:** more details on any external assistance requirements to implement the CBP.

The CBP will make reference to other plans necessary for its implementation. These include Human Resource Development and Training Plans and, of course, the SAP.

The **SAP** is intended mainly for **internal use** so that auditors can plan their work over the long-term cycle. However, it does have some external use:

- **Resource Requirements:** it can be used to provide scientific evidence of the resources (staff and others) required to complete the mandate put on the SAI by Parliament;
- **"Defence":** if, for example, a major fraud is detected in an area, the SAI is often, unfairly, blamed for not finding it. A detailed SAP will enable to SAI to show when it would have audited that particular system.

Thus, the Strategic Audit Plan is a long term (ideally five year) plan which defines the SAI's strategy, direction, objectives required to fulfil its mandate and identifies the resources necessary to achieve this. As well as a planning tool, it is a useful document to try to obtain additional audit resources as a "gap analysis" between the requirements to meet the mandate and the current and proposed staffing levels will indicate any shortfall in staff.

The plan, thus, covers both ongoing activities necessary to achieve the mandate and areas where development is necessary. The Strategic Audit Plan should be a rolling Five Year Plan of the SAI which seeks to identify every client, and every system of those clients, which requires auditing in the plan period.

Each Directorate/Department of the SAI should prepare its own Strategic Audit Plan – structured identically to make easy use of Excel technology – which are then merged to form the overall Strategic Audit Plan for the SAI as a whole.

The first year of the SAP is often in more detail and is the Annual Audit Plan for that year.

In the tables below, and for both Strategic and Annual Audit Plans, the following definitions can be used:

- **Planning and Administration:** this refers only to the planning and administration work within an audit. It does not include the wider functions which are undertaken by non-audit staff;
- **Financial Audit:** this is all work specifically undertaken to enable an opinion to be made on the Annual Financial Statements (AFS);
- **Compliance Audit:** this is work on the Financial and Administrative Frameworks (are the systems sound and are they being followed?). This is divided into Fundamental; Non-fundamental and Minor categories. This either in support of the audit of the AFS or as stand-alone activities;
- **Performance Audit:** these are more detailed studies to determine the extent to which policy implementation has been made with sue regard to equity, economy, efficiency and effectiveness;
- **Substantive Planned Audit Work:** the total of the above four categories;
- **Reserve:** an arbitrary amount set aside for unforeseen work and/or over-runs in allocated audit man-days. Once allocated it increases the day in the category allocated to as well as the Substantive Planned Audit Work Total. A figure if 10% is reasonable; and
- **Training:** this is non-productive time which could have been used for audit work. As staff are become more proficient over the years after training, this amount should decline.

This assumes that each Directorate/Department undertakes a full range of audits. If, for example, there Performance Audit is only undertaken by a dedicated unit, the structure can be adjusted accordingly. When analysing the available resources, the SAI will need to determine the number of working days available for each auditor, taking into account leave, sickness and public holidays. The total number of days allocated per person is typically around 220.

Tables 13-16 below provide an illustration at a summary level. This will flow automatically from the Excel Spreadsheet developed by each Directorate/Department. An example of spreadsheets for a ministry and the Directorate/Department summary appears by way of illustration below the tables.

Table 13: Analysis of Total Work

	Days	%
Planning and Administration	2,690	
Audit Work	53,826	
Total Planned Work	**56,516**	
Reserve	9,609	
Total Audit Work	**66,125**	**87.29**
Training	9,625	12.71
TOTAL MAN-DAYS	**75,750**	**100.00**

Table 14: Analysis of Substantive Planned Audit Work by Type

	Days	%
Planning and Administration	2,690	4.76
Certification Audit	16,605	29.38
Compliance Audit	23,976	42.42
Performance Audit	13,245	23.44
Total	**56,516**	**100.00**

Table 15: Strategic Audit Plan: SAI Summary

(Man-Days)

	Five-year total	2020	2021	2022	2023	2024
Substantive Audit Work	**56,516**	6,957	6,910	6,957	6,910	6,957
Training	**9,625**	1,255	1,305	1,255	1,155	1,155
Reserve	**9,609**	1,288	1,285	1,288	1,435	1,388
Total	**75,750**	**9,500**	**9,500**	**9,500**	**9,500**	**9,500**

Table 16: Strategic Plan: Details by Directorate

	Five-year Total	2020	2021	2022	2023	2024
Directorate A						
Substantive Audit Work	**9,834**	1,956	1,983	1,956	1,983	1,956
Training	**1,900**	400	400	400	350	350
Reserve	**2,266**	444	417	444	467	494
Total	**14,000**	**2,800**	**2,800**	**2,800**	**2,800**	**2,800**
Directorate B						
Substantive Audit Work	**9,705**	1,941	1,941	1,941	1,941	1,941
Training	**1,900**	400	400	400	350	350
Reserve	**2,395**	459	459	459	509	509
Total	**14,000**	**2,800**	**2,800**	**2,800**	**2,800**	**2,800**
Directorate C						
Substantive Audit Work	**9,152**	1,860	1,786	1,860	1,786	1,860
Training	**1,550**	300	350	300	300	300
Reserve	**1,298**	240	264	240	314	240
Total	**12,000**	**2,400**	**2,400**	**2,400**	**2,400**	**2,400**
Directorate D						
Substantive Audit Work	**11,855**	2,371	2,371	2,371	2,371	2,371
Training	**1,750**	350	350	350	350	350
Reserve	**1,645**	329	329	329	329	329
Total	**15,250**	**3,050**	**3,050**	**3,050**	**3,050**	**3,050**
Directorate E						
Substantive Audit Work	**6,000**	1,200	1,200	1,200	1,200	1,200
Training	**775**	155	155	155	155	155
Reserve	**725**	145	145	145	145	145
Total	**7,500**	**1,500**	**1,500**	**1,500**	**1,500**	**1,500**
Directorate F						
Substantive Audit Work	**9,970**	1,994	1,994	1,994	1,994	1,994
Training	**1,750**	350	350	350	350	350
Reserve	**1,280**	256	256	256	256	256
Total	**13,000**	**2,600**	**2,600**	**2,600**	**2,600**	**2,600**

Figure 18: Example of Strategic Plan Spreadsheets

N12

Directorate A						
Ministry of Education						
Area of Work	**Total Time**	**2020**	**2021**	**2022**	**2023**	**2024**
Planning	15	3	3	3	3	3
Administration	25	5	5	5	5	5
Financial Audits - Annual Financial Statements	250	50	50	50	50	50
Compliance Audits - Regularity Audits						
Fundamental Tasks*	450	90	90	90	90	90
Non-fundamental Tasks*	300	60	60	60	60	60
Minor Tasks*	50	10	10	10	10	10
Performance Audit Studies*	500	100	100	100	100	100
Total (to Departmental Summary	**1,590**	**318**	**318**	**318**	**318**	**318**
*NB List tasks in Annual Plan						

Directorate A						
Auditee	**Total Time**	**2020**	**2021**	**2022**	**2023**	**2024**
Ministry of Education	1,590	318	318	318	318	318
Ministry of Higher Education	1,055	211	211	211	211	211
Ministry of Social Affairs	1,375	275	275	275	275	275
Ministry of Tourism	775	155	155	155	155	155
Ministry of Health	1,400	280	280	280	280	280
Ministry of Women's Affairs	950	190	190	190	190	190
Ministry of Culture	975	195	195	195	195	195
Commission for Detainees	54	0	27	0	27	0
Higher Council of Youth and Sports	81	27	0	27	0	27
Higher Council of Information	54	0	27	0	27	0
Hospitals	900	180	180	180	180	180
Universities, Colleges and Institutes	625	125	125	125	125	125
Planned Substantive Audit Work	**9,834**	**1,956**	**1,983**	**1,956**	**1,983**	**1,956**
Training	1,900	400	400	400	350	350
Reserve	2,266	444	417	444	467	494
Directorate Total	**14,000**	**2,800**	**2,800**	**2,800**	**2,800**	**2,800**
NB 13 staff @ 218 days = 2834pa						
NB Say 2,800 days						

Summary - Social Services | Ministry of Education | Ministry of Higher Education

6.3 Annual Audit Plan

The Annual Audit Plan flows from the Strategic Plan and confirms the areas which will be subject to audit during the upcoming year. A separate plan will be developed for each Department/Directorate with an overall summary for the SAI as a whole.

The steps to be taken to develop the plan are summarised, in bullet format, below. By summing data from each Department/Directorates, the totals for the whole SAI can be obtained. It is for this reason that each Department/Directorate Summary spreadsheet must remain identical to every other one.

Following the basic principle of conservatism, staff number should only be shown as increasing if this is a definite development (or a footnote indicating that any increases are speculative).

The steps required to develop and Annual Audit Plan are as follows:

- **Time Available:** how many man-days are available for audit work each year over the plan period (218[26] per full-time professional);
- **Training:** deduct the number of days allocated for training (this should decline over time). This will be an estimate. It is not a target and unused days should be reallocated to audit tasks;
- **Reserve:** deduct an amount of time for reserve (unforeseen audit work and/or time over-runs). Use around 10% of the total time available. Unlike training, all the reserve days must be used up during the year;
- **Time Available:** for Auditing (Time Available less Training and Reserve);
- **Clients (Auditees):** list (or check pre-existing list) to ensure all clients are listed;
- **Major Systems (of Auditees):** list (or check pre-existing list) to ensure all systems are listed;
- **Select Clients and Systems:** using risk analysis etc. determine which clients (and which systems) are going to be audited in the upcoming year (Annual Plan);
- **Allocate Time:** allocated enough man-days to undertake each piece of audit work to comply with audit standards. This will be based on the time the audit took last time it was undertaken or a professional estimation;
- **Total Time Required:** total all allocated man-days;
- **Compare:** Time Available with Time Allocated;
- **Adjust Plan:** if Time Available > Time Allocated add further audit tasks or if Time Available < Time Allocated determine:
    - Can more resources be made available?; and/or
    - Reduce the time allocated for audit work; and/or
    - Postpone audit work.
- **Write Annual Plan:** based on the above data draft the Annual Plan for the SAI. If there are insufficient resources to undertake the required work to the necessary standard, this must be highlighted in the Plan. This is a valuable tool when trying to persuade the government or legislature to provide additional audit resources. They have determined the mandate and, thus, **must** provide the necessary resources to achieve it.

Annex 8 provides an illustration of an Annual Audit Plan.

26 Based on 52*5 days – 260 days; less allowances for public holidays annual leave and sickness. Adjust for your own situation

PART THREE: THE FINANCIAL AUDIT PROCESS

Chapter 7: Introduction to Financial Audit

This chapter looks at Overview; Why We Audit; What Is Financial Audit; and the Purpose of Financial Audit

There are no specific internet links in this chapter.

This Chapter refers mainly to Financial Auditing using ISSAI. SAI using GAGAS will need to adapt this chapter by inserting references to the appropriate GAGAS.

7.1 Overview

The purpose of every Supreme Audit Institution (SAI) is to provide independent assurance to Parliament on how public money and resources are managed and spent in terms of regularity, efficiency, effectiveness and integrity of the performance of the public bodies.

As part of this process, the SAI is obligated to pass on the results of its audits, as well as its accumulated experience, to the government, parliament and those responsible for the bodies audited.

To ensure transparency in the operations of the SAI this information should also be available to the public. It will consist of audit findings, opinions and recommendations concerning organisation, management and policy.

In line with its task and mission, the purpose of this manual is to provide reference information and guidance for the auditors of the region's SAI on the content of the Financial Auditing Principles (ISSAI #200 to #299), Financial Audit Standard (ISSAI #2000 to #2899 and Supplementary Guidance to Financial Auditing (ISSAI #2900 to #2999) produced by the International Organisation of Supreme Audit Institutions (INTOSAI). (see Chapter 5 above)

The text represents the essence of those International Standards for Supreme Audit Institutions (ISSAI), with additional explanations and examples in order to make the ISSAI requirements understandable.

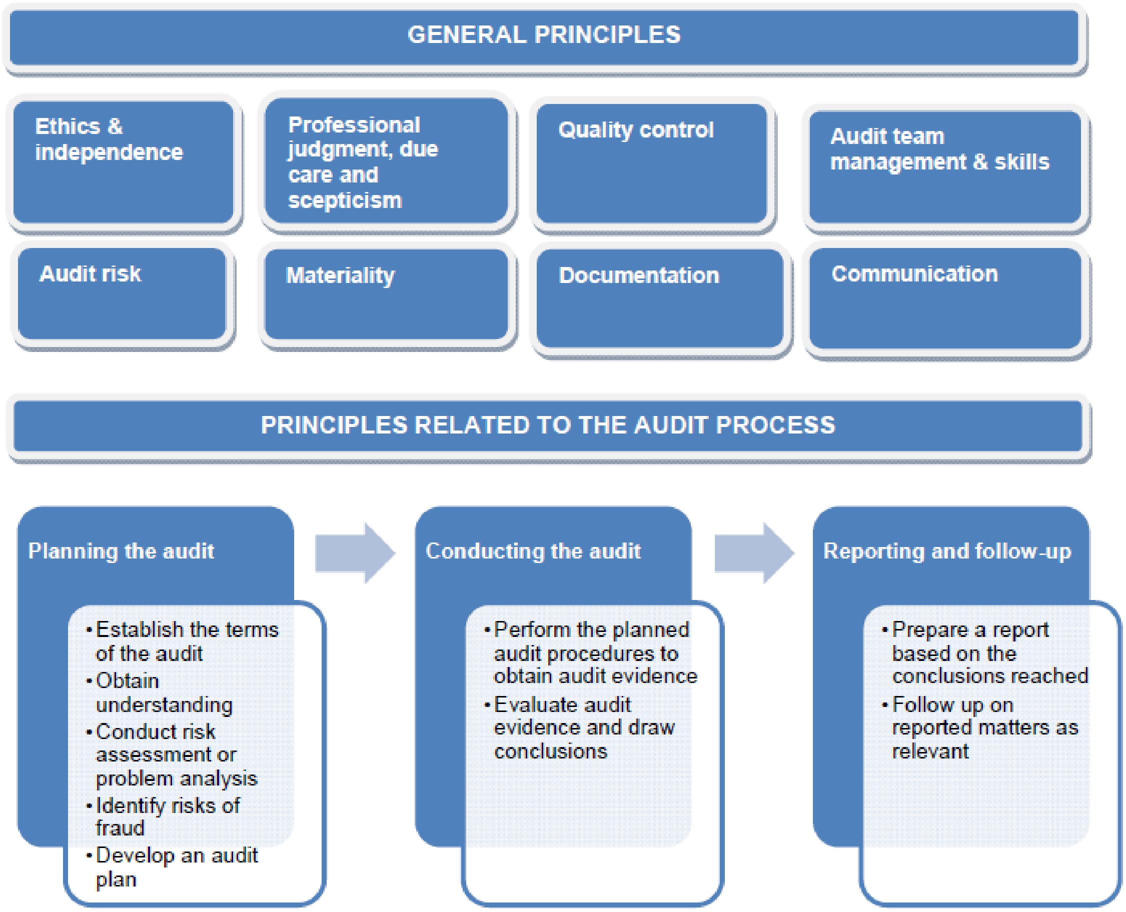
Other materials used for the preparation of this manual are working papers, practical guidance and methodological materials selected with a twofold purpose: to satisfy the ISSAI and to provide sufficient information and tools to the users in terms of their understanding and ability to apply the guidance.

This manual should be seen only as a model and reference for general practices in financial. The objectives of a financial audit of public sector entities always include audit and reporting responsibilities related to the public sector entity's compliance or non-compliance with authorities, legal framework, budget, accountability, effectiveness of internal control over financial reporting.

The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust. Audit is not an end in itself but an indispensable part of a regulatory system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent – or at least render more difficult – such breaches.

By adopting the ISSAI and the Generally Accepted Government Auditing Standards (GAGAS), where appropriate, as audit standards for the SAI, the SAI has to comply with the general principles and principles related to the audit process set by the governing bodies. These principles, for ISSAI, are shown in Figure 19.

Figure 19: General Principles and their Relationship to the Audit Process



7.2 Why Audit?

According to the INTOSAI's Lima Declaration (ISSAI-P #1):

> *"The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust."*

Audit is not an end in itself but an indispensable part of a regulatory system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent – or at least render more difficult – such breaches.

The public-sector audit environment is that in which governments and other public-sector entities exercise responsibility for the use of resources derived from taxation and other sources in the delivery of services to citizens and other recipients. These entities are accountable for their management and performance, and for the use of resources, both to those that provide the resources and to those, including citizens, who depend on the services delivered using those resources. Public-sector auditing helps to create suitable conditions and reinforce the expectation that public-sector entities and public servants will perform their functions effectively, efficiently, ethically and in accordance with the applicable laws and regulations.

In general, public-sector auditing can be described as a systematic process of objectively obtaining and evaluating evidence to determine whether information or actual conditions conform to established criteria. Public-sector auditing is essential in that it provides legislative and oversight bodies, those charged with governance and the general public with information and independent and objective assessments concerning the stewardship and performance of government policies, programmes or operations.

All public-sector auditing contributes to **good governance** by:

- providing the intended users with independent, objective and reliable information, conclusions or opinions based on sufficient and appropriate evidence relating to public entities;
- enhancing accountability and transparency, encouraging continuous improvement and sustained confidence in the appropriate use of public funds and assets and the performance of public administration;
- reinforcing the effectiveness of those bodies within the constitutional arrangement that exercise general monitoring and corrective functions over government, and those responsible for the management of publicly funded activities; and
- creating incentives for change by providing knowledge, comprehensive analysis and well-founded recommendations for improvement.

In general, public-sector audits can be categorised into one or more of three main types: Audits of Financial Statements (Financial Audit), Audits of Compliance with authorities and Performance Audits.[27]

This manual covers Financial Audit; Compliance Audit and Performance Audit are covered by the accompanying manuals in this PASAI series.

Audit of Financial Statements – more commonly named “Financial Audit” – focuses on determining whether an entity’s financial information is presented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.

ISSAI #100:29 distinguishes **two types of audit engagement**:

- **Attestation Engagements:** the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion;
- **Direct Reporting Engagements:** it is the auditor who measures or evaluates the subject matter against the criteria. The auditor selects the subject matter and criteria, taking into consideration risk and materiality. The outcome of measuring the subject matter against the criteria is presented in the audit report in the form of findings, conclusions, recommendations or an opinion. The audit of the subject matter may also provide new information, analyses or insights.

Financial Audits are always attestation engagements, as they are based on financial information presented by the responsible party.

27 ISSAI #100, no. 17, 18, 20, 21.

7.3 What is a Financial Audit?

According to INTOSAI (ISSAI #200) financial audit focuses on determining whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.

The purpose of an audit of financial statements is to enhance the degree of confidence of intended users in the financial statements. This is achieved through the expression of an opinion by the auditor as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, or – in the case of financial statements prepared in accordance with a fair presentation financial reporting framework – whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

Laws or regulations binding public-sector audit organisations may prescribe other wordings for this opinion. An audit conducted in accordance with standards based on the INTOSAI Fundamental Principles of Financial Auditing and relevant ethical requirements will enable the auditor to express such an opinion.

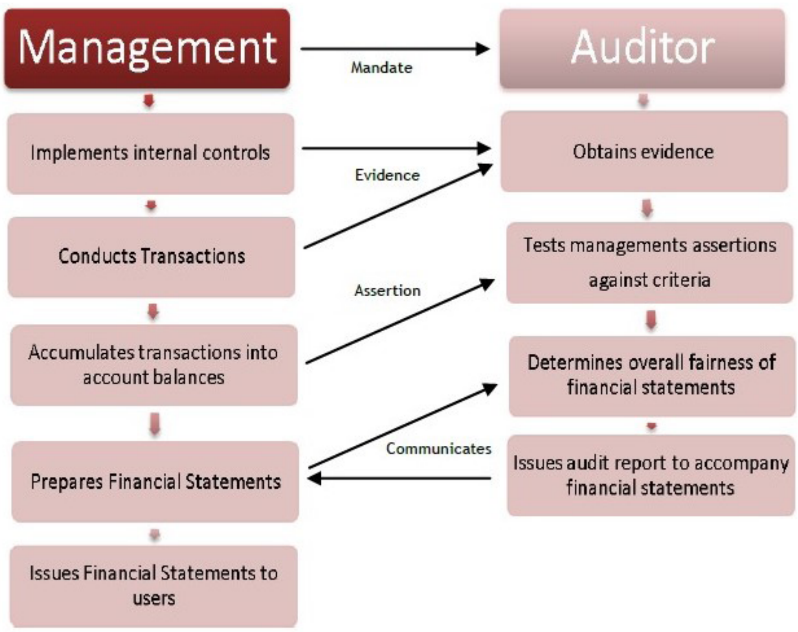
The main objectives in conducting an audit of financial statements are:

- To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- To report on the financial statements, and communicate the result of the audit, in accordance with the auditor's findings.

As we have seen, the general principles of a financial audit are described in ISSAI #200. These principles are expanded in the Financial Audit Standard (ISSAI #2000 to #2899 and Supplementary Guidance to Financial Auditing (ISSAI #2900 to #2999).

Figure 20 indicates the Terms of the Financial Audit Engagement.

Figure 20: Terms of the Financial Audit Engagement



7.4 What is the Purpose of a Financial Audit?

Audit is not an end in itself but an indispensable part of a control system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of resource management early enough so as to make it possible to take corrective measures.

Audit coverage should include the following and, ideally, be specified in the constitution:

- Public bodies including institutions abroad;
- Tax audits;
- Public contracts and public works;
- Electronic data processing;
- Industrial and commercial enterprises with public participation; and
- Subsidised institutions.

Public officials are answerable for their fiscal, managerial and programme actions and to report to those that have conferred responsibilities. Regular audits are performed on those actions as follows:

- Attestation of accountable entities (**opinion on financial statements**);
- Attestation of government as a whole (audit of financial systems and transactions);
- Audit of internal control and internal audit;
- Audit of administrative decisions; and
- Reporting of other matters.

The key areas of the audit cycle are shown in Figure 21.

Figure 21: Key Areas of the Audit Cycle

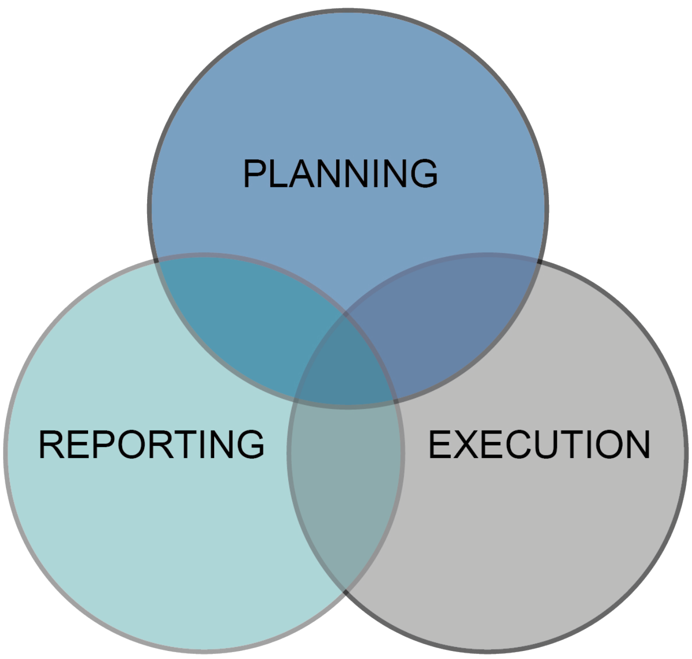
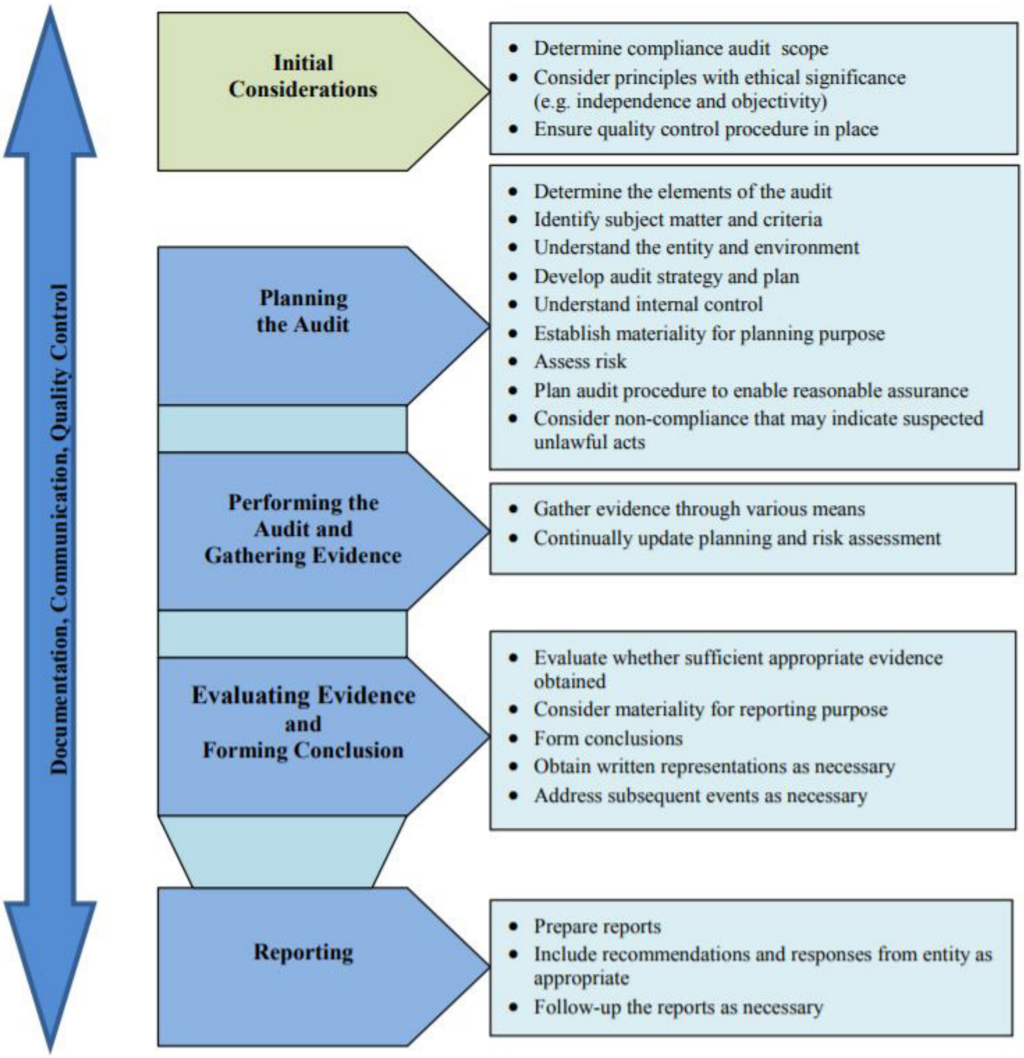


Table 17 below shows the steps to be taken at each phase of the cycle; Figure 22 shows the same data. These are discussed in the following chapters.

Table 17: Steps taken for Planning, Executing and Reporting a Financial Audit

Planning	Execution	Reporting
• Obtain an understanding of the entity • Determine audit scope and objectives • Establish materiality • Assess audit risk • Determine audit approach • Determine sampling procedures • Prepare audit plan	• Design audit program • Perform tests of control procedures • Perform substantive procedures • Conduct Analytical review • Working papers	• Perform audit evaluation • Finalise audit conclusions • Produce management letter • Prepare audit report • Plan/Carry out follow-up

Figure 22: Audit Process



Chapter 8: Pre-engagement Activities

This chapter examines: Overview of Pre-engagement Activities; Assessing the Acceptability of the Financial Reporting Framework; Agreement of Management Responsibility; and Terms of Audit Engagement.

There are no new specific internet links in this chapter.

Whilst the steps to be undertaken are identical, the acceptable Financial Reporting Framework will need to be customised according legislation.

8.1 Overview of Pre-engagement Activities

According to ISSAI #200 the auditor should assess whether the preconditions for an audit of financial statements have been met. Those preconditions are the following:[28]

- The financial reporting framework used for preparation of the financial statements is deemed to be acceptable by the auditor; and
- The management of the entity acknowledges and understands its responsibility:
    - For preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;
    - For such internal control that management deems necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
    - To provide the auditor with unrestricted access to all information of which it is aware and that is relevant to the preparation of the financial statements.

If the above conditions are not met, the auditor should evaluate the effect of the misleading nature of the financial statements on the auditor's report and the opinion and consider the need to inform the legislature about the matter.

This situation could arise through the lack of internal controls, lack of documentation and absence of previous audit work to rely on. If these are serious, the SAI would have no option other than to report that, for the appropriate reason, it was unable to form an opinion on the AFS.

However, this is of little use to anyone, and the SAI can work with the client to identify where the weaknesses are and determine how they can be corrected. Use can be made of an Examination of Overall Arrangement and Strategic Intelligence (see Chapter #6 of the Performance Audit Manual).

Whilst it is acceptable for the SAI to help the client with some short-term "first aid" work, it will compromise your independence if you do more as you cannot criticise a system that you have had a hand in designing. It would be better to work with the client's management to develop Terms of Reference for external consultancy work to correct the faults.

This chapter examines the initial considerations in audit planning. Auditors are required to examine a number of conditions before deciding whether or not to accept an audit engagement (where a choice exists).

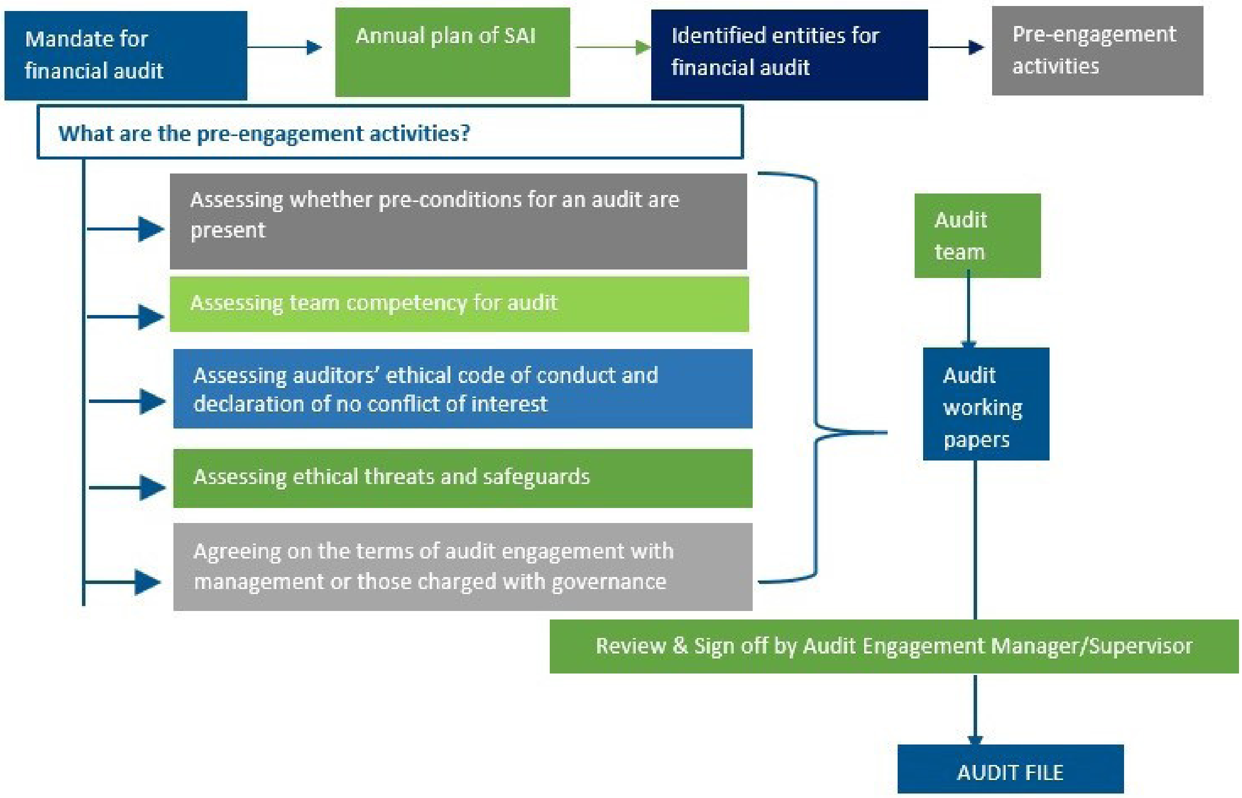
The steps required are to be found in the International Standards for Supreme Audit Institutions (ISSAI #2210) and, where appropriate, the Generally Accepted Government Auditing Standards (GAGAS).

28 ISSAI #200, art. 18 and 19.

The purpose of performing pre-engagement activities is to help ensure that the auditor has considered any events or circumstances that may adversely affect the auditor's capability to plan and perform the audit engagement to reduce **audit engagement risk** to an acceptably low level (see Illustration below).

The separate volume of templates and cases studies contains a detailed template (**Template 1**) which can be used to assess whether pre-conditions exist to facilitate the audit by the SAI.

Figure 23: Overview of Pre-engagement Activities



Source: IDI: FA Implementation Handbook

8.2 Assessing the Acceptability of the Financial Reporting Framework

This section explains the process of assessing the **Financial Reporting Framework (FRF)** applied by the audited entity in preparing the **Annual Financial Statements (AFS).**

ISSAI #2200, paragraph 13(f) indicates the disclosures we would expect to see in the AFS. Similarly, paragraph 13(g) refers to the presentation of any historical financial information.

The applicable FRF is the financial reporting framework adopted by the management and, where appropriate, those charged with governance in preparation of the financial statements and 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[29].

Annex 9 provides details of potential source material to use to establish **the nature of the entity.**

29 ISSAI #2200, Paragraph 13(a)

There are two types of FRF, which are further explained in ISSAI #2200:

- **Fair Presentation Framework** is used to refer to an FRF that requires compliance with the requirements of the framework and that:
    - 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 that
    - acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.
- **Compliance Framework:** is used to refer to a FRF that requires compliance with the requirements of the framework but does not contain the acknowledgements in (i) and (ii) above.

Both compliance and fair presentation accounting frameworks are found in public sector environments.

Acceptable **Financial Reporting Frameworks (FRF)** normally exhibit certain attributes that ensure that the information provided in the financial statements is of value to the intended users:

- **Relevance:** the information provided in the financial statements is relevant to the nature of the audited entity and the purpose of the financial statements;
- **Completeness:** no transactions, events, account balances or disclosures that could affect conclusions based on the financial statements are omitted;
- **Reliability:** the information provided in the financial statements: - where applicable, reflects the economic substance of events and transactions and not merely their legal form; and
    - results, when used in similar circumstances, in reasonably consistent evaluation, measurement, presentation and disclosure;
    - **Neutrality and Objectivity:** the information in the financial statements is free from bias;
    - **Understandability:** the information in the financial statements is clear and comprehensive and not open to significantly diverse interpretations.

The FRF is the audit criteria and the benchmark against which the subject matter (the AFS) will be evaluated. Without an acceptable FRF the auditor will not be able to fulfil the audit objectives.

The SAI should perform the steps indicated below to see whether an applicable FRF exists and whether it is acceptable, and how the matter can be dealt with if it is not acceptable.

Considering that similar entities exist across SAI for the purpose of conducting financial audits, these steps can be performed at the SAI level rather than at the level of every audit engagement:

Step 1: Is there an applicable FRF for public sector entities?

These will usually be found in primary or secondary legislation.

To **conclude the first step**, SAI need to identify if there is an applicable FRF for public sector entities in the SAI's environment or jurisdiction.

Step 2: Is the FRF acceptable?

The acceptability of an FRF is evaluated against the nature of the entity and the objective of its AFS. The characteristics of an acceptable FRF are discussed in ISSAI #200 and ISSAI #2210 *(*refer to Appendix 2 of ISSAI #2210*).*

Acceptable FRFs normally exhibit the attributes referred to in Figure 24.

Figure 24: Acceptable Features of a Financial Reporting Framework

Characteristics	Description
Relevance	The information provided in the financial statements is relevant to the nature of the audited entity and the purpose of the financial statements. Relevance is subject to the entity's nature as reflected in Illustration 4.2 below. Clearly the relevance is a critical decision for the SAI and it needs to be assessed in consultation with the stakeholders.
Completeness	No transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are omitted. The purpose of the financial statements may vary from funding/ investment purposes as explained in the Illustration 4.2 below to certification and approval of the annual budget. This needs to be evaluated in the context of the stakeholders' needs and accountability cycle.
Reliability	The information provided in the financial statements • reflects, where applicable, the economic substance of events and transactions and not merely their legal form; and • results in reasonably consistent evaluation, measurement, presentation and disclosure when used in similar circumstances. Reliability reflects whether the information provided is in a format that links to the accounting policies and / or financial procedures.
Neutrality and objectivity	Information in the financial statements is free from bias. In other words, information provided in the financial statements does not provide an interpretation that can lead to bias toward certain results or entities.
Understand-ability	The information in the financial statements is clear and comprehensive and not subject to significantly diverse interpretation. This underlines that the statements are "fit for purpose" and are used and understood in the manner for which they were intended.

Source: IDI: FA Implementation Handbook

Acceptability of the FRF results in information provided in the AFS that is useful to the intended users. To determine that usefulness, users themselves must be identified and their requirements understood.

In the public sector, there will typically be users of financial statements of several types of entities and for different reasons. The illustration below presents situations within a public-sector environment. The last column lists examples of commonly used FRF; however, their inclusion does not mean that the corresponding FRF are acceptable. That decision must be taken by SAI in the context of their auditing practice.

Figure 25: Typical Situation of an FRF in a public-sector environment

Type of Entity	Typical User	Type of Requirement	Commonly Used FRF
Ministry	Public Accounts Committee, ministries	Accountability for government expenditure and the assessment of financial management	Cash basis Modified cash basis Accrual basis
Non-revenue-generating agencies	Public Accounts Committee and responsible ministries, donor community	Accountability for funding and assessment of the performance of the entities against their mandates	Cash basis Modified cash basis Accrual basis
Revenue generating entities and corporations	Public Accounts Committee, ministries, investment authorities, banks, etc.	Assessment of return on investment and sustainability; assessment of effects of policy and regulation of the entities	Accrual-basis financial statements often aligned to a recognised reporting framework (e.g. IFRS & IPSAS)

Source: IDI: FA Implementation Handbook

To **conclude the second step** for assessing FRF, SAI need to identify whether the FRF in question is acceptable.

Step 3: Is the FRF a special-purpose or a general-purpose framework?

Based on ISSAI #200 and #2200, SAI need to examine whether the applicable FRF is a general- or a specific-purpose framework. For example, in many cases government consolidated accounts and financial statements of public sector agencies or ministries are designed to meet the common financial information needs of a wide range of users, and the applicable reporting framework would consequently be classified as general-purpose.

When the auditor concludes that the accounting framework that is applied to prepare the financial statements to be audited is a special purpose framework, the auditor must apply ISSAI #2800 which deals with special considerations relevant to

- the acceptance of the engagement;
- the planning and performance of that engagement; and
- forming an opinion and reporting on the financial statements.

ISSAI #2800 does not override the requirements of the other ISSAIs. Therefore, the auditor must continue to comply with all relevant requirements in other ISSAIs when applying ISSAI #2800.

To **conclude the third step** for assessing FRF, SAI need to conclude if the FRF in question is a general-purpose framework or a special-purpose framework.

Step 4: Is the FRF a fair presentation framework or a compliance framework? How to report accordingly?

The FRF can be either a fair presentation framework or a compliance framework. The type of framework used to prepare the AFS affects the wording of the auditor’s opinion. In case of a **fair presentation framework**, SAI need to evaluate whether the financial statements achieve fair presentation, including (ISSAI #2700:14) a consideration of:

- the overall presentation, structure and content of the financial statements; and
- whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

When expressing an opinion on the financial statements prepared in accordance with the fair presentation framework, the auditor's report includes expressions such as:

> *"the financial statements present fairly..." or "the financial statements give a true and fair view of...".*

When the financial statements are prepared in accordance with a **compliance framework**, the auditor does not express an opinion on the fairness of presentation. Instead, the auditor is required to evaluate whether the financial statements are prepared, in all material respects, in accordance with the prescribed presentation of the financial statements that may be included in a specific FRF or in applicable laws and regulations. The use of a compliance framework should not be confused with a compliance audit. The wording of the opinion will be as follows:

> *"Financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework."*

To **conclude the fourth step** for assessing FRF:

- SAI need to decide whether the FRF in question is a fair presentation framework or a compliance framework; and
- Depending on the FRF used by an entity, to prepare the financial statements, the SAI words the audit opinion accordingly.

Step 5: What are the SAI's options if the FRF is deemed unacceptable?

As explained in ISSAI #2210:8, if the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation, the auditor shall not accept the proposed audit engagement.

Non-acceptance of the engagement is often not possible in the SAI's environment, since SAI are required to carry out audits according to their legal mandate. In this regard, SAI need to explore alternative ways to deal with unacceptable FRF.

If the auditor has determined that the FRF prescribed by law or regulation is unacceptable, ISSAI #2210:19 requires that the auditor discuss the issue with management of the audited entity and ask it to provide **additional disclosures** to prevent the financial statements from misleading[30] users.

Even if management prepares additional disclosures, the auditor's report on the financial statements needs to incorporate an **Emphasis of Matter** paragraph, drawing users' attention to the additional disclosures.

If management refuses to act upon the auditor's request to prepare additional disclosures, and the SAI cannot withdraw from the engagement as discussed above, the SAI should in accordance with ISSAI #2210.20;

a) evaluate the effect of the misleading nature of the financial statements on the auditor's report; and

b) include appropriate reference to this matter in the terms of the audit engagement.

ISSAI #2210:20 prescribes that if conditions outlined in ISSAI #2210:19 are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor should:

> *"evaluate the effect of the misleading nature of the financial statements on the auditor's report; and include appropriate reference to this matter in the terms of the audit engagement."*

30 The auditor has to determine if the financial statements are misleading using the criteria for acceptability.

Practice Note (PN) #5 to ISSAI #2210 explains that if public sector auditors determine that the framework prescribed by law and regulation is not acceptable, the SAI can consider:

- informing the legislature; and
- influencing standard-setting by professional or regulatory organisations.

To conclude on actions in the case of an unacceptable FRF:

- The SAI needs to ask management of the audited entity to prepare additional disclosures;
- If additional disclosures are presented, then the SAI should add an Emphasis of Matter paragraph to the opinion;
- If management refuses to present additional disclosures, the SAI may consider withdrawal from the audit engagement; if withdrawal is not possible, the SAI may consider a modified auditor´s opinion (a disclaimer of opinion) explaining the misleading nature of the financial statements; and
- The SAI should consider informing the legislature and standard setting bodies about the unacceptability of the FRF.

The process of assessing the FRF as explained above is summarised in the decision tree given in Figure 26.

Examples of acceptable FRF include IPSAS, IFRA and GAAP. Accounting principles promulgated by the national accounting standards authorities are also deemed acceptable if a due process for pronouncement of the standards has been followed to consider views of wide range of stakeholders.

Nevertheless, in the public sector it may also happen that those standards are supplemented by law or regulation, and then the auditor shall determine whether there are **any conflicts** between the financial reporting standards and the additional requirements (ISSAI #2210:18, A36).

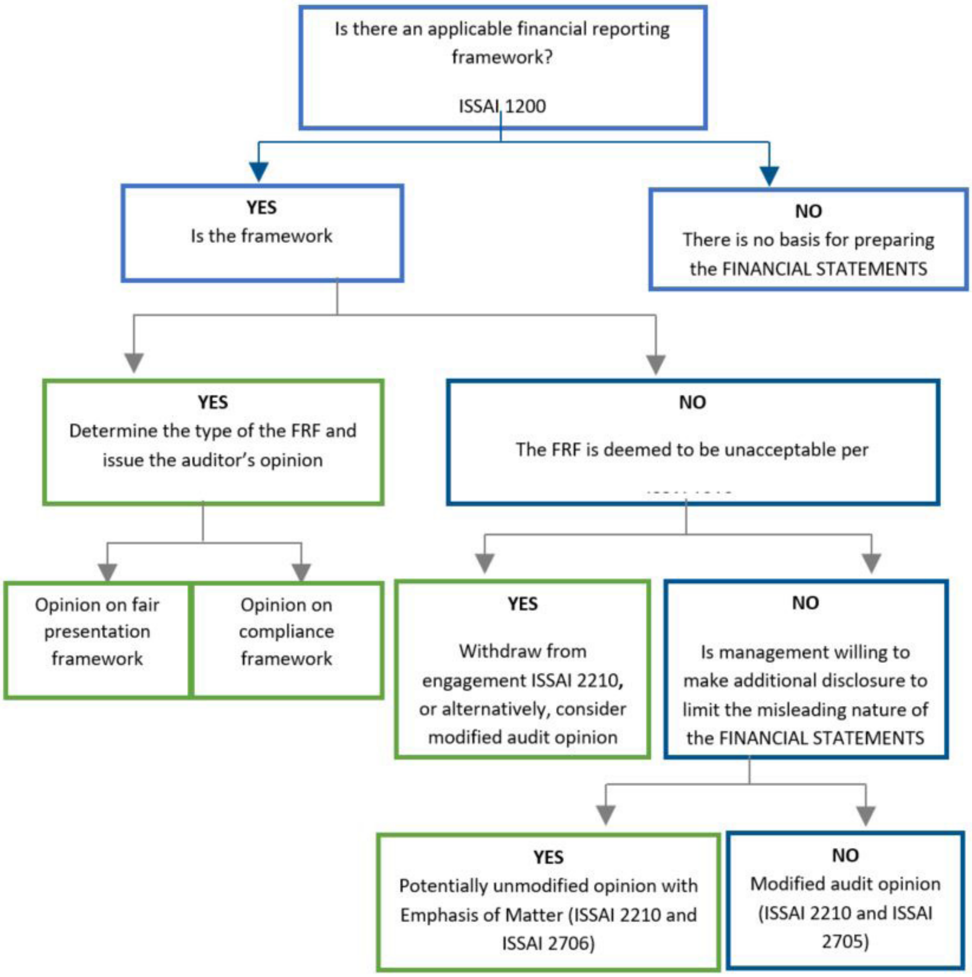
The additional requirements refer to those requirements that are prescribed by the law or regulation, in addition to the requirements of the financial reporting framework relating to preparation of financial statements. This may for example, be the case when law or regulation prescribes additional disclosures in addition to those required by the financial reporting standards (ISSAI #2210, A36).

In some countries, the financial statements of government entities are prepared solely according to a set of financial rules and regulations issued by parliament, the ministry of finance or the treasury department. As *per* ISSAI #2210, A9, in the absence of indications to the contrary, the FRF prescribed by law or regulation is presumed to be acceptable for general-purpose financial statements prepared by such entities. If it is not acceptable, then the steps indicated above apply.

Normally this assessment of the legal financial reporting framework has to be done only once and when there have been changes in this framework. This means that the assessment of the financial reporting framework is not a part of every financial audit.

Any material deviations from the demands for a proper financial reporting framework should therefore be reported to the legislature specifying the deviations, the consequences for the ability to give an opinion with the financial statements and the recommended amendments.

Figure 26: Decision Tree for determining FRF's acceptability



8.3 Agreement of Management Responsibility

Every time when an entity is audited for the first time, an assessment should be made to assure that management complies with the demands specified above. The results must be added to the permanent file and follow up must be given in any following audit, if there were relevant deviations from the demands. Re-assessment should be performed if there have been changes in the management responsible for the public entity.

As required under ISSAI #2210.6(b), the auditor needs to obtain the written agreement of the entity's management that it acknowledges and understands its responsibilities to prepare the financial statements in accordance with the applicable financial reporting framework including, where relevant, their fair presentation; to establish internal controls that management feels are necessary in order to prepare financial statements that are free from material misstatements; and to provide the auditors with access to information and persons within the entity and any additional information required by the auditors. The auditors ensure that these requirements are specified in the audit engagement letter and explained to management at the audit entry conference.

These demands may seem trivial, but they are essential for the efficiency of an audit. It is no use investing in preparing an audit and conducting it when these demands or not met, because it is already certain that the auditor cannot gain sufficient assurance that the financial statements will be free of material mistakes (give a true and fair view).

8.4 Terms of Audit Engagement

The next step in the pre-engagement is to agree on the terms of the audit engagement with the auditee, particularly with management or, where appropriate, with those charged with governance. ISSAI #2210:10 states,

> *"… the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement."*

The terms of audit engagement should include, among others, the following:

- The objective and scope of the audit of financial statements;
- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of the applicable FRF for the preparation of the financial statements;
- Reference to the expected form and content of any reports to be issued by the auditor;
- A statement that there may be circumstances in which a report may differ from its expected form and content; and
- Relevant law and regulation affecting the audit.

The engagement team may also include other terms and conditions in the audit engagement letter if deemed appropriate and necessary. An example of an audit engagement letter that can be used by an SAI's engagement team is provided in the separate volume of Templates and case studies (**Template 2**). This can be adapted to the specific needs of different SAI.

The audit engagement letter should be sent out to management or, where appropriate, to those charged with governance and they should be asked to acknowledge agreement with these terms by signing a copy of the engagement letter. The engagement team can also inform management that the terms of the engagement can be discussed in the audit entry conference before being signed, as some terms may require explanation by the engagement team itself. The audit entry conference is usually convened after sending out the audit engagement letter.

Any changes to the terms of engagement from those initially stated in the audit engagement letter should be documented, in the form of either notes or minutes of the meeting between management and the audit engagement team.

A lack of agreement with the terms of engagement by management and those charged with governance may not arise, since laws and regulations usually mandate SAI to conduct audits, and the audit terms and conditions for audit defined in the engagement letter are to be consistent with certain laws and regulations.

Chapter 9: Planning and Designing the Audit

This chapter examines: Audit Objectives and Scope; Ethics and Independence; Professional Judgement, Due Care and Scepticism; Understanding the Audited Entity and its Environment; Identification of the Parties Involved and the Legal Basis; Subject Matter and Subject Matter Information; Compliance Criteria; Permanent File; Audit Strategy and Audit Plan; Internal Control; Internal Audit Function; Information Systems; Evaluating Internal Controls – Preliminary Review; Materiality; Risk Assessment; Planning Audit Procedures; Further Audit Procedures and Special Audit Considerations; Performing Financial Audits and Gathering Evidence; and Performing Audits in a Computerised Environment.

There are no specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

The Code of Conduct will need to be tailored to each individual SAI's unique circumstances.

9.1 Introduction

This chapter examines the wide range of activities which need to be undertaken as part of the Planning and Design Phase of the audit. These comprise:

- **Clear Assignment:** knowing what the audit should cover;
- **Audit Objectives and Scope of Audit:** ensuring that these are clearly defined;
- **Ethic and Independence:** ensure that there is not conflict of interest;
- **Professional Judgement, Due Care and Scepticism:** skills in addition to the technical ability required by the audit team; and
- **Agreement of Management's Responsibility:** written agreement of the entity's management that it acknowledges and understands its responsibilities

The separate volume of templates and case studies includes a template for use in developing the Overall Audit Strategy (**Template 3**).

9.2 Clear Assignment

The annual audit plan of a SAI should be clear about the entities subject to financial audit, the objective of the audit and the timing of the audit. This will give the Audit Manager who is assigned with the audit, the necessary guidance to draft the audit plan.

9.3 Audit Objectives and Scope

9.3.1 General

The SAI prepares a Financial Audit plan for the coming year that specifies the entities (or subdivisions thereof) and the types of their activities to be audited. For Financial Audits, the main objectives would be to give an opinion on the Annual Financial Statements (AFS) of the entities concerned.

The audits that have to be carried out during the year are indicated in the annual plan prepared by each department. The annual plan already should provide a broad definition of the scope and objectives of the audits. From the plan it should be clear whether Financial Audits should aim at both Financial and Non-financial information.

ISSAI #2000 states:

> *"6. By comparison with the objectives of an audit of financial statements in accordance with the ISA (i.e. to express an opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework), the objectives of a financial audit of public sector entities may include additional audit and reporting responsibilities.*
>
> *For example, public sector auditors may be required to report on: a public sector entity's compliance or non-compliance with authorities, including budget and accountability; the effectiveness of internal control over financial reporting; or on the economy, efficiency and effectiveness of programmes, projects and activities."*

There are several procedures that must be undertaken before the actual audit work can be performed. The objective is to ensure that:

- **Appropriate and sufficient evidence** is obtained to support the audit opinion;
- **Auditing standards** are complied with; and
- **Only necessary audit work** is carried out.

These procedures are described in the rest of this section.

9.3.2 Overall Audit Objectives

The audit objectives are a statement of what the auditor intends to examine and what has to be achieved by the audit.

For a Financial Audit the objective would be to give an opinion on the AFS; an opinion that the statement is without material mistakes.

In considering the objectives, the auditor should take into account points raised during the preceding audit of the audited body, which might suggest specific additional objectives. The file for the preceding audit should contain a schedule of points for attention at the time of the next audit, which can be copied and brought forward into the current planning file.

9.3.3 Establishing the Audit's Scope

The audit scope is a statement of what areas, processes, activities, programmes and locations will be looked at, the time period under review, what work must be done and what will not be done.

The audit scope should be a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The scoping of an audit is influenced by materiality and risk, and it determines which authorities and parts thereof will be covered. The audit process as a whole should be designed to cover the entire audit scope.

The main objective of the SAI is to give an opinion with the AFS of the entities subject to audit. This is considered to be a whole-of-government financial statement.

In determining the scope of such an audit, the auditors should be aware that they have to obtain sufficient appropriate audit evidence regarding the financial information of all components and the consolidation process to express an opinion as to whether the whole-of-government financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

This should already be expressed in the annual audit plan of the SAI, wherein it is clear what components, entities will be audited in the respective year to gather sufficient evidence to be able to give the opinion.

9.4 Ethics and Independence; Professional Judgement, Due Care and Scepticism

9.4.1 Ethics and Independence

It is of fundamental importance that the SAI is looked upon with trust, confidence and credibility. Therefor according to the professional standards, a SAI must "lead by example". This means that the highest ethical standards apply to the SAI.[31] If the public, parliament and/or audited entities suspect members of the SAI to be corrupt or eligible to fraud, the trustworthiness of the SAI would diminish and its reputation seriously damaged. The consequence could be that the results of the audits would no longer be accepted by the auditee and, worse Parliament. In the end the consequence could be and that SAI loses its significance.

The adoption and application of a **Code of Ethics** for Auditors in the Public Sector promotes trust and confidence in the auditors and their work.

A Code of Ethics has to be set for SAI with respect to the culture, language, legal and social systems of the country concerned.[32] This code should be part of the training of auditors and frequently discussed within the organisation. The code should also be made public on the website.

The conduct of auditors should be beyond reproach at all times and in all circumstances. Any deficiency in their professional conduct or any improper conduct in their personal life places the integrity of auditors, the SAI that they represent, and the quality and validity of their audit work in an unfavourable light, and may raise doubts about the reliability and competence of the SAI itself.

Therefore, the auditors have to live up to the code prescribed. In their audits, contacts with the audited entity and reports they have to show Integrity, Independence, Objectivity, Confidentiality and Competence.[33]

ISSAI #130 – Code of Ethics – must be taken into consideration prior to commencing the audit. These principles relate to:

- The independence of the SAI and the auditor, including political neutrality;
- **Avoidance of conflicts of interest** between the auditor and the audited entity;
- The need for the auditor and the SAI to possess the **necessary competencies**; and
- Exercise of due care and concern by the SAI and the auditor in **complying with the Fundamental Auditing Principles**.

With regard to the independence it is important that, when preparing an audit, it is made sure that all the auditors are independent of the entity subject to the audit. It is the responsibility of the Audit Manager to safeguard against this.

Any kind of dependency of auditors with the entity might compromise the results of the audit (e.g. the opinion). For that reason, the auditors involved should also show their independence in practice by showing skepticism while drafting the audit plan, during the audit and when reporting their findings.

31 See ISSAI #130.
32 ISSAI #130, article 4.
33 These criteria can also be found in the annex to ISSAI #2200: ISA #200, A 15.

In addition to the general legal requirements for avoiding conflicts of interest and ensuring adherence to the Code of Ethics, the Audit Manager that will be performing a given audit must make sure that there are no indications of a conflict of interest amongst the team members, that the audit team as a whole has the necessary competencies and skill sets to carry out the specific audit, and that the team is aware of the requirements defined in the auditing principles, domestic legislation and internal regulations of the SAI.

It is the responsibility of senior management that every person within the SAI (including hired experts) live up to the code of ethics and to take due action were this appears not be the case.

9.4.2 Professional Judgement, Due Care and Scepticism

As mentioned above, the auditors assigned to the audit of an entity must have sufficient skills to perform that audit. The approach advertised by the professional standards is the system-based approach. In this approach the auditor must assess the relevant risks and the presence of internal controls to mitigate those risks. Therefore, the skills of the auditors should comprise the ability to do so.

In the pre-audit stage of the audit, the auditor will begin with collecting information about and from the entity subject to the audit. Upon this information the auditor will plan the objective of the audit, the scope of the audit, the depth of the audit and the methods and techniques which will be applied to reach the desired conclusions with regards to the objective. Therefor it is crucial that the information gathered to plan the audit is reliable.

Auditors need professional skepticism in looking at the information gathered in this stage (and while planning and conducting the audit). Although mistrust is not appropriate, complete trust isn’t either. Sometimes it is in the interest of the entity subject to the audit (the auditee) to be less transparent (e.g. when the auditee has committed fraud) and could withhold relevant information or give a wrong presentation of the facts.

Professional skepticism from the auditor can prevent that the audit will be performed on the basis of this misstated information. He or she should use other sources of information to assess the reliability. The auditor could e.g. use historical information from previous audits.

Even if the information gathered in this pre-planning stage is considered reliable and sufficient complete for planning purposes, it is of course not all the information necessary to draft the report and present conclusion. The audit itself has still to be conducted.

This means that while planning an audit, the auditor always has to deal with incomplete information. This is where professional judgement plays an important role. Based on the professional skills of the auditor and his/hers experience and given the incompleteness of the information, the auditor must decide on objectives, methods and techniques etc.

Professional judgement, due care and skepticism is an important element in the fundamental principles of INTOSAI. Those terms are frequently used in the International Standards on Auditing (ISA) when formulating requirements relating to the auditor’s decisions about the appropriate course of action and to express the attitude that includes a questioning mind.

In ISA #200 (as part of ISSAI #2200) it says, in relation to due care:

> *“…Auditors need to be alert for situations, control weaknesses, inadequacies in record keeping, errors and unusual transactions or results which could be indicative of fraud, improper or unlawful expenditure, unauthorized operations, waste, inefficiency or lack of probity.”*

The concept of professional skepticism enhances and broadens the concept of due care and is fundamental for planning and performance of the audit.

ISA #200 requires the auditor to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. Professional skepticism includes being alert to, for example:

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;
- Circumstances that suggest the need for audit procedures in addition to those required by the ISA.

Both professional judgement and professional skepticism will have to be maintained also while conducting the audit and when evaluating the evidence and formulating the conclusions.[34]

9.5 Understanding the Audited Entity and its Environment

During the planning phase, auditors must:

- Obtain a general understanding of the legal, regulatory and appropriations framework, and any contracts and conditions applicable to the scope of the audit;
- Obtain an understanding of the entity's management's assessment of applicable laws and regulations including management's internal controls; and
- For audits of propriety, obtain an understanding of relevant principles of sound public sector financial management and expectations regarding the conduct of public sector officials.

Determining those subject matters and suitable criteria are part of a broader process of gaining an understanding of the audited entity and the circumstances surrounding the audit. An understanding of the entity, its environment, relevant programme areas and authorities is especially important in determining materiality and conducting risk assessments. For most audits, the following information should be reviewed:[35]

- the audited body's strategic plans;
- a list of the main users of the audited body's services;
- information about whether other public entities report to the audited body, whether the audited body itself reports to other public entities, and what approvals the audited body must seek in order to spend its funds or take action;
- legislation, regulations and administrative instructions affecting the audited body's operations;
- practices for the sector in which the audited body operates, including any special accounts practices;
- the core activities in which the audited body engages (public works, issuing grants and contributions, collecting taxes, etc.);
- the size of the audited body (its total assets, liabilities, revenue and expenditure);
- the types of transactions and documents that the audited body processes;
- the audited body's organisational structure;
- the audited body's internal control structure; and

34 See ISA #200, A19 – A 27 for more guidance on how to practice professional judgement and professional scepticism.
35 See also ISSAI #200, article 86 general and 90 internal controls.

- economic trends that could affect the valuation of its significant assets and liabilities (those held in foreign currencies, for example).

For the purpose of the whole of government statement, the understanding should also comprise government wide controls, as well as the consolidation process. The understanding thus obtained should be sufficient to confirm or revise the initial identification of components that are likely to be significant for the group financial statements, and to assess the risks of material misstatement, whether due to fraud or error, of the whole of government financial statement.

A template for use in understanding the Entity in its Environment can be found in the separate volume of templates and case studies at **Template 4.**

9.6 Identification of the Parties Involved and the Legal Basis

9.6.1 Parties Involved

Before the start of the audit, the audit team must identify the relevant parties involved: the organisation in charge of the implementation of regulations subject to audit, the units within this organisation, external parties, etc.

At this stage, the users of the audit report must also be identified. The form and content of the report should be aligned with the reader's positions, knowledge, competencies, etc. The auditor must make a professional judgement as to how to communicate most effectively with the intended users. Users' needs may vary depending upon whether they are the legislature, a funding agency, a donor organisation, the citizens or other relevant stakeholders.

9.6.2 Legal Basis

Financial Audits aim to give an opinion to Parliament and other interested parties that the National Budget and other resources have been executed in compliance with laws and regulations of the country concerned and that the Annual Financial Statements are free of material mistakes.

This logical consequence is that the auditor or auditors planning the audit should be aware of and have a working knowledge of all the law, regulations, etc. that apply to the subject matter and subject matter information of the entity subject to the audit. The auditor should have a list what laws, regulations, etc. are applicable or ask the auditee to present a complete list.

Management governing the entity subject to the audit should be aware of the relevant rules because they are charged with the responsibility to comply with them. So, they should be able to supply such a list. The auditor should use professional judgement to assess whether the list is just and complete or not. The list should be made part of the permanent file. During the audit other relevant formal rules could emerge and other could be assessed irrelevant. In those cases, the auditor should adjust the list and use these other rules also as criteria for the regularity.

The auditor should also list what internal rules and regulations determine and/or manage the organisational structure, authorities, responsibilities and procedures. Knowledge and assessment of the rules and regulations as meant above is acquired to determine risks and weaknesses.

Therefore, in the planning stage all relevant legal regulations concerning the financial statement and/or subject matters whose compliance is being audited must be compiled and considered for inclusion in the audit programme.

ISSAI #2250 distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows:

- The provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations; and
- Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); noncompliance with such laws and regulations may therefore have a material effect on the financial statements.

9.7 Subject Matter and Subject Matter Information

Determining the subject matter (the activities, results, outcomes and outputs whose compliance is being reviewed) and the subject matter information is one of the first steps to be carried out in planning and performing of a financial audit.

The subject of the audit, the subject matter or the subject matter information depends on the type of engagement. There are two types of engagement:[36]

Attestation Engagements: where the subject of the audit is the subject matter information;

Direct Reporting Engagements: where the subject of the audit is the subject matter itself.

In attestation engagement the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.

In direct reporting engagements it is the auditor who measures or evaluates the subject matter against the criteria. The auditor selects the subject matter and criteria, taking into consideration risk and materiality. The outcome of measuring the subject matter against the criteria is presented in the audit report in the form of findings, conclusions, recommendations or an opinion. The audit of the subject matter may also provide new information, analyses or insights.

For the audit of a financial statement, ISSAI #200 (art. 37) describes the subject of the audit as follows.

> *"The financial position, financial performance, cash flows and notes presented in the financial statements (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure (criteria) to a public-sector entity's financial data (subject matter). The term "subject matter information" refers to the outcome of the evaluation or measurement of the subject matter. It is on the subject matter information (e.g. the entity's financial statements) that the auditor gathers sufficient appropriate audit evidence to provide a reasonable basis for expressing an opinion in the auditor's report."*

According to ISSAI #300 the subject matter of a compliance audit may take the form of activities, financial transactions or information. For attestation engagements on compliance

36 ISSAI #100: 29. Financial audits are always attestation engagements as they are based on the financial information presented by the responsible party.

(in compliance audits related to financial audit) it is more relevant to identify the subject matter information, which may be a statement of compliance prepared in accordance with an established and standardised reporting framework.[37] Subject matters take many forms and have many different characteristics. Subject matters may be general or highly specific in nature. Some are quantitative and are often easy to measure (such as financial performance and conditions), while others are qualitative and more subjective in nature (such as behaviours).

The subject matter should be identifiable, and it should be possible to assess it against suitable criteria. It should be of such a nature that it enables sufficient and appropriate audit evidence to be gathered in support of the audit report, conclusion or opinion.

9.8 Compliance Criteria

After establishing the subject matter, the auditors should identify the criteria against which the subject matter will be compared. The identified criteria will then form the basis for the entire audit review. Some examples of compliance auditing criteria are listed in Annex 10.

The criteria can be formal, such as a law or regulation, ministerial directive or the terms of a contract or agreement. They may also be less formal, such as a code of conduct or principles of propriety, or they may relate to expectations regarding behaviour, for example what may be considered acceptable in regard to class of travel or levels of hospitality and entertainment at the government's expense if such limits are not explicitly stated elsewhere. Administrative guidelines used as criteria should be in compliance with laws and regulations. The sources used as a basis for the audit criteria can themselves be part of the compliance audit.

The criteria should be appropriate and meet the following requirements:

- **Relevance:** relevant criteria provide meaningful contributions to the informational and decision-making needs of the intended users of the audit report;
- **Reliability:** reliable criteria result in reasonably consistent conclusions when used by different auditors in the same circumstances;
- **Completeness:** complete criteria are those that are sufficient for the audit's purpose and do not omit relevant factors. They are meaningful and make it possible to provide the intended users with a practical overview for their informational and decision-making needs; and
- **Objectivity:** objective criteria are neutral and free from any bias on the part of the auditor or on the part of management of the audited entity. This means that criteria cannot be informal to a degree allowing very subjective judgement. They should preclude other public sector auditors from reaching a very different conclusion.

Appropriate Criteria are those defined after considering materiality related to the risk of potential non-compliance of each audit topic (budget law, other specific laws, contract terms, etc., as well as propriety where relevant). Materiality should be seen in two aspects: quantitative (size) and qualitative (nature and characteristics).

The scope of the compliance audit (activities, volume, processes, period, etc.) must be clearly stated. In cases where the scope of the compliance audit has been restricted, this should be stated in the audit plan and/or in the audit report.

In cases where the provisions of relevant legislation are unclear or conflicting, for example where an act of legislation provides that more specific provisions should be set out by the relevant administrative body and these provisions have not yet been developed or where one law contradicts another, the auditors must clearly state in the audit report what they

37 ISSAI #400, article 33.

believe the relevant legislation requires, or explain that the scope of the audit has been restricted and the reasons for this reduction in scope.

The criteria should be made available to the intended users and others as appropriate, for example by listing them in the auditor's report, or making reference to the criteria if they are readily available in another document.

In situations where, for whatever reason, the audit criteria are not considered suitable, the SAI will recommend that the appropriate bodies clearly formulate the general principles to be applied for public sector entities in such matters.

9.9 Permanent File

One of the most important sources of information in the planning phase of the audit is the permanent file. For each entity within the mandate of the SAI such a file should be created. When getting acquainted with an entity's activities, the first step is to check the information in the Permanent File, which includes the following content:

1. Permanent File Update Control Sheet;
2. Permanent File Index;
3. Permanent File Information Gathering Checklist;
4. Status of the Audited Body;
5. Background Information;
6. List of applicable laws, rules, regulations etc.;
7. List of Auditable Locations;
8. List of Bank Accounts;
9. List of Authorised Signatories;
10. Contact Information for Executives and Management;
11. Financial Records and Accounting Systems;
12. Staff Structure; and
13. Audited Body's Audit Profile.

The Permanent File should be updated for every new audit cycle or whenever appropriate.

9.10 Audit Strategy and Audit Plan

9.10.1 Audit Strategy Audit of Annual Financial Statements

One of the main objectives of any SAI is to present an opinion to Parliament about the Annual Financial Statements. This statement is a consolidation of information from a large number of public entities. The audits in the annual audit plan of the SAI must cover enough of that information to be able to substantiate this opinion with reasonable assurance.
The audit plan for each Financial Audit and Compliance Audit must be drafted from that perspective, taking into account the relative size of the audit subject in relation to the total budget.

Issues to be dealt with in general are the concepts of materiality and assurance in relation to giving an opinion with the annual financial statement. It could be reasoned that materiality thresholds may differ for the financial statement as a whole, for the budget lines within the financial statements and for the subject matters that are accounted and reported for in those budget lines.

In a more practical sense, it would mean that the criteria set in each of the Financial and Compliance Audits at least meet the same or comparable criteria at the level of the Annual Financial Statement of the country.

9.10.2 Audit Strategy and Audit Plan Financial and Compliance Audits

For each of the audits in the annual audit plan of the SAI, an audit strategy and audit programme have to be prepared by the assigned Audit Managers. The information gathered during the activities described in the prior paragraphs should be used by the auditor for drafting the audit strategy and plan.

Planning for a specific audit includes strategic and operational aspects.

- **Strategically**: planning should define the audit scope, objectives and approach. The objectives refer to what the audit is intended to accomplish. The scope relates to the subject matter and the criteria which the auditors will use to assess and report on the subject matter and is directly related to the objectives. The approach will describe the nature and extent of the procedures to be used for gathering audit evidence. The audit should be planned to reduce **audit engagement risk** to an acceptably low level; and
- **Operationally:** planning entails setting a timetable for the audit and defining the nature, timing and extent of the audit procedures. During planning, auditors should assign the members of their team as appropriate and identify other resources that may be required, such as subject experts.

The **Audit Plan is based on the Audit Strategy** and includes:

- A description of identified criteria related to the scope and characteristics of the compliance audit and to the legal, regulatory or appropriations framework;
- A description of the nature, timing and extent of risk assessment procedures that will be sufficient for an assessment of the risks of non-compliance with the audit criteria; and
- A description of the nature, timing and extent of planned audit procedures in relation to the compliance audit criteria and risk assessment.

The audit plan is not a static one. Some of the information gathered in the planning stage can prove to be wrong or there could be significant changes in the audit environment. Audit planning should be responsive to this kind of developments and the lead auditor has to act by, timely, adjusting the plan to these developments. This is an iterative process that takes place throughout the audit. The developments and responsive actions of the Audit Manager must be documented in the audit file.

9.10.3 Documentation of the Audit Plan

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the Assertion Level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programmes or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

The separate volume of templates and case studies provides a template which links Risks and Controls at the Assertion Level (**Template 5**) and also provides one for Risks and Controls for Financial Statement as a Whole (**Template 6**)

9.10.4 For Audits of Financial Statements and any other Financial Audits

The components to be included in the audit plan will depend on the audit objectives. Standard audit objectives for financial audits are:

- **Lawfulness and Regularity*:*** operations (transactions) are performed in accordance with current laws and by-laws and within the budget;
- **Completeness*:*** operations (transactions) are properly recorded in account books as per existing legislation;
- **Truthfulness of Operations:** operations (transactions) appearing on the financial statements are recorded efficiently, are relevant to the audited body and refer to the audit period in question;
- **Evaluation:** all transactions are precisely evaluated and recorded, as well as being compliant with existing legislation; and
- **Acceptance and Reporting:** transactions have been classified with reference to the structure and final reporting is produced, in line with the specialised regulatory authority's instructions.

When auditing financial statements, the audit of **each part of the statement is planned separately**. In general, each group of revenues, expenditures, assets, equity and liabilities is considered a separate component. Depending on the level of aggregation and/or disaggregation on the financial statement or budget report, there may be reports on programmes, projects, specific functions (education, healthcare, etc.), consolidated reports of main budget administrators, etc.

The selection and grouping of the components will depend on the size, volume and types of activities and transactions, etc. The division of the different segments of the audit plan should follow the audited entity's financial cycles and pattern of activities.

Note that cross-government functional audits, such as payroll and procurement audits, can also be broken down into components, although these will be functional components rather than financial line items.

9.10.5 Individually Significant Transactions and Events

Each component may include transactions and events that are so significant that they must be selected for examination by the auditor. Individual significant transactions and events include:

- Very large transactions and events; and
- High risk transactions and events.

The auditor should audit 100% of these transactions and events.

Very large transactions and events are usually audited 100% because they are large enough that, should there be an error, that error could be significant. The auditor therefore does not want to risk failing to find an error in these transactions and events.

High risk transactions and events are those that, owing to their very nature, run a high risk of error. They are often audited 100% because, while the error in each one of these transactions and events may not be significant, the high likelihood of error for each individual transaction and event could add up to a significant error in total.

During the planning phase, the auditor should identify these individually significant transactions to ensure they are tested. Very large transactions are normally easy to find (especially using Computer Assisted Audit Techniques (CAAT) and involve looking for transactions and events that exceed a predetermined amount.

High risk transactions can be more difficult to detect. Auditors should use their knowledge of the audited body's business to identify these transactions and events.

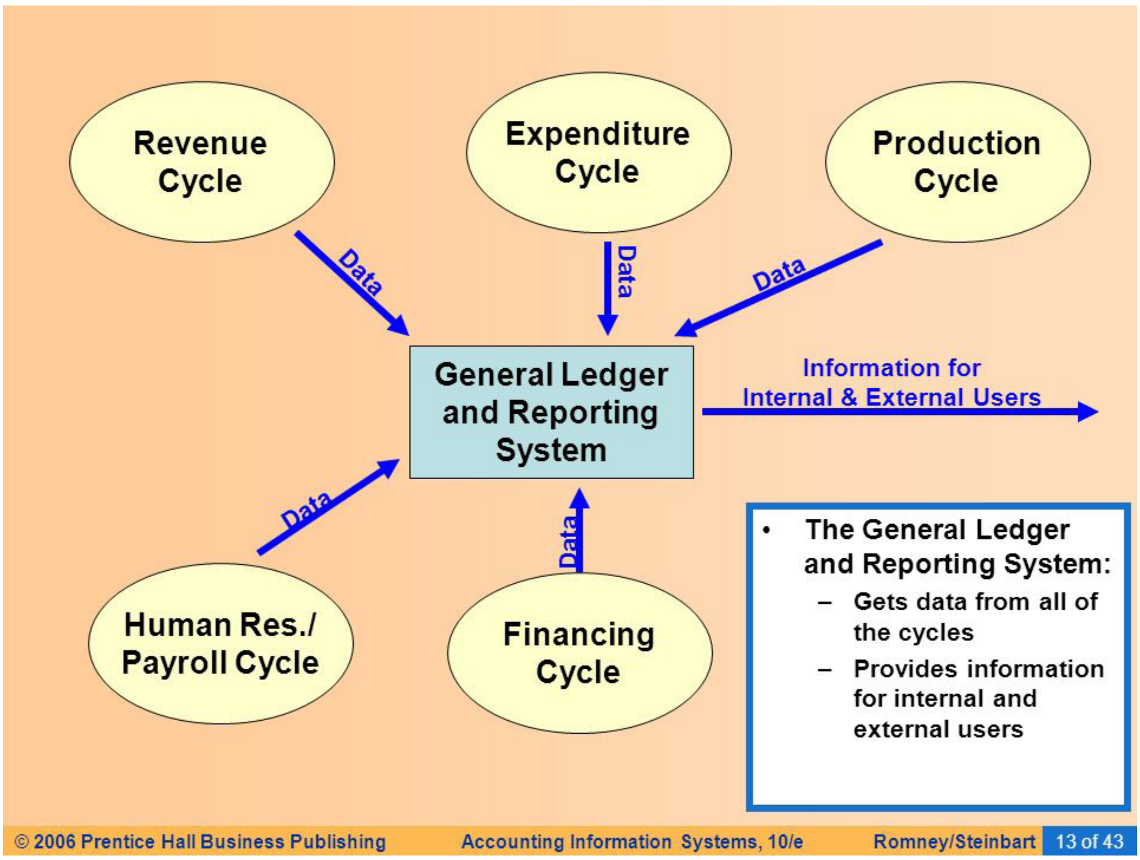
9.10.6 Related Components and Transaction Cycles

Some components are related to others. For example, an understatement of expenditures may also result in an understatement of liabilities and/or an overstatement of cash. Therefore, the audit of one of these components will provide the auditor with some assurance as to the accuracy of the related components. To avoid duplicating any work, auditors should take the assurance gained from auditing the related components into account.

One way to do this is to consider transaction cycles, or the flow of transactions. For example, under an accruals-based accounting approach the purchase of medical supplies will either be reflected in expenses for the year or in the year-end stock balance. This purchase will also result in a cash disbursement or a payable at year end.

The illustration below shows the different transaction cycles with regards Accounting Information Systems.

Figure 27: Accounting Information Systems Transaction Cycles



Source: Prentice Hall

38 See http://www.issai.org/media/13329/intosai_gov_9100_e.pdf.

9.11 Internal Control

9.11.1 Definition[38] and Concepts of Internal Control

Internal control is an integral process that is affected by an entity's management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission, the following general objectives are being achieved:

- executing orderly, ethical, economical, efficient and effective operations;
- fulfilling accountability obligations;
- complying with applicable laws and regulations;
- safeguarding resources against loss, misuse and damage.

Internal control is not one event or circumstance, but a series of actions that permeate an entity's activities. These actions occur throughout an entity's operations on an ongoing basis. They are pervasive and inherent in the way management runs the organisation. The internal control system is intertwined with an entity's activities and is most effective when it is built into the entity's infrastructure and is an integral part of the essence of the organisation. Internal control should be built in rather than built on. By building in internal control, it becomes part of and is integrated with the basic management processes of planning, executing and monitoring.

The internal control structure consists of the entity's plans and actions, including management's attitude, as well as methods, procedures, and other measures that can provide reasonable assurance that the following general objectives are achieved:

- Executing orderly, ethical, economical, efficient and effective operations;
- Fulfilling accountability obligations;
- Compliance with laws, regulations, and management directives;
- Safeguarding of assets against loss due to waste, abuse, mismanagement, error, fraud and other irregularities; and
- Development and upkeep of reliable financial and management data, and their fair disclosure in timely reports.

If the controls appear to be well-designed, tests of these controls (compliance tests) must be designed to check how they are performing. Depending on the outcome of these tests, more or less detailed substantive tests will be carried out.

A good understanding of internal controls, and any control weaknesses, is necessary in order to prepare relevant recommendations for improvements. Checking or auditing individual transactions results in the correction of individual errors. It does not provide for the identification of the cause behind the malfunction. It is therefore critical that the controls are examined first, and the transactions afterwards. The system-based approach is about improving the system in such a way that the system will prevent that the same errors will occur again.

An Internal Control System consists of the Control Environment and Control Procedures. A good definition of Internal Control is that of the US Committee of Sponsoring Organizations (COSO).

The COSO Framework defines Internal Control as "the achievement of objectives" in three categories:

- **Reliability of Financial Reporting:** through Financial Controls;
- **Effectiveness and Efficiency of Operations**: through operational controls; and

39 Annex 17 provides a detailed review of Compliance Deviations.

- **Compliance with Laws and Regulations:** through Compliance Controls.[39]

Figure 28 indicates where the Control Environment fits into the Control Process.

Figure 28: Control Environment and the Control Process.

9.11.2 Understanding Internal Control at the Audited Entity

Understanding the internal control environment of the entity subject to the audit is essential in the system-based approach. Internal controls should ensure compliance to laws, regulations, rules etc., and aspects of propriety. The quality of this internal control framework determines the methods and techniques to apply, the quantity of the work and the necessary resources.

Understanding internal control is an integral part of understanding the entity and the relevant subject matter. The evaluation of the reliability of internal control is critical for planning the general orientation of the compliance audit. The internal control system should be assessed for its ability to prevent or detect material non-compliance and to correct identified instances of non-compliance. The assurance derived from the assessment of internal controls is used to determine the confidence level and, consequently, the extent of the audit procedures to be performed (ISSAI #300 and #2315).

Good practice requires the auditors to have an up-to-date understanding of the audited body's internal control structure in order to determine how much reliance can be placed on these internal controls in evaluating management's assertions.

According to ISSAI #200 the auditors understanding of internal controls relevant to financial reporting may include the following areas:

- the classes of transactions in the audited entity's operations that are significant to the financial statements;
- the procedures, both manual and using IT, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- the accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this

includes procedures for correcting incorrect information and transferring information to the general ledger;

- how the information system captures events and conditions, other than transactions, that are significant to the financial statements;
- the financial reporting process used to prepare the audited entity's financial statements, including significant accounting estimates and disclosures;
- controls surrounding journal entries, including non-standard journal entries used to record unusual non-recurring transactions or adjustments;
- relevant controls that relate to compliance with authorities;
- controls related to monitoring performance against the budget;
- controls related to transferring budgetary funds to other audited entities;
- controls of classified national security and sensitive personal data, such as tax and health information;
- supervision and other controls performed by parties outside the audited entity in areas such as:
  - compliance with laws and regulations, such as procurement regulations;
  - execution of the budget;
  - other areas as defined by legislation or audit mandate; and
  - management accountability.

Auditors should understand the control environment and the relevant internal controls and consider whether they are likely to ensure compliance. An understanding of the audited entity and/or the subject matter relevant to the audit scope depends on the auditor's knowledge of the control environment. The control environment is the culture of honesty and ethical behaviour that provides the foundation for the system of internal controls to ensure compliance with the authorities.

As the subject matter may be qualitative or quantitative, the auditor will focus on quantitative or qualitative internal controls, or a combination thereof, according to the audit scope. In evaluating internal controls, the auditor assesses the risk that they may not prevent or detect material instances of non-compliance. The auditor should consider whether the internal controls are in harmony with the control environment so as to ensure compliance with the authorities in all material respects.[40]

9.11.3 General Standards for an Internal Control Structure

There are five general internal control standards recommended by INTOSAI that audited body's management and employees should follow:

- **Reasonable Assurance:** Internal control structures must provide rea
- **Supportive Attitude:** Managers and employees must maintain and demonstrate a positive and supportive attitude toward internal controls at all times;
- **Integrity and Competency:** Managers and employees must have personal and professional integrity and are to maintain a level of competency that allows them to understand the importance of developing, implementing and maintaining good internal controls, and to fulfil the general objectives referenced above;
- **Control Objectives:** Specific control objectives must be identified or developed for each of the organisation's activities; these objectives must be appropriate,

40 ISSAI #400:53.

comprehensive, reasonable, and integrated into the overall organisational objectives; and

- **Monitoring Controls:** Managers must continuously monitor their operations and take prompt action in response to any findings of irregular, uneconomical, inefficient or ineffective operations.

9.11.4 Detailed Standards for an Internal Control Structure

In addition to the above general standards, there are six detailed standards that the audited body should apply:

- **Documentation:** The internal control structure and all transactions and significant events must be clearly documented, and the documentation is to be readily available for examination;
- **Prompt and Proper Recording of Transactions and Events:** Transactions and significant events must be promptly recorded and properly classified;
- **Authorisation and Execution of Transactions and Events:** Transactions and significant events must be authorised and executed only by persons acting within the scope of their authority;
- **Segregation of Duties:** Key duties and responsibilities for authorising, processing, recording, and reviewing transactions and events should be separated amongst different individuals;
- **Supervision:** Competent supervision is to be provided to ensure that internal control objectives are achieved; and
- **Access to and Accountability for Resources and Records:** Access to resources and records is to be limited to authorised individuals who are accountable for their safeguarding or use. To ensure accountability, the allocated resources must periodically be assessed against the recorded amounts to determine whether the two are in alignment. An asset's vulnerability should determine the frequency of these assessments.

In one of the last ISSAI that was been endorsed, ISSAI GOV 9100, auditing standards have been tailored to the COSO-framework of internal controls. According to this framework internal control consists of five interrelated components:

- control environment;
- risk assessment;
- control activities;
- information and communication;
- monitoring.

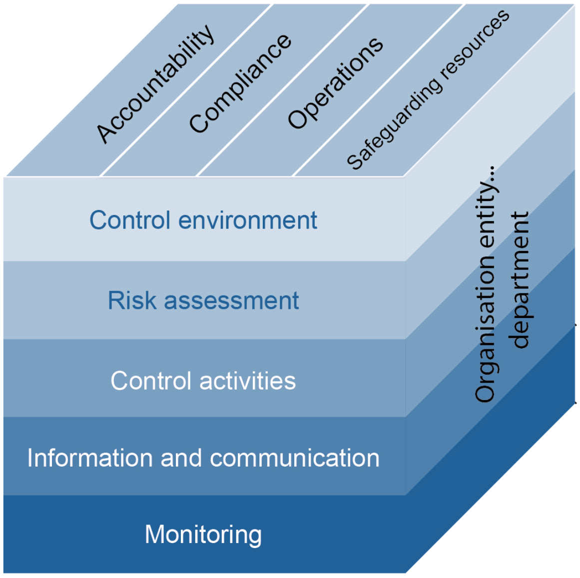
The next illustration shows the relation between the general objectives and these internal control components.

ISSAI GOV 9100 elaborates on each of these internal control components. For:

- a thorough understanding of the requirements of internal controls;
- the professional ability to assess whether the controls at the auditee are sufficient or not regarding the general standards; and
- the determination of the audit methods and techniques that should be applied.

Auditors of all SAI should familiarise themselves with this ISSAI which also provides an extensive list of definitions regarding elements of internal control.

Figure 29: Internal Control Components



The separate volume of templates and case studies provides a Control Environment Questionnaire (**Template 7**) and a template on the Entity's Control Environment, Risk Assessment, Monitoring and Communications Considerations (**Template 8**).

9.11.5 Responsibility for Maintaining Internal Controls

Management of the audited entity is responsible for ensuring that a proper internal control structure is instituted, reviewed, and updated to keep it effective.

Employees at all levels are responsible for ensuring that the internal control structure functions as it should.

The Ministry of Finance (by whatever title) also has responsibility for maintaining an overall public sector environment that promotes adequate internal control.

9.11.6 Testing Internal Controls

The SAI should test the internal controls. Annex 11 provides guidance on this process.

9.12 Internal Audit Function

A distinct form of internal control is an internal audit function. This is an independent unit within an organisation charged with audit activities in behalf of the management of the organisation. They act as an independent check on performance and can be very effective in helping management to fulfil its monitoring role.

To be most effective, internal audits must remain independent and *not* become part of operational controls. The internal audit unit should not be performing checks (such as ex-ante or ex-post controls of expense vouchers) on an on-going basis. It should carry out risk-based audits as independent reviews, to ensure that management and staff have been carrying out their duties properly.

The Audit Manager charged with the audit should inquire with the auditee which types pf internal audit are undertaken. If acceptable, this would mean that the SAI could apply a more efficient approach by making use of the work and results of the internal audit. Since it is the SAI that caries the sole responsibility for the report about In addition the audit plan should comprise a review work of the internal audit.

If the entity has an internal audit function, the auditor shall obtain an understanding of the following in order to determine whether the internal audit function is likely to be relevant to the audit:

- The nature of the internal audit function’s responsibilities; and
- How the internal audit function fits in the entity’s organisational structure; and
- The activities performed, or to be performed, by the internal audit function.

The SAI can use the checklist which appears in the separate volume of templates and case studies (**Template 9**) to determine whether or not to rely on the work undertaken by internal audit.

9.13 Information Systems

9.13.1 Documentation

Information systems can be either manual or computerises; for notes on “Auditing in a Computerise Environment see **section 9.20** below. Documentation of key aspects of the Information System helps the auditor to gain knowledge to enable the risk assessment to be completed and to design audit procedures including:

- Significant classes of Transaction that are relevant to Financial Reporting;
- Procedures, both manual and automated, through which transactions are initiated, recorded, processed and reported;
- Related Accounting Records;
- Information Flow that captures other events and conditions that may affect the financial statements; and
- The entity’s financial reporting process.

In recording the understanding of the system, the auditor also documents control activities, both overall monitoring controls and controls within individual process and systems that may be relevant to the audit.

9.13.2 Control Activities

Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether manual or electronic, have various objectives and are applied at various organisational and functional levels. Examples of control activities include:

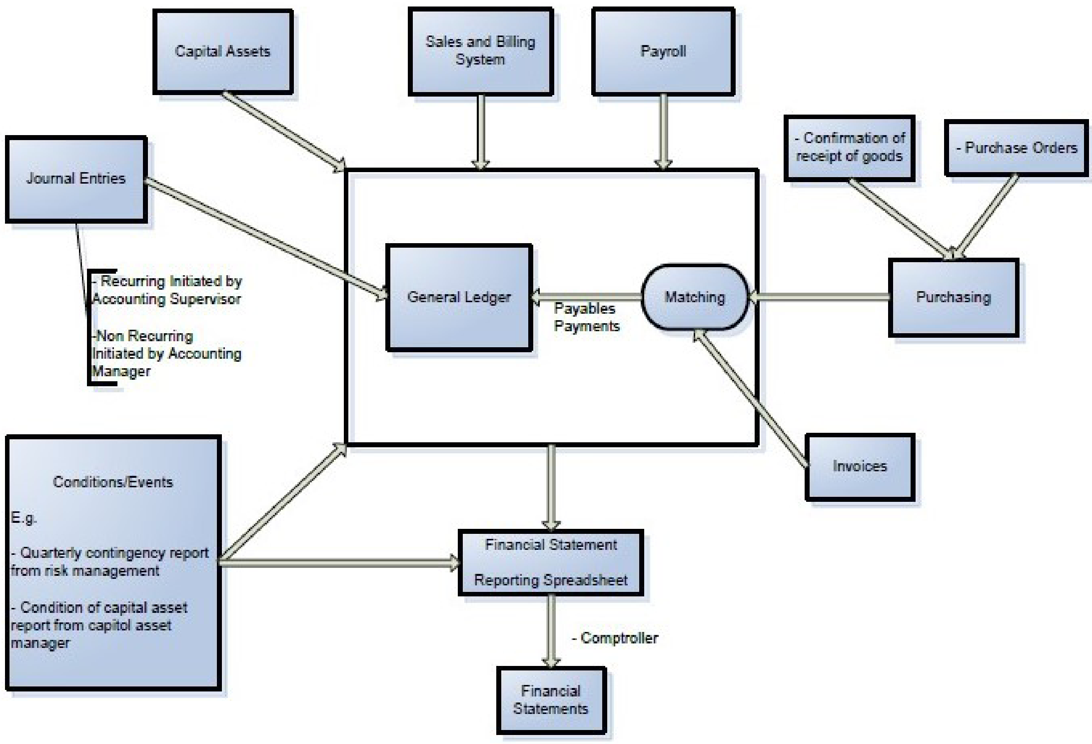
- Authorisation;
- Performance Reviews;
- Information Processing;
- Physical Controls; and
- Segregation of Duties.

Figure 28 shows the overall flow of data.

Figure 28 will be accompanied by a description that clearly document's the auditors understanding of:

- The entity's accounting records; supporting information and accounts in the financial statements;
- How the information system captures data relevant to the financial reporting events;
- The financial reporting process used to produce the financial statements;
- The controls over journal entries; and
- How information is transferred from the individual business processing systems to the general ledger.

Figure 28: Overview Flow Chart



9.14 Evaluating Internal Controls – Preliminary Review

9.14.1 Overview

In the **planning phase**, the auditor should obtain a first understanding of the internal controls with the auditee. In the **execution phase** the presence and effectiveness of these controls must be tested. In the planning phase the auditor will decide on the methods and techniques that will be applied to test the controls (e.g. interviews, cradle to grave tests, dual purpose tests).

Internal Control Questionnaires are used as a standard tool for evaluating internal controls. In order to be able to make a determination of the controls in place. To evaluate control adequacy and effectiveness, and assess risk, auditors must familiarise themselves with the descriptions of all processes, systems, operations, protective measures, assigned authorities, separations of duties, etc. If such formal descriptions do not exist, they will have to be recorded.

As a next step, the expected controls must be identified. In most cases, controls give concrete shape to legal requirements. Routine processes such as budgeting, expenditure management, procurement, etc., should be clearly described, regulated and highly automated, which an advantage for the performance of internal controls is.

The preliminary review of the internal control system is the basis for deciding on the scope, specific focus and the balance between tests of control (compliance testing) and detailed testing in the fieldwork phase. The areas usually covered are:

- General Information;
- Internal Control Plan;
- Accounting and Fiscal Operations;
- Budget;
- Cash;
- Procurement;
- Monitoring and Reporting General Programme Performance;
- Payroll and Personnel;
- Fixed Assets;
- Revenue and Receivables;
- Investment;
- Administrative Controls Over Special State Funds; and
- Representations.

Depending on the audit's scope and objectives, the preliminary review of the internal controls should be designed individually for each area under audit. However, there are also standard questionnaires for internal control systems. One of these for Preliminary Systems Evaluation is provided in the separate volume of templates and case studies as **Template 10**.

9.14.2 Documenting the Understanding of Controls

A clearly documented description of the controls has to be available for the assessment of internal control performance levels. Depending on the subject matter under audit there might be ready-made process and control descriptions available, otherwise the auditors will have to prepare them on their own. This documentation should form part of the working papers and should be retained in the Permanent File. Different methods for documenting controls are outlined in Annex 12 – Documenting Controls – Different Approaches.

Once these components have been identified, a list should be prepared and added to the Planning File.

9.14.3 Systems Based Approach

As part of audit planning the auditor should decide whether sufficient reliance can be placed on internal controls to allow the use of a System Based audit approach (**SBA**), or if Direct Substantive Testing (**DST**) is needed).

In general, it should be noted that, at the operational level, most organisations rely on a combination of two different types of control, and the auditor will need to identify and test both types:

- **Processing Controls and Reconciliations:** These are performed periodically for batches of transactions and include things such as verifying batch totals and checking bank reconciliations; and
- **Transaction Controls:** These are controls over individual transactions and include

approval and authorising signatures and evidence of receipt of goods purchased and the supply of services.

9.15 Materiality

The objective of the financial audits of the SAI is to present an opinion to Parliament that the financial statement of the country is without material mistakes. A misstatement is material if it could reasonably be expected to influence the decisions taken by users on the basis of the financial statements. One of the most important users is Parliament.

A misstatement of the figures could have the consequence that Parliament discharges government where they should have been held accountable for misuse of budget or, the other way around, ministers are held accountable were in fact there was no reason.

Material misstatement of quantitative or qualitative information can also result in continuation of policy programmes that are, in fact, (much) more expensive than appears from the financial statements, or less effective than the non-financial information suggests.

Materiality is key to arriving at professional conclusions. Auditors should be able to ignore any minor, non-systematic omissions and gaps that do not have a vital impact on overall compliance. Materiality is determined by quantitative and qualitative factors for planning purposes, for evaluation of the evidence obtained and the effects of identified instances of non-compliance, and for reporting the results of the audit work. (See ISSAI #2320 and #2450).

Relevant considerations regarding materiality are:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
- Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group.

The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

The auditor’s determination of materiality is a matter of professional judgment and is affected by the auditor’s perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

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

Depending on the subject matter and/or subject matter information, the objective of the audit and considering the information collected at “understanding the business” stage of the audit, the SAI should determine the relevant materiality thresholds. When a financial statement is subject of the audit, thresholds should be determined at the level of the financial statement as a whole and on the level of the budget lines, the entries in the balance sheet, the explanatory notes and the non-financial information. This is defined in the ISSAI as performance materiality:

> *"Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transaction, account balances or disclosures."*

Example:

The threshold at the totals of the financial statement could be 2% where the threshold on the level of the budget lines (programmes) could be set at 5%.

This is statistically acceptable because normally there will be compensating effects between budget lines. In some programmes, errors will stay far below 5% where in other programmes the materiality border will be exceeded; but in the end the total of the errors will still be below 2% of the total budget.

Non-financial information is often considered to have less influence of the decisions of the users, especially in the public sector, so that a higher threshold of e.g. 10% is suitable.

When determining the audit strategy, the auditor should assess materiality for the financial statements as a whole. If, for one or more classes of transactions, account balances or disclosures, misstatements of amounts less than materiality for the financial statements as a whole could reasonably be expected to influence the decisions of users on the basis of the financial statements, the auditor should also determine the materiality level or levels to be applied to the classes of transactions, account balances or disclosures concerned.

For Financial Audits, materiality is determined based on the rules applicable to different types of transactions, assets and liabilities, revenue and expenditures, etc. An example of a materiality assessment is included in Annex 13.

The auditor should also determine performance materiality for the purposes of assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The concept of materiality is applied by the auditor in planning and performing the audit, as well as in evaluating the effect of identified misstatements on the audit and of any uncorrected misstatements, including omissions, on the financial statements.

The auditor's opinion deals with the financial statements as a whole, and therefore the auditor is not responsible for detecting misstatements that are not globally material. The auditor should still identify and document quantitative immaterial misstatements, as they may be material due to their nature or when aggregated. Misstatements below the trivial threshold need not be considered.

Materiality thresholds are also a border for the percentage or amount of errors or mistakes that is considered acceptable. For some categories of expenses and items in the balance sheet the SAI should set a zero materiality. For example, every factual case of fraud or corruption is to be considered as material. Other matters that must be considered material at a lower level of value or incidence are:

- Intentional unlawful acts or non-compliance;
- Incorrect or incomplete information communicated to management, the auditor or the legislature (concealment);
- Intentional disregard for follow-up of requests made by management, authoritative bodies or auditors; and
- Events and transactions taking place despite knowledge of the lack of a legal basis to carry out the particular event or transaction.

In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for:

- Determining the nature, timing and extent of risk assessment procedures;
- Identifying and assessing the risks of material misstatement; and
- Determining the nature, timing and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. As mentioned above the circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality.

Although it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.

The determination of materiality for planning purposes, in all cases where a law or regulation, or agreed-upon terms, establish an unconditional requirement of compliance – for example if the Constitution prohibits overspending in relation to the approved budget – is straightforward.

More guidance about how to determine a materiality level or levels is described in paragraphs 10 and 11 of ISA #350 (ISSAI #2350) as well as in Annex 13 – Concepts of Materiality. The separate volume of templates and case studies contains a template for judging the effects of misstatements on the audit opinion (**Template 11**).

9.16 Risk Assessment

9.16.1 Introduction

The system-based approach is about risks and controls that mitigate those risks and thus prevent errors or mistakes to emerge or discover those errors or mistakes in time to be corrected before the financial statement is composed and published. The approach must identify the relevant risks in relation to the accounting and reporting framework which applies to the financial statements and to the related criteria considering the regularity. It should also inventory the controls that should mitigate the risks and assess if these are sufficient. If so, the auditor would be able to rely on the controls and reduce its audit activities.

Not the errors and mistakes found in the audit are relevant in this approach but the reason that these could emerge in the first place and that they were not detected and corrected.

41 Audit risk: the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated, also known as the Bêta (β) risk.

This paragraph is about the risk that material errors or mistakes are not discovered by the auditor which could result in the SAI giving a wrong opinion with the financial statement, the audit risk.[41]

This paragraph will elaborate on the different types of risks, the way to inventory the risks, the way to assess them taking into consideration the controls and the way to sufficiently reduce the risk for the auditor by applying certain audit methods and techniques.

Many ISSAI deal with risk assessment. A selection on the general principles:

- **ISSAI #2315.3:** The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement;
- **ISSAI #100.46:** Auditors should conduct a risk assessment or problem analysis and revise this as necessary in response to the audit findings. The nature of the risks identified will vary according to the audit objective. The auditor should consider and assess the risk of different types of deficiencies, deviations or misstatements that may occur in relation to the subject matter. Both general and specific risks should be considered. This can be achieved through procedures that serve to obtain an understanding of the entity or programme and its environment, including the relevant internal controls. The auditor should assess the management's response to identified risks, including its implementation and design of internal controls to address them. In a problem analysis the auditor should consider actual indications of problems or deviations from what should be or is expected. This process involves examining various problem indicators in order to define the audit objectives. The identification of risks and their impact on the audit should be considered throughout the audit process; and
- **ISSAI #200: 92, Financial Audit:** The auditor should assess the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances and disclosures so as to provide a basis for further audit procedures.

9.16.2 Risk Assessment Procedures

Risk assessment procedures may include:

- Inquiries of:
  - management and staff within the audited entity who, in the auditor's judgement, may have information that could assist in identifying risks of material misstatement due to fraud or error;
  - Auditors involved in performance and other audits related to the entity; and/or
  - Government officials.
- analytical procedures;
- legislative reports or minutes;
- observation and inspection.

The risks of material misstatement should be identified and assessed at both the financial statement level and the assertion level for classes of transactions, account balances and disclosures so as to provide a basis for designing and performing further audit procedures. For this purpose, the auditor needs to:

- identify risks throughout the process of obtaining an understanding of the audited entity and its environment, by examining relevant controls that relate to the risks and considering the classes of transactions, account balances and disclosures in the financial statements;

- assess the risks identified and evaluate whether they relate more pervasively to the financial statements as a whole and could potentially affect many assertions;
- relate the risks identified to what could go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
- consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential for misstatement is such as to render it material.

In the system-based approach, the auditor will rely on the system as much as possible in order to reduce his audit activities as far as possible without the risk that his opinion on the financial statement will be material wrong. The assessment of risks and controls should give the auditor the information he needs to determine to what degree he can rely on the system and to what degree he should further reduce the risk by performing audits.

In theory the system could prove to be that good and above the risk assessment and assessment of the controls no additional audit activities would be necessary to give the opinion at an acceptable low level of audit risk. This is not allowed by INTOSAI. According to the standards the auditor should always undertake some substantive testing, irrespective of whether controls have been tested.

When designing and performing tests of the relevant controls to obtain sufficient appropriate evidence as to their operating effectiveness, the auditor should consider that, the greater the reliance placed on the effectiveness of a control, the more persuasive should be the audit evidence obtained.

The auditor should design and perform substantive procedures for each material class of transactions, account balance and disclosure, irrespective of the assessed risks of material misstatement.

If the auditor has determined that an assessed risk of material misstatement at the assertion level is significant, substantive procedures should be performed that specifically respond to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details. More general responses to assessed risks include designing audit procedures that address the risks, such as substantive procedures and test of controls. Substantive procedures include both tests of details and substantive analysis of classes of transactions, account balances and disclosures.

In exercising judgment as to which risks are significant public sector auditors also take the following into account:

- Complexity and inconsistency in regulations and directives;
- Non-compliance with authorities; and
- The budget process and the execution of the budget.

The budget in the public sector is an authoritative tool determined by the legislature. Public sector auditors therefore normally include the budget process as an essential part of their understanding of the entity and its environment, and of the risk assessment, rather than only as a management procedure.

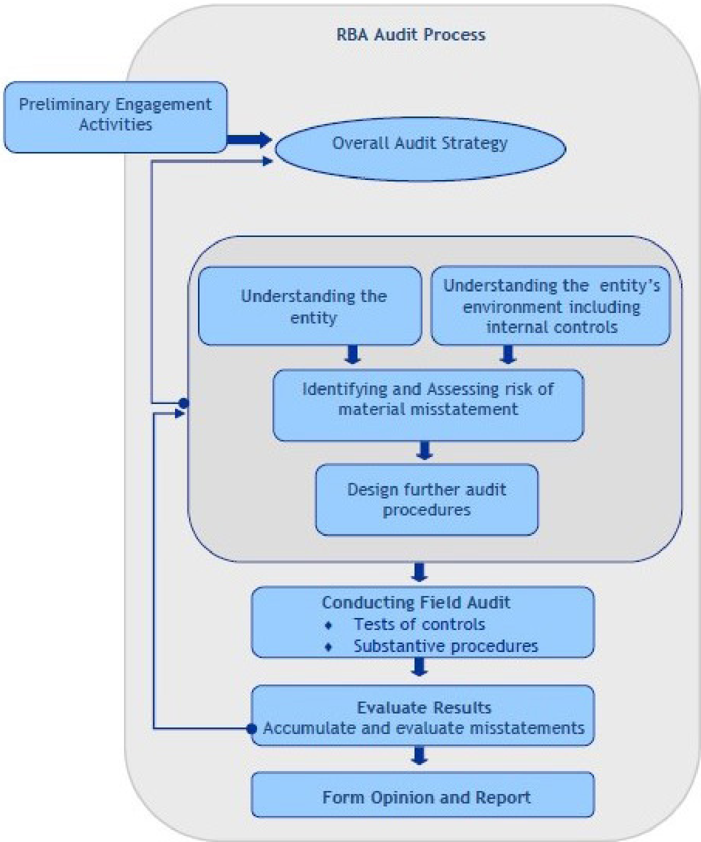
The nature, timing and extent of audit procedures are based on and are responsive to the assessed risks of material misstatement at the assertion level. In designing the necessary audit procedures, the auditor should consider the reasons for the assessed risks of material misstatement at the assertion level for each class of transactions, account balance and disclosure. Such reasons may include the inherent risk of transactions (the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance or disclosure) and the control risk (whether the risk assessment takes account of relevant controls).

High risk transactions can be more difficult to detect. Auditors should use their knowledge of the audited body's business to identify these transactions and events.

Some additional information on risk factors is provided in Annex 14 – Examples of Risk Factors Related to a Particular Subject Matter. The separate volume of templates and case studies provides a template of a Risk Register (**Template 12**).

Figure 29 summarises the approach to the risk-based audit process.

Figure 29: Approach to the Risk-Based Audit Process.



9.16.3 Inherent Risk, Control Risk, Detection Risk

Each financial report contains a ***risk of material misstatement.*** This is the risk that the financial statements may be materially misstated prior to the audit. This consists of two components, described as follows at the assertion level:

- **Inherent risk**: The sensitivity of an assertion (about a class of transaction, 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; and
- **Control risk**: The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either

individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal controls.

9.16.4 Inherent Risk

As part of the risk assessment, the auditor determines whether any of the risks identified are, in the auditor's judgment, significant. In exercising this judgement, the auditor should exclude the effects of controls identified in relation to the risk (inherent risk).

When judging which risks are significant, the auditor needs to consider at least the following:

- whether the risk is a risk of fraud;
- whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;
- the complexity of transactions;
- whether the risk involves significant transactions with related parties;
- the degree of subjectivity in the measurement of financial information related to the risk, especially measurements which involve a wide range of measurement uncertainty;
- whether the risk involves significant transactions that are outside the audited entity's normal course of business, or that otherwise appear to be unusual; and
- whether the risk also affects compliance with laws and regulations.

9.16.5 Control Risk

If the inherent risks are determined and assessed as significant, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk. Examination of the control risk requires the auditor to obtain evidence that the controls are operating effectively. (i.e. the auditor intends to rely on the operating effectiveness of controls when determining the nature, timing and extent of substantive procedures).

Additional information on inherent risk and control risk is provided in Annex 15: Inherent Risk and Control Risk.

9.16.6 Detection Risk

A third component of any risk assessment is detection risk, or the risk that the auditors will not discover material misstatements in the financial reports.

9.16.7 Audit Risk

From the auditors' point of view, **Audit Risk** is the level of risk that the auditor is willing to accept when issuing an unqualified opinion on a set of financial statements that are materially in error.

Audit Risk is defined as:

- **AR** = IR x CR x DR where;
- **AR** = Audit Risk;
- **IR** = Inherent Risk;
- **CR** = Control Risk;
- **DR** = Detection Risk.

9.16.8 Explanation of the Audit Risk Model

The risk model is meant to assist the auditors in exercising their professional judgment, not to replace that judgment.

Individual risks have to be defined independently of one another. For example, if an auditor makes an assumption that the auditee's system processes 60% of the entries properly, this means that 40% of the total entries contain an error. If it is known that this auditee's control system is designed to detect 80% of all errors in the original accounts, the control risk will be 20%. In such a scenario, 80% of 40 errors would be caught by the control system, leaving just 8 errors in the system prior to audit.

This is recorded as follows:

IR (40%) x CR (20%) = 8% of errors in the system.

Normally, audit risk is set at 5% which means that the degree of assurance the auditors will reveal material errors is 95%.

In some cases, a much higher level of assurance might be needed and audit risk will be set at 1%. This means that the auditors should be able to reveal 99% of the errors.

For example:

IR = 40%

CR = 50%

AR = 5%

Detection Risk will be: 0.05/(0.4*0.5) = 0.25 or 2.5%

If **Control Risk** is reduced to 20%, detection risk will be: 0.05/ (0.4*0.2) = 0.625 or 6.25%.

This means that the auditors will need to perform less testing.

9.16.9 Risk Assessment Considerations in Regard to Fraud

Fraud can result in material misstatement of financial statements and fraud is considered material by nature because it undermines the values of good governance. This obliges the SAI to identify and assess the risk of fraud in relation to the subject matter/subject matter information of the audit.

The primary responsibility for the prevention and detection of fraud rests with the entity's management and those charged with governance. It is important that management, under the oversight of those charged with governance, strongly emphasise fraud prevention (limiting opportunities for fraud to take place) and fraud deterrence (dissuading individuals from committing fraud because of the likelihood of detection).

The auditor should consider both hard and soft controls.

Example:

The tone at the top is crucial for mitigating the risk of fraud and corruption, but also for enhancing this risk. If the tone at the top is such that the risk of fraud and corruption is not taken serious, no actions are taken upon signals of possible fraud or corruption or worse the auditor would even have indications that the top itself is likely to commit fraud or corruption, it is likely that this attitude will corrupt the whole organisation. If that is the case the risk of material misstatements of the financial statement is very high and the SAI should act accordingly.

The auditor should obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud and should respond appropriately to fraud or suspected fraud identified during the audit.

If the management shows awareness of the risk and addresses it by a specific policy to create the awareness throughout the organisation and acts upon it, the risk of fraud and corruption is considerably lower.

While assessing the risk of fraud and corruption the auditor should be alert for conditions that are normally present when fraud occurs. The most important conditions are: [42]

- **Incentive or pressure** (placed on or perceived by management or employees giving them a reason to commit fraud) – public sector employees are often under pressure to deliver high quality services with few resources and to meet budget expectations. This may be especially relevant in tough economic conditions where there is pressure to maintain user charges and tax rates, resulting in incentives to overstate revenues and understate expenditures. There may also exist incentives to spend the available budget by the end of the financial year;
- **Opportunity** (characteristics or circumstances related to an entity allowing for the perpetration of fraud) – a difficult recruitment environment or a lack of sufficient qualified personnel may be more prevalent in the public sector. Such situations may often result in deficiencies in internal control creating the opportunity for fraud. The widespread use of high volume, low value cash transactions in certain public sector entities such as cash transactions at police departments or health clinics may add to those risks. Although monetary values may be small, such situations may lead to violation of public trust, expectations and accountability; and
- **Rationalisation or attitude** (Behaviour, character or ethical values that allow individuals to justify their reasons for committing fraud)- generally lower salary levels in the public sector compared to the private sector may lead employees to believe that they can justify misuse of funds. As above, this may violate principles of public trust, expectations and accountability.

Appendix 1 of ISSAI #2240 gives a list examples related to these conditions. Appendix 2 gives practical guidance, also on methods (per type of expenditures) to be applied like substantive testing and Appendix 3 contains circumstances that might indicate the possibility of fraud.

The auditor should be aware that not every misstatement is caused by fraud. Employees are likely to make errors due to, for example, lack of knowledge, complex rules and regulations. The distinguishing factor is whether the action resulting in a misstatement was intentional or not.

Although fraud is a broad legal concept, in a financial audit the auditor is concerned only with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from

42 ISSAI #2240, P5.

fraudulent financial reporting and those resulting from the misappropriation of assets.

Fraud in compliance auditing relates mainly to the abuse of public authority, but also to fraudulent reporting on compliance issues. While detecting fraud is not the main objective of compliance audit, auditors should include fraud risk factors in their risk assessments and remain alert to indications of fraud when carrying out their work.

If the auditor comes across instances of non-compliance which may be indicative of fraud, he or she should exercise due professional care and caution so as not to interfere with any future legal proceedings or investigations.

Another factor to consider is the **risk of abuse of public funds**.[43] Abuse involves behaviour that is deficient or improper when compared with behaviour that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement.

Abuse is a departure from the concept of propriety, which relates to the general principles of sound public sector financial management and conduct of public sector officials. When information is obtained indicating that abuse may have occurred, public sector auditors consider whether such possible abuse could significantly affect the financial statements. Such abuse may be considered from both a qualitative and quantitative perspective. Public sector auditors do not provide reasonable assurance of the detection of abuse but consider the need to report such instances as deemed appropriate.

Examples of fraud risk areas with significant materiality are:

- Grants and benefits to third parties;
- Procurement;
- Exercise of public officials' duties and powers;
- Intentional misstatement or misrepresentation of results or information;
- Privatisation of government entities; and
- Relationships between public sector officials or entities.

Auditors should maintain an attitude of professional scepticism and be alert to the possibility of fraud throughout the audit process.

9.16.10 Risk Assessment Considerations in regard to Relationships between Public Sector Entities

Relationships between various public sector entities might create opportunities for non-compliance and should be considered when assessing audit risk. A typical situation involves one entity exerting influence over another, causing the latter to take inappropriate actions resulting in non-compliance or, in some cases, in unlawful acts. The risk of non-compliance with reporting requirements regarding transactions between entities must also be evaluated.

9.16.11 Summary of Risk Assessment Considerations in regard to Audits of Financial Statements

When auditing financial statements, auditors are expressing an opinion, but not a certainty, about whether the financial statements accurately present the results of operations. The auditor's statement refers to a reasonable degree of assurance that the financial statements are not materially misstated. For example, if the level of confidence that the financial

43 Ibid, p6 and p9.

statements are not materially misstated is 95%, there is a 5% audit risk that the auditors might have failed to detect errors and non-compliance beyond the materiality level.

Audit risk is normally set at 5% (i.e. overall audit assurance is normally set at 95%). The level of acceptable audit risk will be higher if the audited entity has well-established internal controls and a good reputation. Conversely, if the audited entity is perceived to be a much higher risk than others, audit risk might be set at 3%. Defining a lower audit risk level will entail more in-depth testing. Therefore, a balance should be sought between materiality, risk assessment and level of audit risk.

9.17 Planning Audit Procedures

ISSAI #2330 (ISA #330):3 states:

> *"The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks."*

All the activities described in the paragraphs above should provide the auditor with sufficient information to design the audit procedures necessary to obtain sufficient and appropriate audit evidence in order to be able to give an opinion with reasonable assurance about compliance of the financial statement with all relevant laws and regulations.

The auditor of the SAI should use his understanding of the controls to determine to what degree the assessed risks are mitigated. Using the audit risk model, the auditor can calculate what additional assurance should be realised by his audit activities and plan those activities.

The auditor shall design and perform audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. In designing the further audit procedures to be performed, the auditor shall:

- Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including: - The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (that is, the inherent risk); and
- Whether the risk assessment takes account of relevant controls (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and obtain more persuasive audit evidence the higher the auditor's assessment of risk.

Each audit procedure has to be linked to the identified risks. Risk controls must be identified and tested (for design and effectiveness). If any controls are found to be inadequate, substantive tests have to be carried out to establish the at-risk value, the number of transactions at risk, etc.

The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end. Deficiencies in the control environment, however, have the opposite effect.[44]

44 ISA #330: A2.

Each type of risk asks for a tailored approach. ISSAI #2330 (ISA #330) deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with ISA #315[45] in an audit of financial statements. These guidelines provide both theoretical and practical guidance.

(ISA #330:7) In designing the further audit procedures to be performed, the auditor shall:

- Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:
  - The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (that is, the inherent risk); and
  - Whether the risk assessment takes account of relevant controls (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures).
- Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

Assessment of risks and controls is, as mentioned before, the core of the system-based approach. This approach is considered to be the opposite of the analytical approach. In practice an audit is always a mix of procedures from both of these approaches. This is well illustrated by ISA #330: A4

The auditor's assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that:

- Only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion;
- Performing only substantive procedures is appropriate for particular assertions and, therefore, the auditor excludes the effect of controls from the relevant risk assessment. This may be because the auditor's risk assessment procedures have not identified any effective controls relevant to the assertion, or because testing controls would be inefficient and therefore, the auditor does not intend to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures; or
- A combined approach using both tests of controls and substantive procedures is an effective approach.

The inventory and understanding of internal controls is no guarantee that these controls have been in place all year and that they have been functioning appropriately. Since the auditor wants to rely on these controls, the planning procedures should at least comprise assessing the existence and working of the controls (operating effectiveness) by e.g. walk through tests, dual purpose tests and/or substantive testing. The results of these tests can prove the primary assessments of the controls being wrong urging the auditor to redesign his audit procedures.

(ISA #330: 10) In designing and performing tests of controls, the auditor shall:

- Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including: - How the controls were applied at relevant times during the period under audit;

45 ISA #315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

- The consistency with which they were applied; and
- By whom or by what means they were applied.

- Determine whether the controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.

The planning of the procedures is not only about the types of audit but also about the timing. When planning the timing of further audit procedures public sector auditors also take into account that tests of compliance with laws and regulations may be carried out during the year while tests of budget execution normally are completed at year-end. For example, when selecting samples to test whether controls have been in place during the whole year, samples should be picked equally spread throughout the year.[46]

In addition to the audit procedures for testing the controls, the auditor should also plan Substantive procedures for each material class of transactions, account balance, and disclosure. The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

- Agreeing or reconciling the financial statements with the underlying accounting records; and
- Examining material journal entries and other adjustments made during the course of preparing the financial statements.[47]

The guidelines do not only give guidance on the audit procedures, but also provide guidance for *'overall response to assessed risks of material misstatement at the financial statement level'*. ISA #330: A1.

Overall responses to address the assessed risks of material misstatement at the financial statement level may include:

- Emphasising to the audit team the need to maintain professional scepticism;
- Assigning more experienced staff or those with special skills or using experts;
- Providing more supervision;
- Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed; and
- Making general changes to the nature, timing, or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.

9.18 Further Audit Procedure and Special Audit Considerations

If misstatements that we did not expect when assessing the risks of material misstatement are detected at an interim date, we will need to evaluate whether further audit procedures are necessary.

If we conclude that such additional procedures are necessary, the modifications may include extending or repeating the procedures previously performed.

The separate volume of templates and case studies provides template to offer guidance on how to do this (**Template 13**); it also provides a template to offer guidance on identifying controls relevant to special consideration risks and to design audit procedures to respond to that risk (**Template 14**).

46 ISA #330 (ISSAI #2330): 11-15.
47 ISA #330: 20.

9.19 Performing Financial Audits and Gathering Evidence

Audit procedures must be designed to obtain sufficient, appropriate, and relevant evidence that will provide a reasonable basis for the auditor's judgements and conclusions. The assessment of the internal control systems' ability to prevent or detect non-compliance is the core of these audit procedures.

The auditor should perform audit procedures in such a way as to obtain sufficient and appropriate audit evidence and thus draw conclusions on which to base the auditor's opinion. Sufficiency is a measure of the quantity of evidence, while appropriateness relates to the quality of evidence – its relevance and reliability. The quantity of evidence required depends on the risk of material misstatement of the subject matter information (the greater the risk, the more evidence is likely to be required) and on the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence does not compensate for its poor quality.

The audit procedures should be appropriate in the circumstances of the audit and suited to the purpose of obtaining sufficient and appropriate audit evidence. The nature and sources of the necessary audit evidence are determined by the criteria, the subject matter and the scope of the audit.

As the subject matter may be qualitative or quantitative, the auditor will focus on quantitative or qualitative audit evidence, or a combination thereof, according to the audit scope.

In case of any significant deficiencies or when gathering evidence from testing is likely to be very costly, the auditors must immediately report this problem to their superior so that appropriate action can be taken.

9.20 Auditing in a Computerised Environment

9.20.1 Introduction

Whilst all of the above features apply equally to manual and computer-based systems, there are other factor specifically related to auditing in a computerised environment – which will be most audits these days – which are considered below.

Most administrative and financial functions are now carried out with the aid of computer systems. The term **information systems** (IS) has come into general use for all such systems, as not prejudging the amount or type of technology concerned.

All auditors should have a general understanding of how computerised systems work. They should also be able to make use of computers to aid their audits but will not be expected to, for example, be able to write a program.

Each SAI should have a member of staff charges with the general maintenance of its systems and website. However, most SAI will not have Computer Auditors with advanced technical skills. This is because such individual can command salaries far in excess of those payable by any SAI. To alleviate this situation, the SAI should have a budget to buy in specialist IT assistance as and when required. This could either be a separate budget or as part of a general budget line for buying in external assistance.

This section deals with the methodology for audit of such information systems. It is intended to provide guidance at the level required by the generalist auditor who is familiar with the issues and methods of IS audit, can undertake simple IS audit tasks, and can use IS audit specialists to serve general audit objectives. The guidance does not attempt to present detailed specialist information on the highly technical areas of the subject. The scope of IS audit work needed in any particular case must be decided in the light of the general objectives of the audit being undertaken.

Some SAI (e.g. Bangladesh[48]) develop separate Audit Manuals for this topic.

9.20.2 Basic Concepts and Definitions

The presence of information technology has no direct effect on the objectives of an audit, but it introduces specific control concerns and may mean that there have to be changes in the audit approach.

Information technology brings two particular problems for management and auditors:

- computers and networks, like any technology, are vulnerable to **breakdown and damage**. As soon as an organisation or a function becomes dependent on information technology, therefore, contingency planning becomes more important than before and must take sufficient account of technical matters; and
- **data and programmes held in computer systems are invisible and intangible,** and they can be accessed or changed without leaving a trace. Management and auditors alike need to take special measures to be sure of the reliability, integrity and confidentiality of any data resulting from computers.

Generally recognised control techniques have been developed accordingly. IS audit deals with the evaluation of these controls. Different components of IS audit should be distinguished because they require differing skill levels, techniques and timing; and because they make different contributions to audit work as a whole. Each of these components is discussed at greater length later in this guidance.

9.20.3 General (Installation) Controls Audit

General controls are the controls in place over a whole computer installation or network. The quality of these controls has a pervasive effect on all applications run in that environment: for example, if there are weaknesses in access control at the installation level or for a whole network, it is most likely that all applications will be vulnerable to unauthorised access, regardless of any specific access controls in the applications themselves.

Most auditors need support from IS specialists to carry out a full general controls audit. However, full audits are not always necessary. Generalist auditors may be able to obtain sufficient assurance that data are complete and correct, and that internal controls covering the computer are functioning adequately **so far as they affect a particular audit**, without a full review of general controls.

In some cases, generalist auditors may rely on third party statements (TPS) given by specialist IS auditors. These TPS usually cover the general controls regarding computer centres and/or applications. Should TPS not be available, generalist auditors should nevertheless always evaluate certain non-technical general controls.

9.20.4 Application Audit

An application audit evaluates the internal controls specific to the input, processing, data files and output of a defined function. All auditors carrying out systems-based audits of administrative functions where information technology is used need to address this aspect of IS audit.

48 http://www.cagbd.org/assets/upload/publication/68fc6364b2ab848b4524463a3c485f19.pdf

Applications audits are not necessarily highly technical. Generalist auditors will need to call on IS specialists where the application controls are exceptionally complex or technical, and there are no satisfactory compensating controls in the user area. But many applications are designed so that they give definite assurance to user managers that data and processing are in order without requiring them to be IS experts. In such cases, checks and procedures (including manual procedures) routinely carried out by user staff may give satisfactory assurance that data and output are reliable. In many audit situations this level of assurance will also be adequate for the auditors.

9.20.5 Computer-Assisted Audit Techniques (CAATs)

The term CAATs is used for a wide range of programmed procedures and packages which auditors may use to make tests on controls or (much more commonly) to sort, compare or extract data for further testing. It is essential when using CAATs to ensure that the data being used by the auditor are in fact complete and correct.

Specialist help may be needed with CAATs. Whilst some CAATs products on the market can be used relatively easily by generalist auditors, where the task is complex, or where the data are not available to a package in the form it requires, more advanced programming skills are needed. In such cases CAATs can be an expensive use of audit resources; the decision on whether they are needed, and the design of the procedures, should depend closely on the objectives of the audit.

The phrase CAATs most commonly refers to the use of retrieval software to identify transactions with particular characteristics for more detailed audit, or to make samples.

Examples of CAATs tests and procedures are:

- identifying erroneous values;
- identifying exceptional values;
- testing the posting or summarizing of transactions;
- re-performing computerised processing (e.g. foreign currency conversions);
- comparing data on separate files;
- producing aged analysis of accounts; and
- stratification.

CAATs are the means to an end, not an end in themselves. The use of CAATs needs to be planned and they should only be used where they produce added value or where manual procedures are not possible or less efficient. The functions to be carried out should be documented in advance and the actual use made of CAATs should be recorded. Normal rules of audit evidence must be applied. The CAATs documentation should include details of all settings, queries etc. that were used to produce the results. In all cases, it is important to be able to show that the CAATs programme operated on the complete and correct set of underlying records.

A commonly used one is IDEA[49] which is a powerful data-analyses tool.

9.20.6 Audit of Developing Systems

Audits of developing systems cover two main aspects:

- the **management** of the development work. This may be the subject of a performance audit (see the Performance Audit Manual); and

49 https://idea.caseware.com/products/idea

- the adequacy of the **system design** for achieving the internal control requirements of the function (these should normally be defined by user management).

In addition, and whether or not they carry out formal audits of developing systems, SAI need to ensure that new applications subject to their audit are designed so that they are efficiently auditable.

It is important that new information systems should be designed in such a way that they are auditable and that there is sufficient internal control. Since making changes to the design becomes progressively more expensive in the later stages of development, auditors must consider carefully both the timing and the nature of their approach to new information systems. If no audit action is taken, there is a risk that systems may be introduced which lack important controls or are unnecessarily difficult to audit.

On the other hand, any audit contribution must be made in such a way that audit independence is retained. The possibilities are:

- carrying out an **audit of the developing system;**
- being directly involved as a **user** of the developing application; in such cases, audit independence should be reserved, for example by arranging that other audit staff will be available to review the system independently;
- ensuring that the project owner or another principal **user represents auditability requirements** as a management requirement of the system (in accounting systems it is quite logical for the accountant to do that, in consultation with both internal and external auditors); or
- ensuring that the audited organisation has **general application design standards that provide for auditability** and that its quality control assures this (in addition, internal audit should have arrangements for keeping an eye on auditability generally).

Of these possibilities, the first two both demand considerable resources and may give little or no reportable audit result. It is therefore normally preferable to work through the third and fourth.

In order to foster the third option, auditors should always take the opportunity of reminding management of the need to ensure that adequate management/audit trails are specified in new applications and should invite consultation at the planning stage for important new financial systems.

The general standards can be checked by an examination of the systems development methodology applied by the IS division of the auditee, and a dialogue with the IS standards branch and the internal auditors to ensure that it is executed properly.

9.20.7 Planning and Staffing Information Systems Audits

Staffing and Training

Since there are now few functions without some computer component, all auditors need to know how the presence of computers influences the evaluation of internal control. Training programmes should reflect this general requirement.

Auditors need additional training to become specialists in IS audit. IS professionals usually do not have training in control evaluation which equates to that of an auditor. Care must be taken therefore that staff who are to be IS audit specialists acquire and maintain an appropriate body of both IS and audit knowledge. Specific qualifications exist which can provide a measure of this. IS audit specialists are often a scarce resource, use of which must be focused on the points where it is of greatest benefit. When this is so, it follows that IS specialists must only be called on when the objectives of the audit and the complexity of the information systems make their expertise necessary. The following section, on planning, gives guidance on this.

Generalist auditors can be trained in the use of CAATs products without having to become full IS specialists.

Planning and Use of Specialists

Standards of IS security and control are not absolute. Too high a level of control ("over-engineering") is expensive and usually inefficient. The set of controls in place should reflect the purpose and use of each system and is usually a mixture of technical and manual procedures. Efficient controls over computer processing may be found in manual procedures in user areas, or in user management activities. Information systems should, therefore, not be examined in isolation, but as part of the general audit of the whole administrative or financial function of which they are part. Only in this way can the auditor realistically assess the appropriate control standard and evaluate the interaction of technical and user controls.

At the planning stage, information should be gathered to decide on the scope of the IS audit to be carried out. It may be useful to consult an IS auditor at this stage to help decide on priorities. In particular, a decision should be made on whether a general controls review is necessary, and the extent to which CAATs will need to be used. Since both of these can represent an expensive demand on specialist resources, it may be necessary to apply strict priorities in the use of IS auditors.

In the light of the general objectives of the audit, the following factors should be taken into account:

- the **extent** to which the function concerned uses computer processing or **data held on computers**;
- the extent to which the **correctness of processing and data is proved**, to the degree necessary for the function, by controls in the user area, including user management procedures;
- the **complexity of the computer processing**, specifically the extent to which the function uses data generated by computer programmes (as opposed to data which are simply recorded, sorted or analysed by the application);
- the **size of the installation**: for example, it may be intrinsically impossible to have good general controls because there are not enough staff to provide sufficient separation of duties. This will be the case, for example, if a full separation of duties cannot be made between programmers, operators and access administration;
- the **sensitivity** of the data and data protection obligations; and
- any **special difficulties** in the management/audit trail. In older or poorly designed systems there may be problems, for example in tracing the underlying details for data which are accounted for in aggregate, or in getting assurance that totals include all relevant transactions. These will increase the need for the auditor to use CAATs simply to establish that data are correct.

Where the correctness of data and processing is proved, to the extent required for the audit being undertaken, by compensating controls carried out in the user area (including user management procedures), a technical general controls review as part of the audit may be unnecessary. In such cases, the generalist auditor should nevertheless obtain TPS or himself cover the IS management questions.

Materiality Consideration

During the planning stage the IT auditor should establish levels of materiality such that the audit work will be sufficient to meet the audit objectives. When planning the IT auditor should determine, based on materiality, which controls will be examined. Financial auditors usually measure materiality in monetary terms, since what they are auditing is also measured and reported in monetary terms. IT auditors may audit non-financial items, like physical access controls, logical access controls, program change controls, password generation and quality control. The IT auditors therefore need guidance on how materiality should be assessed in order to plan their audits effectively, focus their effort on high risk areas and assess the severity of any errors or weaknesses found.

Materiality is important to the auditor because the materiality of an item in the financial statements will determine its importance and therefore the amount of audit effort to be devoted to it. Materiality determines the starting point at which adjustments would need to be done in the financial statements. In determining his strategy and deciding on the extent of his further detailed work the auditor will have materiality in mind since he/she will wish to detect material misstatements in the financial statements.

The assessment of what is material is a matter of professional judgment and includes consideration of the effect on the organisation's errors, omissions and irregularities, which may arise as a result of control weaknesses in the area being audited.

In assessing materiality, the IT auditor should consider:

- The aggregate level of errors to management; and
- The potential for the cumulative effect of small errors or weaknesses to become material.

Where the audit objective relates to systems which process financial transactions, the value of the assets controlled by the system or value of transactions processed per day/week/month/year should be considered in assessing materiality.

Where financial transactions are not processed, the following are examples of measures, which should be considered to assess materiality:

- **Cost of the system:** hardware, software, staff, third-part services, overheads etc.;
- **Nature of the item:** for example, irregularities or illegal acts by management would be considered to be material even if the amounts involved were small. Items are considered material by their nature usually because there are legal disclosure requirements for example items which need to be shown separately because of their exceptional nature;
- **Cumulative effects:** the total effect of individual accounts on the financial statements taken as a whole;
- **Potential cost of errors:** possibly in terms of lost sales, unnecessarily high costs of production, high wastage etc.;
- **Number of transactions:** processed per period;
- **Nature and extent of reports prepared**: and files maintained; and
- **Nature and qualities of material handled** e.g. where stock movements are recorded without values.

In determining the findings, conclusions and recommendations to be reported, the IT auditor should consider both the materiality of any errors found and potential materiality of errors which could arise as a result of control weaknesses. Where the audit is used by management to obtain a statement of assurance regarding IT controls, an unqualified opinion on the adequacy of controls should mean that controls meet the control objective and are devoid of any material control weakness. If the IT audit work identifies material control weaknesses, the auditor should consider issuing a qualified opinion or adverse opinion.

9.20.8 General (Installation) Controls Audits

The areas covered by general controls audits are set out below. The first four are general management issues which should be addressed by generalist auditors even when the technical aspects are not being examined.

General Management Issues

These comprise:

- **organisational:** strategic planning, structure and reporting lines of the IS department, adequate segregation of duties within the department;
- **IS security policy:** exists, is adequate, communicated and followed;
- **continuity:** back-up and standby arrangements; and
- **management** of IT assets.

Specialist Technical Issues

These comprise:

- logical and physical access controls: detailed execution;
- operations: all jobs submitted to the computer are properly authorised and are completely, accurately and promptly processed;
- systems software (including specific access restrictions);
- programmes maintenance and development procedures;
- data/database management;
- data communication; and
- (local) networks.

9.20.9 Application Audits

As has been indicated, an application audit is not normally free-standing, but part of a systems-based audit of a business or administrative function. In any particular case, the objectives and key control questions will therefore be modified and often made more specific in accordance with the scope and subject of the whole audit.

The aspects which must always be addressed can be summarised in a generally applicable form as follows below:

- **Organisation and Documentation:** Management responsibility for every aspect of maintaining and running applications should be properly allocated. The costs of running applications should be identified and kept under review. All necessary documentation should exist considering the type of application concerned and the organisation's needs;
- **Input:** Only authorised items, and all authorised items, should be input. Data input to applications should be accurate and complete. (Input comprises both transaction and permanent/reference data.);
- **Processing:** Processing of transactions should be complete and arithmetically accurate, and the results (including generated data) should be correctly classified

and recorded properly in the computer files. Other processing activities should be carried out on time and give correct results;

- **Data Transmission:** Data should be transmitted accurately and completely;
- **Standing Data:** The continued correctness of stored data should be ensured.
- **Output:** Output released whether on paper, via screens, on magnetic media, or through electronic links, should be correct and complete. Output should reach all those, and only those, for whom it is intended.

In deciding which controls he needs to rely on, the auditor should bear in mind that tests of control will need to establish, among other things, that the control operated correctly throughout the period subject to audit (see the guideline on Evaluation of internal control and compliance testing). It will usually favour good use of audit resources if, where he has a choice, the auditor seeks by preference to rely on controls in the user area which can be tested readily, provided that these give sufficient assurance about the control objective concerned. The use of CAATs may help to increase assurance. If there has to be reliance on the more technical controls, it will often make a general controls audit necessary. For example, to be certain that validation checks made by a programme always operated, the auditor would need to obtain definite evidence that controls over programme changes were effective throughout the period - a question which would involve a full general controls audit.

Chapter 10: Conducting the Audit and Gathering Evidence

There are no specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

10.1 Introduction

The next phase of the financial audit is **"conducting the audit".** This is the phase in which the planned audit procedures will be executed to gather sufficient appropriate audit evidence to support the audit opinion with the financial statement. As result of the planning stage the auditor has designed an audit plan with audit procedures that are a response to the assessed risks of material misstatement. For the SAI those risks regard both the financial statements itself as well as risks regarding compliance of budget execution with relevant authorities and obligations as result of policy (like terms for obtaining subsidies).

In this phase the auditor implements the audit plan in order to gather sufficient and appropriate evidence whether or not the assessed risks for material misstatements in fact lead to material misstatements or not. The evidence must mitigate the audit risk to the desired level and to reasonable assurance with regard to the opinion the auditor will give with the financial statement.

The auditors' conclusions must be supported by sufficient and appropriate audit evidence (ISSAI #2500). The sufficiency of evidence relates to its quantity. The aptitude, relevance, reliability and appropriateness of evidence relate to its quality.

The evidence-gathering process is not a one-off exercise. It is systematic and iterative. It must continue until the auditor is satisfied that his/her conclusions are backed by enough objective, convincing evidence. The process involves:

- Gathering evidence by carrying out appropriate audit procedures;
- Evaluating the evidence obtained as to its sufficiency (quantity) and appropriateness (quality); and
- Re-assessing risk and gathering further evidence as necessary.

Audit evidence is defined by INTOSAI as: any information used by the auditor to determine whether the subject matter complies with the applicable criteria. Evidence may take many forms, such as electronic and paper records of transactions, written and electronic communication with outsiders, observations by the auditor, and oral or written testimony by the audited entity. Methods of obtaining audit evidence can include inspection, observation, inquiry, confirmation, recalculation, re-performance, analytical procedures and/or other research techniques. The kind of evidence to be gathered and the methods that will be applied are expressed in the audit plan which is the result of the planning phase.

10.2 General Approach to Testing

Throughout the audit fieldwork the auditor should be aware of the link between the evaluation of each system and the amount of audit testing performed. To be kept under review are the sizes of samples examined and the basis on which samples were selected. The auditor should revise the sample approaches and sizes in response to any problems identified in the testing undertaken.

The Auditor should prepare a test programme for each system being audited. Each programme should:

- Set out in full the objective of the test;
- Be specific about what is to be done, (i.e. describe the documentary evidence to be examined, the procedures to be checked, the persons to be interviewed and the questions to be asked);
- Set out the way the sample size is established and the number of transactions to be tested; and
- Define what is considered to be an error.

Any failures identified must be reported in the management letter. The auditor should also consider the potential impact on the audit opinion.

The auditor should fully document all errors discovered during the course of testing and consider the significance of these errors in relation to the financial statements.

Audit evidence is obtained from an appropriate mix of control and substantive testing. The type of test to be performed is important for an understanding of the application of audit procedures in gathering audit evidence.

10.3 Compliance Testing

Based on a full understanding of the accounting and internal control systems, the auditor identifies the characteristics or attributes of individual transactions or records that indicate that controls have worked properly and effectively, such as by recorded approvals and endorsements, use and control of numbered accountable forms and document sequencing. The auditor should also set out conditions that, if observed, would indicate that controls have not worked in respect of a transaction or event. Testing will then establish whether attributes are present or absent in the instances selected in the sample. The results provide audit evidence on the operation of the controls under test.

10.4 Substantive Procedures

Substantive procedures are concerned with amounts and are of two types: analytical review and detailed testing of transactions. The purpose of substantive procedures is to obtain audit evidence to detect material errors in transaction records and failures in compliance with legal requirements. It is useful in this case also for the auditor to analyse the requirements and set out a list of conditions against which transaction records can be tested.

10.5 Sufficient Appropriate Evidence

10.5.1 Sufficient Evidence

The basic principle is that those who want to use the findings and opinion of the auditor may put their confidence in the professionalism of the auditors and in the completeness and reliability of their findings and opinion (reasonable assurance).

Sufficiency of the evidence means that the auditor must have gathered enough evidence (quantitative and qualitative) to substantiate his findings. Appropriate means that the evidence must be both relevant and reliable.

Sufficient evidence relates to the extent of an audit procedure judged necessary.[50] The extent is determined after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. In general, the extent of audit procedures increases as the risk of material misstatement increases.

For example, in response to the assessed risk of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk (appropriateness of the audit procedures).

When the risk is assessed as high, the auditor should obtain more persuasive audit evidence. For that he may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

10.5.2 Relevant Audit Evidence

The evidence the auditor gathers should be relevant. Relevance considers the relation between the subject matter/subject matter information and the information that should prove the subject matter/subject matter information to be reliable and/or complete depending on the assertion.

For example, if the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.[51]

10.5.3 Reliable Audit Evidence

The reliability of evidence depends on the source and nature as well as the circumstances in which the evidence was obtained:[52]

- Evidence is more reliable when it is obtained from independent sources outside the audited entity;
- Evidence that is generated internally is more reliable when the related controls are effective;
- Evidence obtained directly by the auditor (for example, through observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (for example, through inquiry into the application of a control);
- Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a simultaneous written record of a meeting is more reliable than a subsequent oral report of what was discussed);
- Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles; and
- Evidence is more reliable when it comes from different sources. For example, evidence from a single interview is not considered to be sufficient appropriate. Another source should confirm the information from the interview. This could be other persons saying

50 ISSAI #2320: A15.
51 For more information and examples see ISSAI #2500: A27-A30.
52 ISSAI 200:129 and ISSAI #2520: A12.

the same or, better, documentation/written proof.

The same applies for accounts records. These records in themselves are not sufficient. The auditor needs to gather additional evidence of the effective operation of the relevant controls and/or check with the original document to which the record refers.

More detailed guidance on reliability can be found in ISSAI #2500 (A31-A33).

10.6 Evidence Gathering Procedures

10.6.1 Types of Audit Procedures

INTOSAI distinguishes two general types of audit procedures to gather audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained:[53]

- Risk Assessment Procedures;
- Further Audit Procedures, which comprise:
  - Tests of Controls, and
  - Substantive Procedures, including tests of details and substantive analytical procedures.

10.6.2 Risk Assessment Procedures

The Risk Assessment Procedures themselves are described in Chapter 9. This chapter elaborates on the auditor's response to those risks. In the system-based approach the auditor wants to rely on the controls that would mitigate the risks of material misstatements.

From the assessment of the risks and controls in the planning phase the auditor of the SAI could learn that some of the controls are not in place or are not operating effectively. For some assertions the auditor could also decide that testing the controls would not be efficient, e.g. when there is only one case to be tested or when the assertion regards the occurrence of assets. This would mean that the auditor has to or will perform substantive procedures to assess the factual materiality of the misstatements (and errors/mistakes/uncertainties).

In practice the audit approach will be a combination of both tests of controls and substantive procedures bearing in mind that according to the ISSAI, the auditor always has to perform substantive procedures for or each material class of transactions, account balance, and disclosure.

The nature of an audit procedure refers to its purpose (that is, test of controls or substantive procedure) and its type (that is, inspection, observation, inquiry, confirmation, recalculation, re-performance, or analytical procedure). The nature of the audit procedures is of most importance in responding to the assessed risks. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because of internal controls, and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls.

10.6.3 Timing of the Audit Procedure

Depending on the subject matter, subject matter information and the assessed risks audit procedures have to be implemented before or after the year end.

53 See ISSAI #2315 and ISSAI #2330.

Audit procedures that can only be performed after the draft version of the financial statements is available to the auditor are:

- Agreeing the financial statements to the accounting records;
- Examining adjustments made during the course of preparing the financial statements; and
- Procedures to respond to a risk that, at the period end, the entity may have entered into improper sales contracts or transactions may not have been finalised.

Also, the higher the risk of material misstatement, the more appropriate it is for the auditor to perform substantive procedures nearer to, or at, the period end rather than at an earlier date.

An exception is the risk of material misstatement related to fraud or corruption. To address these risks the auditor shall perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis).

Performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters.

Performing audit procedures at an earlier stage also contributes to the efficiency of the work of the SAI because the audit capacity can be spread over the year. Of course, there will be still a peak in the work after completion of the financial statements of the public entities and the consolidation process resulting in the Annual Financial Statement of government.

Further relevant factors that influence the auditor's consideration of when to perform audit procedures include the following:

- The control environment;
- When relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times);
- The nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may wish to examine contracts available on the date of the period end); and
- The period or date to which the audit evidence relates.

10.6.4 Tests of Internal Control

In the planning phase the auditor has made an assessment of the risks and the controls that would mitigate those risks, thus determining the **"control risk"**. Normally in the planning phase the assessment of the controls has the character of an inquiry: are there controls, are there written procedures, etc.? If available the auditor would also consider the findings or earlier audits or audits of other bodies. However, that does not guarantee that those controls have not been changed during the year, have been in place all year and have been operating effectively. This has to be tested in the execution phase.

Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The SAI should, therefore, when drafting the audit plan, decide whether it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.

From the perspective of efficiency of the audit, the auditor should also consider whether so-called dual-purpose tests can be used. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, also known as a dual-purpose test.

For example, the auditor may design, and evaluate the results of, a test to examine an invoice to determine whether it has been approved by the person with the relevant mandate, if it has been subject to internal control (if applicable) and to provide substantive audit evidence of a transaction. Such an audit would provide evidence about the effective operations of internal controls and about the correctness of the invoice itself. A dual-purpose test is designed and evaluated by considering each purpose of the test separately.

The nature of the tests of the controls has to be tailored to the nature of the particular control. For example, controls related to compliance with laws and regulations or controls related to the registration and occurrence of goods. So, tests could be comparison with relevant documents, the applicable laws and regulations, mandates and taking inventory.

More and more processes are part of an automated information system. For example, records of all public entities may be kept in an automated system at the Ministry of Finance. Relevant controls should be built in those systems. The SAI should test the system and the controls build in since this system is the basis for the consolidated financial statement of the country. Testing automated systems requires specific audit skills.

An alternative would be to go around the system ("black box approach"), but that is considered to be less reliable because it is hard to determine if the output is correct. There are many examples were data in the automated system has been manipulated, but were the output shows the (seemingly) correct figures.

Depending on the process, the relevance of the process and the reliance which is put to the process more persuasive evidence is needed regarding the effectiveness of a control. This is part of the professional judgement and scepticism of the auditor. Based on that, the auditor should decide on increasing the extent of testing of the control.

Other matters the auditor should consider in determining the extent of tests of controls include the following:

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

As a result of the inherent consistency of IT processing, normally it is not necessary to increase the extent of testing of an automated control. An automated control can be expected to function consistently unless the program (including the tables, files, or other permanent data used by the program) is changed. Once the auditor determines that an automated control is functioning as intended, the auditor may consider performing tests to determine that the control continues to function effectively. Such tests should include determining that:

- Changes to the program are not made without being subject to the appropriate program change controls;

- The authorised version of the program is used for processing transactions; and
- Other relevant general controls are effective.

If the auditor has any doubts about the proper functioning of the automated system, he should also apply analytical procedures like recalculation; e.g. the gross – net calculation of salaries using relevant laws and regulations and the personnel file.

The auditor should also be alert to the principle of “garbage in – garbage out”. This means that in designing the audit related to automated systems, the auditor should also consider testing the controls that would guarantee the complete and correct input. If those controls are not in place or not operating effectively it is hardly useful to test the automated system itself, because even if the system itself works properly, it would produce false output.

Like stated at the beginning of this paragraph, the auditor could rely on the findings of previous audits. However, this means that the auditor has to be sure that no changes have been made to particular process and the related controls. If so, the design of controls itself do not have to be assessed again, but still the auditor shall have to test whether the controls have been in place all year and have been working effectively.[54]

One of the objectives of the audit of the SAI is to present proposals for perfecting the execution of the budget. When testing of the controls results in detecting material misstatements, this would be a strong indicator of the existence of a significant deficiency in internal control. In his report the auditor should address those deficiencies and propose measures to improve the internal controls.

10.7.5 Substantive Procedures

Substantive procedures (or substantive tests) are those activities performed by the auditor to detect material misstatement or fraud at the assertion level. Assertion levels are:

- For the **balance**:
  - existence, rights and obligations;
  - valuation and allocation; and
  - presentation and disclosure.
- For **transactions**:
  - occurrence (validity);
  - completeness;
  - accuracy;
  - cut-off; and
  - classification.

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

The auditor should design and perform substantive procedures for each material class of transactions, account balance and disclosure, irrespective of the assessed risks of material misstatement. The auditor should always undertake some substantive testing, irrespective of whether controls have been tested. In addition, if the auditor has determined that an

54 More information about the use of previous audits can be found in ISSAI #2330: A35-A39.

assessed risk of material misstatement at the assertion level is significant, substantive procedures should be performed that specifically respond to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details.[55]

When the results from tests of controls are unsatisfactory the auditor shall determine whether alternative procedures might be applicable. This does not comply with irreplaceable internal controls, since they have to be performed at moment of occurrence of a relevant fact e.g. the delivery of goods or services.

The main audit object for the SAI is the financial statement. This means that the auditor's substantive procedures shall include the following audit:

- Agreeing or reconciling the financial statements with the underlying accounting records; and
- Examining material journal entries and other adjustments made during the course of preparing the financial statements.

The ISSAI requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that:

- the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and
- there are inherent limitations to internal control, including management override.

More information on considerations regarding substantive procedures and techniques that can be applied can be found in ISSAI #2330.

10.7.6 Analytical Procedures

ISSAI #2520 (ISA #520:4) outlines that the term "analytical procedures" means:

> *"evaluation of financial information through analysis of plausible relationships among both financial and non-financial data."*

Examples are:

- Expenditures versus budget or appropriations;
- Benefit payments, such as child support and pensions versus demographic information;
- Tax revenues versus demographic information or economic conditions or indicators;
- Interest as a percentage of national debt compared to the government borrowing rate;
- Results accomplished in relation to expenditure, where performance information is included as part of the financial statements; and
- Government grants for economic and social development, e.g. grants for low income farmers and grants for school buildings, versus economic and demographic indicators. In order to be an effective procedure, such tests need to be at an appropriate level of detail.

Analytical procedures may also comprise of comparison of similar information from different periods or entities as well as relationships between financial and non-financial information. For instance, the total amount of wages would normally by more or less consistent during the year. So, the auditor could compare the payments in twelve months. If there are material deviations, the auditor needs to investigate further. For example, has the number of employees changed and/or has there been an increase in wages and if so, are there

55 ISSAI #200:102-103.

documents that substantiate the compliance of these changes with authorities?

The likeliness of the total amount of wages in a month can be assessed by multiplying the number of employees (non-financial information) with the average wages.

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

The type of analytical procedures to apply is determined by the auditor considering the assertion that will be tested.

10.8 Evidence Gathering Techniques

Depending on the circumstance the auditor uses one or more of the following techniques to gather audit evidence:

- **Inspection:** Inspection involves examining accounts books, records and other case files or physical assets, e.g. examining the books and records to determine how project funds have been accounted for and comparing this accounting to the terms of the project agreement;
- **Observation:** Observation involves looking at a process or procedure being performed. This may, for example, include observing inventory stock-taking to assess whether employees are following instructions;
- **Confirmation:** Confirmation means obtaining a reply from a third party, independent of the audited entity, in regard to some particular information. This can involve obtaining feedback directly from beneficiaries, confirming that they have received the grants or other funds that the audited entity asserts that it has paid out, or that funds have been used for the particular purpose set out in the terms of a grant or funding agreement;
- **Recalculation:** Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically;
- **Re-performance:** Replication involves independently carrying out the same procedures already performed by the audited entity. For example, case file studies may be performed to test whether the audited entity made the correct decisions or provided the appropriate service based on the relevant criteria. Process steps may be replicated to test the appropriateness of decisions to issue visas or resident permits, or the exercise of budget authority. If the criteria for making child benefit payments involve payments to parents with children under a certain age, public sector auditors may replicate the audited entity's process for selecting recipients from a public database, using computer assisted audit techniques to test the accuracy of the entity's process;
- **Analytical procedures:** Analytical procedures involve comparing data or investigating fluctuations or relationships that appear inconsistent. For example, this may involve comparing an increase in pension benefits payments from one year to the next with demographic information such as the number of citizens having reached retirement age within the last year; and
- **Inquiry:** Inquiry involves seeking information from relevant persons, both within and outside the audited entity. These can range from formal written inquiries to more informal oral discussions, interviewing and asking questions of relevant persons (including experts) or preparing and sending questionnaires or surveys.

Regression analysis techniques or other mathematical methods may assist public sector auditors in comparing actual to expected results. More details are provided in Annex 17 – Analytical approaches that may be used during audit testing.

10.9 Management Representations as Audit Evidence

During the course of an audit, management makes many representations to the auditor, either unsolicited or in response to specific enquiries. When such representations relate to matters that are material to the audit opinion, particularly in respect of the financial statements, the auditor should:

- Obtain **written confirmation** of the representations and responses of management;
- Seek **corroborative audit evidence** from sources inside or outside the audited body;
- Evaluate whether or not the representations made by management appear **reasonable and consistent** with other audit evidence obtained, including other representations; and
- Consider whether or not the individuals making the representations can be expected to be **sufficiently well informed** on the particular matters.

In some instances, a representation by management may be the only audit evidence that can reasonably be expected to be available. In general, however, such representations cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. For example, a representation by management as to the cost of an asset is not a substitute for the audit evidence of cost that the auditor would ordinarily expect to obtain through payment or similar documentation. If the auditor is unable to obtain sufficient appropriate audit evidence regarding a matter that has, or may have, a material effect on the financial statements, and such evidence should be available in the normal course of business, this may constitute a limitation in the scope of the audit, even if a representation from management has been received on the matter.

The audit working papers must include evidence of management's representations. A written note should be prepared and filed to record relevant oral discussions with management and should include date, time and place of the discussions, and details of persons present. Written representations from management should also be retained on working paper files.

The auditor should seek to obtain written representations from management on matters material to the financial statements or to the achievement of the audit objectives when other sufficient appropriate audit evidence cannot be provided by management. In these circumstances the auditor should regard such unsupported representations with professional scepticism.

Written representations can take the form of:

- A letter from management;
- A letter from the auditor outlining the auditor's understanding of management's representations, duly acknowledged and confirmed by management; or
- Relevant minutes of management meetings or meetings of a similar body.

When requesting a management representation letter, the auditor must request that it be addressed to the auditor, contain specified information and be appropriately dated and signed.

A management representation letter should be signed by the chief executive officer or the senior financial officer, based on the best of their knowledge and belief. In some circumstances, the auditor may seek to obtain representation letters from other members of management. For example, the auditor may seek written assurances about the completeness of all minutes of management meetings and important committee meetings from the officer responsible for keeping the minutes.

If management refuses to provide information, or cannot or does not respond to requests that the auditor considers essential for sufficient, appropriate audit evidence, the refusal or inability may constitute a limitation on the scope of the audit, leading to a qualified audit opinion or a disclaimer of opinion, as appropriate.

10.10 Using the Work of Others

ISSAI #2610 gives guidance on the conditions the SAI has to meet in order to be allowed to use the work of the other auditors and also gives directions for the procedures to follow to access the sufficiency and appropriateness.

This includes relying on the work of other auditors when forming an opinion. This may be that other auditors audit parts of an organisation or that the SAI has employed private sector auditors to work on commercial or quasi-commercial audits.

In can also include relying on the work of internal auditors (see **Template 9** for how to assess the reliability of internal auditors.

It also includes when the SAI makes use of independent experts; for example, road engineers if auditing a major road construction project or property valuers.

The first criterion is that the auditor must be objective. If the following criteria are met, there is a strong indication that the internal audit function may be presumed to be objective:

- Is accountable to top management, for example the head or deputy head of the government entity, and to those charged with governance;
- Reports the audit results both to top management, for example the head or deputy head of the government entity, and those charged with governance;
- Is located organisationally outside the staff and management function of the unit under audit;
- Is sufficiently removed from political pressure to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal;
- Does not permit internal audit staff to audit operations for which they have previously been responsible for to avoid any perceived conflict of interest; and
- Has access to those charged with governance.

The SAI has to bear in mind that an **internal audit function is never completely independent**, since it is part of the entity, staff is paid by the entity and staff is subject to authority within the entity. Also, irrespective of the degree of autonomy, objectivity of the internal audit function the SAI gives the opinion with the financial statement and thus has sole responsibility for the audit opinion expressed.

The auditor of the SAI has to inquire at the person charged with the governance of the entity if any internal audit functions are present at the auditee and if so has to determine whether, and to what extent, he could use specific work of the internal auditors and whether that work is adequate for the purposes of the audit.

If the auditor judges that the SAI can use the work of the internal auditor (or other relevant bodies) he should determine what the effect is on the nature, timing or extent of his audit procedures.

To determine whether the work of the internal auditors is likely to be adequate for purposes of the audit, the auditor shall evaluate:

- The objectivity of the internal audit function;
- The technical competence of the internal auditors;
- Whether the work of the internal auditors is likely to be carried out with due professional care; and
- Whether there is likely to be effective communication between the internal auditors and the external auditor.

In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the audit procedures, the auditor of the SAI shall consider:

- The nature and scope of specific work performed, or to be performed by the internal auditors;
- The assessed risks of material misstatement at the assertion level for particular classes of transactions, account balances, and disclosures; and
- The degree of subjectivity involved in the evaluation of the audit evidence gathered by the internal auditors in support of the relevant assertions.

To determine the adequacy of the work performed by the internal auditors the auditor shall evaluate whether:

- The work was performed by internal auditors having adequate technical training and proficiency;
- The work was properly supervised, reviewed and documented;
- Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;
- Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and
- Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

10.11 Subsequent Events

In some cases it might be necessary to carry out additional audit work to determine if any events have occurred between completion of the fieldwork and the date of the audit report, and which might have resulted in a case of material non-compliance and may therefore require special disclosure or alter the auditor’s conclusions or report.

ISSAI #200:135: Procedures should be designed, as nearly as possible, to cover the period from the date of the financial statements to the date of the auditor’s report. The auditor is not, however, expected to perform additional audit procedures on matters to which previous audit procedures have provided satisfactory conclusions. Financial statements may be affected by certain types of subsequent events (those occurring after the date of the financial statements). Ordinarily, two types of event are identified:

- Events that provide evidence of conditions that existed at the date of the financial statements; and
- Events that provide evidence of conditions that arose after the date of the financial statements.

Procedures for obtaining sufficient appropriate audit evidence may include:

- steps to obtain an understanding of any procedures established by management to ensure that subsequent events are identified;
- inquiries of management;
- scrutiny of minutes; and
- scrutiny of the entity's most recent interim financial statements, if any.

When making inquiries of management, auditors may need to consider subsequent events that are relevant to the government entity's ability to fulfil its program objectives and may therefore affect the presentation of performance information in the financial statements.

The auditor is under no obligation to perform any audit procedures on the financial statements after the date of the auditor's report. However, if, after the date of the auditor's report but before the financial statements have been issued, a fact becomes known to the auditor that, had it been known at the date of the auditor's report, might have caused an amendment to the report, appropriate action should be taken. Such action may include:

- discussing the matter with the management and, where appropriate, those charged with governance, determining whether the financial statements need amendment; and, if so,
- inquiring how the management intends to address the matter in the financial statements.

If the management does not take the necessary steps to ensure that anyone in receipt of the financial statements, where already issued, is informed of the situation, and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor should notify the management and those charged with governance that the auditor will seek to prevent future reliance on the auditor's report. This may entail seeking legal advice and reporting to the appropriate statutory body.

Further guidance is included in ISSAI #2560.

Chapter 11: Evaluating Evidence and Forming Conclusions

This chapter examines: Introduction; General Considerations on Evaluating Evidence and Forming Conclusions; Formulation of an Opinion; and Types of Audit Opinion.

There are no specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

11.1 Introduction

The next phase of the financial audit is **"evaluating the evidence and forming conclusions thereon".** This is the phase in which the audit evidence gathered in the previous phase is evaluated to support the audit opinion on the financial statement.

11.2 General Considerations on Evaluating Evidence and Forming Conclusions

The major criterion for the sufficiency of evidence is the extent to which it reduces the risk of the audit coming to incorrect conclusions. Evidence must be evaluated with a degree of professional scepticism. It is better to collect more information rather than less, and in both directions – supporting and contradicting the matter under compliance review.

The evidence has to be evaluated in terms of its materiality as defined in the planning phase for each group of transactions, type of activity, etc. Findings must be placed in the proper perspective, for example reported instances of non-compliance have to be based on the number of cases of non-compliance or the associated monetary value. In cases of non-compliance, this should result in imposing reimbursements, fines or other penalties in accordance with SAI legislation.

The ultimate goal of the evaluation is to determine whether there is reasonable assurance that the subject matter information is in compliance, in all material respects, with the identified criteria. Due to the inherent limitations of an audit, it would be unrealistic and excessively costly to attempt to detect all occurrences of non-compliance. More information on forming conclusions is provided in ISSAI #2700.

The following factors are taken into account in applying professional judgement to determine whether or not an instance of non-compliance is material:

- Amounts involved (monetary amounts or other quantitative measures such as number of citizens or entities involved, time delays in relation to deadlines, etc.);
- Circumstances;
- Nature of the non-compliance;
- Cause(s) leading to the non-compliance;
- Possible effects and consequences the instance of non-compliance may have;
- Visibility and sensitivity of the programme in question, (for example, is it the subject of significant public interest, does it affect vulnerable citizens, etc.);
- Needs and expectations of the legislature, the public or other users of the audit report;
- Nature of the relevant authorities; and
- Extent or monetary value of the non-compliance.
- Some examples of compliance deviations and considerations relating to materiality

and forming conclusions are set out in Annex 16 – Examples of Compliance Deviations

The Head of the SAI should evaluate the audit evidence and draw conclusions. After completing the audit procedures, the auditor will review the audit documentation in order to determine whether the subject matter/subject matter information has been sufficiently and appropriately audited. Before drawing conclusions, the auditor reconsiders the initial assessment of risk and materiality in the light of the evidence collected and determines whether additional audit procedures need to be performed.

The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.

If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements.

The objective of the auditor is to evaluate:

- The effect of identified misstatements on the audit; and
- The effect of uncorrected misstatements, if any, on the financial statements.

The auditor should evaluate the audit evidence with a view to obtaining audit findings. When evaluating the audit evidence and assessing materiality of findings the auditor should take both quantitative and qualitative factors into consideration. Based on the findings, the auditor should exercise professional judgement to reach a conclusion on the subject matter or subject matter information.

In some cases, material mistakes can be corrected by management. Consequently, the auditor should communicate those mistakes timely enough for management to correct them before the financial statement is definitive. If mistakes cannot be corrected (e.g. mistakes found in a sample) or management fails to correct them or will not correct them, they should be evaluated for materiality, individually or in aggregate, to determine what effect they may have on the opinion to be given in the auditor’s report.

If, at the auditor’s request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain.

When evaluating whether the financial statements as a whole are misstated, the auditor should consider the reasons of management given for not making corrections. Those charged with governance should be notified of uncorrected misstatements and the effect that they may have, individually or in aggregate, on the opinion in the auditor’s report. The auditor’s notification should individually identify uncorrected material misstatements in classes of transactions, account balances or disclosures.

To determine whether uncorrected misstatements are material, individually or in the aggregate, the auditor should consider:

- the size and nature of the misstatements, in relation both to particular classes of transactions, account balances or disclosures and to the financial statements as a whole, and the particular circumstances of their occurrence; and
- the effect of uncorrected misstatements from prior periods on the relevant classes of transactions, account balances or disclosures, and on the financial statements as a whole.

Further guidance on evaluating misstatements is included in ISSAI #2450.

The separate volume of templates and case studies includes a template for an Audit Working Paper for the Evaluation of Uncorrected Mistakes in the Financial Statements and guidance on how it should be used (**Template 15**).

11.3 Formulation of an Opinion

The objectives of a financial statements audit are to:

- Form an opinion of the financial statements based on an evaluation of the evidence obtained and the conclusions that can be drawn from this evidence; and
- Clearly express that opinion through a written report explaining its basis.

In forming an opinion, the auditors must decide whether the financial statements have been prepared – in all material respects – in accordance with the applicable financial reporting framework. On the basis of the work undertaken during the assignment, the auditors must determine whether or not reasonable assurance has been obtained that the financial statements taken as a whole are free from any material misstatements.

In order to form an opinion, the auditor must first conclude whether reasonable assurance has been obtained as to whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The conclusion should take into account:

- Whether sufficient appropriate evidence has been obtained;
- Whether uncorrected misstatements are material, individually or in aggregate; and
- The auditor's evaluations of the following points, which are taken into consideration when determining the form of the opinion:
    - Whether the financial statements are prepared in all material respects, in accordance with requirements of the applicable financial reporting framework, including consideration of the qualitative aspects of the entity's accounting practices, such as possible bias in management's judgments;
    - Whether the financial statements adequately disclose the significant accounting policies selected and applied;
    - Whether the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
    - Whether the accounting estimates made by management are reasonable;
    - Whether the information presented in the financial statements is relevant, reliable, comparable, and understandable;
    - Whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements;
    - Whether the terminology used in the financial statements, including the title of each financial statement, is appropriate; and
    - Whether the financial statements adequately refer to or describe the applicable financial reporting framework.
- Where the financial statements have been prepared in accordance with a fair presentation framework, the conclusion should also consider whether the financial statements achieve fair presentation:
    - in terms of overall presentation, structure and content; and

- whether the financial statements, including the related notes, fairly present the underlying transactions and events.

In particular, the auditor must evaluate whether:

- The financial statements adequately disclose the most significant accounting policies selected and applied, and any significant interpretations by management of legal or regularity requirements;
- The accounting policies selected and applied are consistent with the applicable reporting framework;
- The accounting estimates made by management are reasonable;
- The information presented in the financial statements is relevant, reliable, comparable and understandable;
- The financial statements provide adequate disclosures to enable stakeholders to understand the effects of material transactions and events on the information conveyed in the financial statements; and
- The terminology used in the financial statements, including their titles, is appropriate.

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

The annual report to Parliament is the result of a **"Whole of Government"** audit of the **National Accounts**. Auditors engaged to audit group financial statements should obtain sufficient appropriate audit evidence regarding the financial information of all components and the consolidation process to express an opinion as to whether the whole-of-government financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

During the audit, each member of the audit team should draft working papers and gather audit evidence. This will, amongst other things, make note of any errors discovered, adjustments suggested, etc. As part of the final examination, these actions should be reviewed and analysed in order to arrive at an opinion on the financial statements as presented.

Before formulating a final opinion, in addition to the written reports, the audit team should hold a meeting with the audited body's management. This meeting should be attended by all participants in the audit assignment. It will offer an opportunity to verbally express the opinion that will be included in the audit report as well as the reasons for it. In turn, management will have the chance to express their own opinions about the conclusions drawn. This meeting is also an opportunity to clear up any disagreements over the facts. Ideally, there should be no differences in opinion between the auditors and the audited body's management over the facts in the final report, only how they have been interpreted.

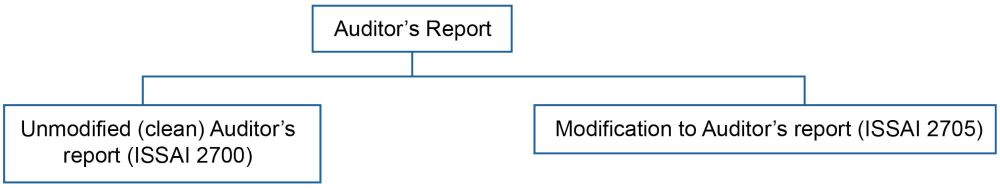
11.4 Types of Audit Opinions

Depending on the conclusions drawn as a result of the audit work, auditors should form an opinion on the financial statements, stating whether or not they believe that these statements represent a true and fair view of the organisation's financial situation. This is a short, clear and explicit statement about the general audit conclusions on the financial statements, considering whether or not presentation is consistent, appropriate accounting policies have been used and relevant standards and legislation have been respected.

There are two types of opinion:

- Unmodified (also unqualified or clean); and
- Modified.

Figure 30: Types of Opinion



The auditor should express an unmodified opinion if from the evidence gathered the auditor may conclude that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework. An unqualified opinion should be stated as follows:

> *"In our opinion, the financial statements do represent a true and fair view, in all material respects, of the financial position, financial performance and the cash flow statement of XYZ Organisation as of 31 December 20XX and the results of the operations for the year then ended".*

If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion. Also, if financial statements prepared do not achieve fair presentation, the auditor should discuss the matter with the management and, depending on the how the matter is resolved, determine whether it is necessary to modify the audit opinion.

There are three types of modified opinions:

- a qualified opinion;
- an adverse opinion; and
- a disclaimer of opinion.

The auditor should express a **qualified opinion** if:

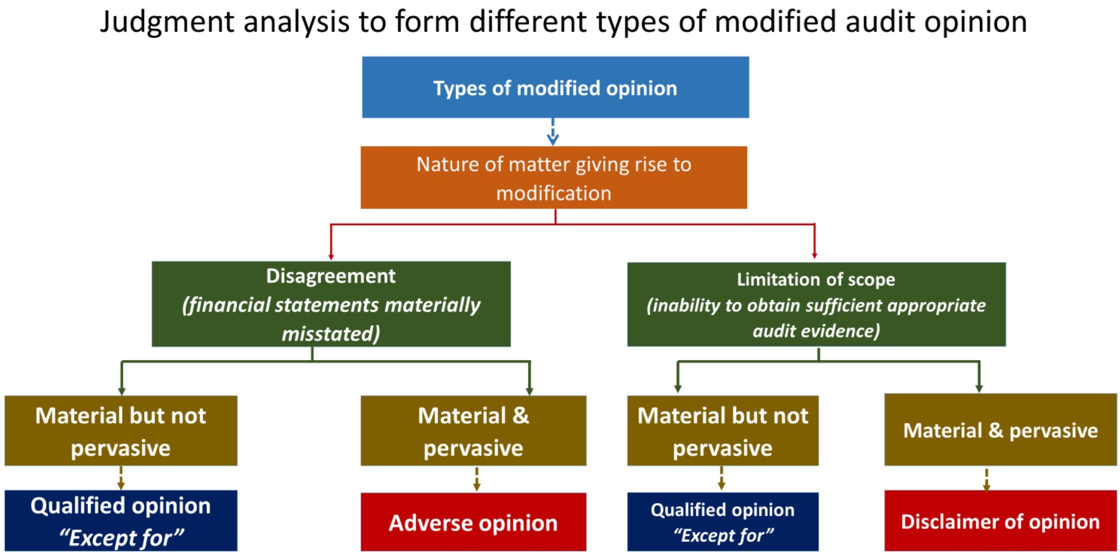
- having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements;
- or, the auditor was unable to obtain sufficient appropriate audit evidence on which to base an opinion but concludes that the effects on the financial statements of any undetected misstatements could be material but not pervasive.

The auditor should express an **adverse opinion** if, having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

The auditor should **disclaim an opinion** if, having been unable to obtain sufficient appropriate audit evidence on which to base the opinion, the auditor concludes that the effects on the financial statements of any undetected misstatements could be both material and pervasive. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the audit scope that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

Figure 31 shows the situations were a modified opinion is appropriate.

Figure 31: When to Modify the Audit Opinion



Where the opinion is modified the reasons should be put in perspective by clearly explaining, with reference to the applicable criteria, the nature and extent of the modification. Depending on the type of audit, recommendations for corrective action and any contributing internal control deficiencies may also be included in the report.

When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the opinion paragraph. ISSAI #2705 provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

An explanation of the different opinions should be attached to all financial statements audit reports, to explain to readers the range of possible opinions and what they mean – see Figures 32-34.

Figure 32: Form and Content of a Qualified Opinion

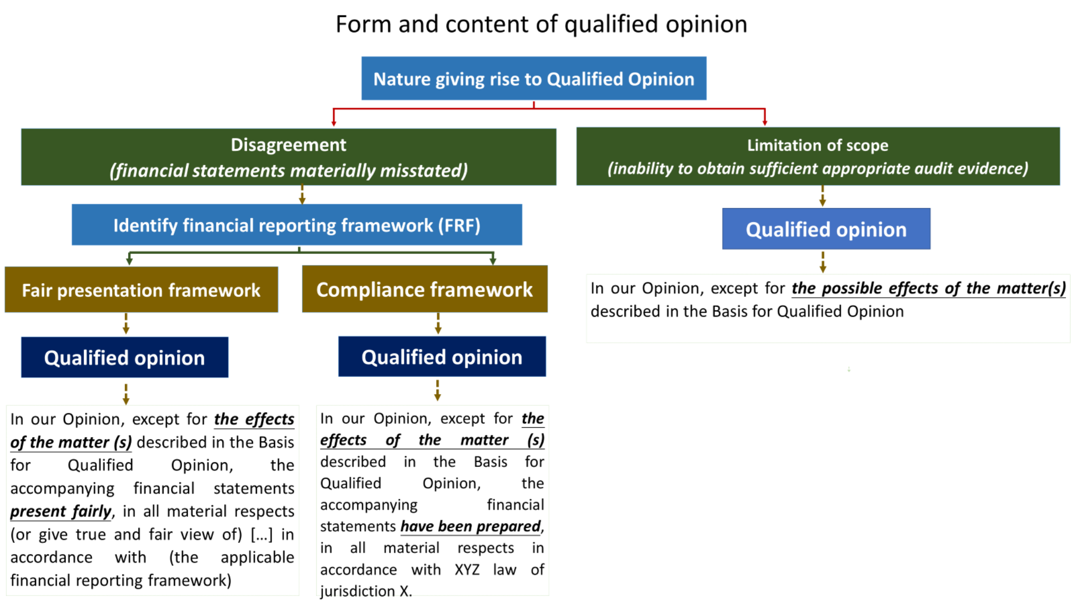


Figure 33: Adverse Opinion on the Financial Statements

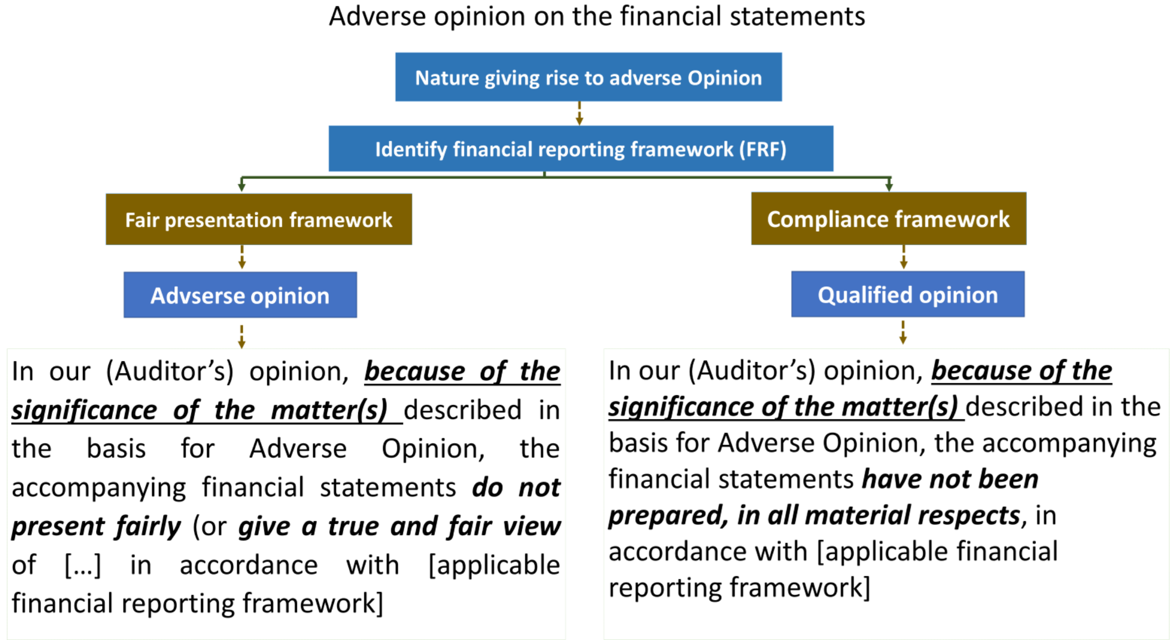
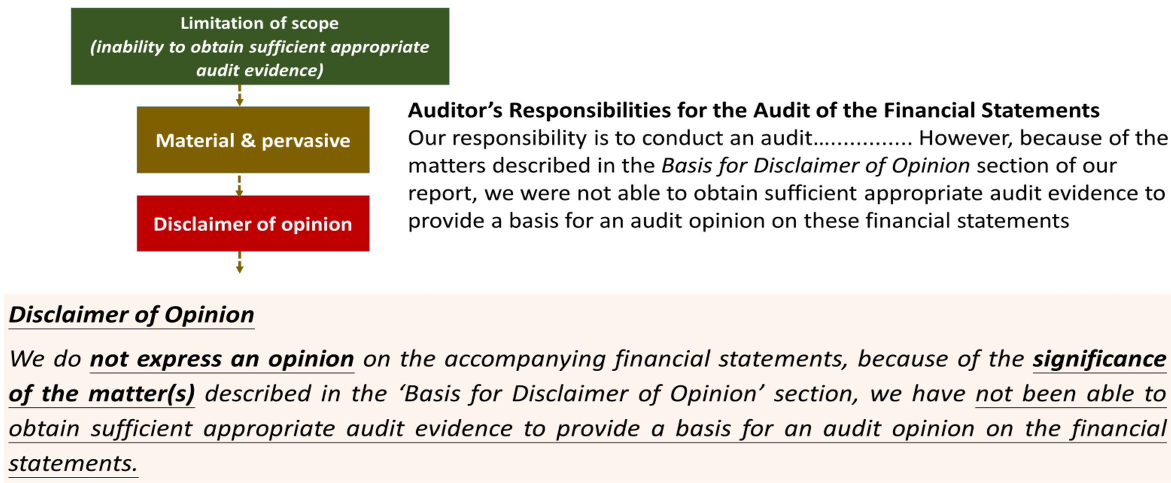


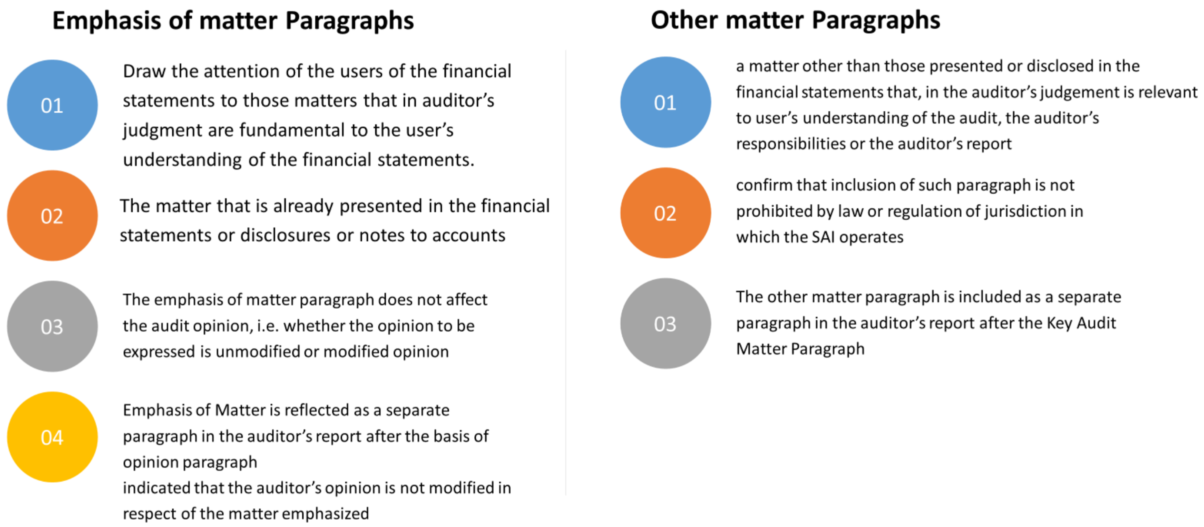
Figure 34: Disclaimer of Opinion on the Financial Statements



If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, but there is sufficient appropriate evidence that the matter is not materially misstated in the financial statements, the auditor should include an **Emphasis of Matter paragraph** in the auditor's report. Emphasis of Matter paragraphs should only refer to information presented or disclosed in the financial statements. An Emphasis of Matter paragraph should:

- be included immediately after the opinion;
- use the Heading "Emphasis of Matter" or another appropriate heading:
  - include a clear reference to the matter being emphasised and indicate where the relevant disclosures that fully describe the matter can be found in the financial statements; and
  - indicate that the auditor's opinion is not modified in respect of the matter emphasised.

Figure 35: Emphasis of Matter Paragraphs



For audits of financial statements, there are standard formats that should be adhered to. This is contained in the separate volume of templates and case studies as **Templates 16 to 21.**

You should also refer to the **Case Study Part Two** in the same volume.

Chapter 12: Reporting

This chapter examines: Introduction; Preparing the Statutory Audit Report; Contents of Financial Statements Audit Report; Management Letter; Following-Up on Audit Recommendations; Considerations Related to the Reporting of Suspected Unlawful Acts; and Case Study.

There are no specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

12.1 Introduction

It is important that SAI understand the difference between the Statutory Audit Report (SAR) (usually to the legislative assembly) in which the SAI provides its opinion on the Annual Financial Statements (AFS) together with a report providing supporting evidence and a Management Letter (or report) which, as the name indicates, is a communication with those responsible for drawing up the AFS. This, typically, contains less material information than SAR. This is dealt with in section 13.6 below.

It is also necessary to know the differences between reporting under a General Purpose Framework and a Special Purpose Framework.

Figures 36-37 summarise the audit reporting processes.

Figure 36: Overview of Reporting

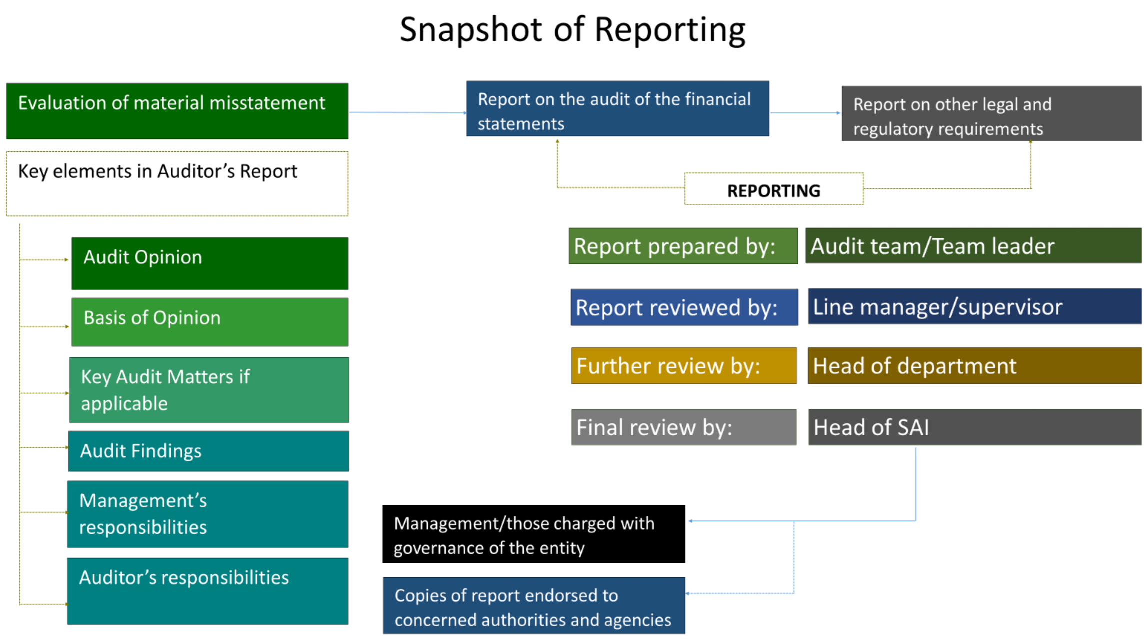
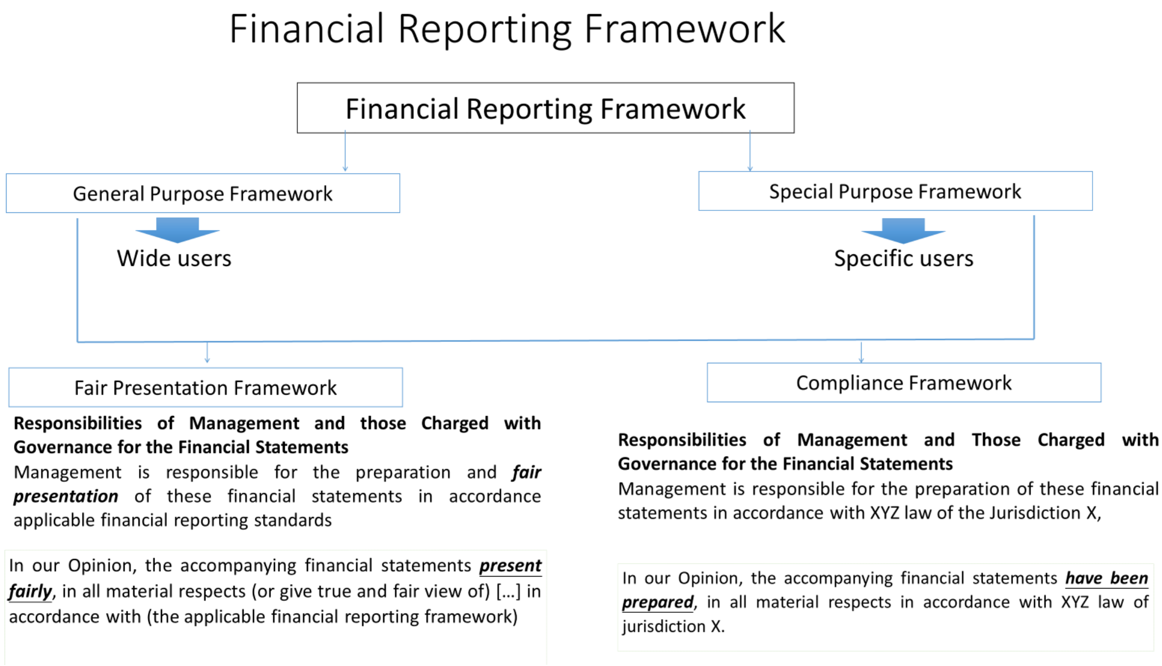


Figure 37: Financial Reporting Framework



12.2 Preparing the Statutory Audit Report

ISSAI prescribe that auditors prepare a report on the conclusions reached to communicate the results to stakeholders, others responsible for governance and the general public. The primary objective of the SAI is to present an annual report to Parliament on the execution of the budget. To accomplish this, the SAI performs a number of audits: Financial Audits and Compliance Audits related of the Annual Financial Statements. This chapter elaborates on reporting about both types of audits.

The report is the major means of conveying the results of the audit work. The quality of this document is critical to ensuring that the conclusions and recommendations will be seriously taken into account. The report should include all deviations and violations so that corrective actions can be taken, and so that those accountable can be held responsible for their actions (ISSAI #200, #400, #2700, #2705 and #2706).

Reporting may vary between brief standardised opinions and various forms of conclusions, presented in short or long form. However, it appears, the report should be timely, complete, accurate, objective, convincing and as clear and concise as the subject matter or subject matter information permits. Any limitations in the audit scope should be described. The report should clearly state the relevance of the criteria used and the level of assurance provided.

The principle of completeness requires the auditor to consider all relevant audit evidence before issuing a report. The principle of objectivity requires the auditor to apply professional judgement and scepticism in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and balanced manner. The principle of timeliness implies preparing the report in due time. The principle of a contradictory process implies checking the accuracy of facts with the audited entity and incorporating responses from responsible officials as appropriate. In both form and content, a compliance audit report should conform to all these principles.[56]

Figure 38 provides an example of a Summary of Issues Identified Form.

56 ISSAI #400:59.

Figure 38: Summary of Issues Identified Form

Finding	Impact	Priority (H, M or L)	Recommendation	Management Response
1.				
2.				
3.				
4.				

Figure 39 provides an example of an Action Plan Form for implementing the audit recommendations.

Figure 39: Action Plan Form

Agreed Recommendation	Agreed Action	Target Date	Responsible Authority	Responsible Officer
1.				
2.				
3.				
4.				

The conclusion may take the form of a clear written statement of opinion on compliance, often in addition to the opinion on the financial statements. It may also be expressed as a more elaborate answer to specific audit questions. While an opinion is common in attestation engagements, the answering of specific audit questions is more often used in direct reporting engagements. Where an opinion is provided the auditor should state whether it is unmodified or has been modified on the basis of the evaluation of materiality and pervasiveness.

The report must be complete, objective and provide up-to-date information. It has to be factually correct, presenting the findings in their proper perspective and in a balanced manner.

Table 18 indicates the features required to meet the reporting standards.

Table 18: Reporting Features Required to Meet Standards

Audit Reports should be:	
Accessible	The report should be simple to be easily accessible to the addressees. The language used should be as clear and simple as possible. When specific technical terms, abbreviations or acronyms are used, these must be carefully defined in a separate glossary.
Accurate	The report should be based on sufficient, relevant and reliable evidence. The audit scope, methodology, procedures and findings should be accurately described. Any inaccuracy in the audit report may create doubts on the validity of the whole report or distract attention from important issues.
Complete	The report should be complete as per the audit plan.
Comprehensive	The report should include the information necessary to understand the conclusions reached.
Objective	As per the INTOSAI Audit Standards, the audit report should be “independent, objective, fair and constructive”. The impact of an audit report is significantly higher when the audit evidence is presented in an objective and impartial manner. The existence of any conflict of interests with the audited entity may create suspicion and may affect the credibility, the independence and the objectivity of the audit reports, of the auditors involved and of the audit institution itself.
Credible	The audit report must be persuasive and credible. The information presented must be sufficient and relevant in order to convince users that findings are real, the reality of the findings, conclusions are reasonable, and that implementing the recommendations would be beneficial. The audit report should include only findings supported by sufficient and relevant evidence. The audit opinion must be supported by evidence justifying the conclusions reached.
Clear	The auditor will ensure that the opinion and findings are expressed accurately and without possibility of misinterpretation. The auditor therefore should use standard phrasing with a generally accepted content and meaning. The report should have a logical structure. The facts and conclusions should be presented accurately. Adequate headings make reports more accessible and easier to understand. Tables, graphics and diagrams may be used to summarise complex information.
Concise	The audit report should be concise and should contain only the issues relevant to the audit purpose, without including non-significant details that may affect the accessibility and the credibility of the report.
Competent	The audit report should be drawn up in a way that reflects the competence and professionalism of the auditors and the quality of the audit activity performed.

12.3 Contents of Financial Statements Audit Reports

This section outlines the high-level contents of a Financial Statements Audit Report. Auditors should refer to the detailed model report for more specific guidance; this section refers to the considerations involved in each part of the report, which should be structured as follows:

COVER PAGE

"Draft/Final (as appropriate) Audit Report on [Organisation Name] for the year ended 31st December 20XX"

TRANSMITTAL LETTER

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

1. EXECUTIVE SUMMARY

This provides a brief description of the subject matter and a reference to the fact that the assignment was carried out in accordance with appropriate international standards.

At the beginning of the report, a summary of the audit opinion should be given. This should be followed by a brief summary of each material finding on which this opinion was based. Finally, a summary statement of recommendations should be presented.

The aim of this section is to enable users to see at a glance what the salient details are. It is important to strike a balance: the executive summary should not be so detailed that it is merely a copy of the rest of the report, but it should also not be so devoid of detail that it becomes meaningless. Ideally, the Executive Summary should normally only be about one page in length although this may vary depending on the complexity of the issues involved.

2. INTRODUCTION

This presents a brief description of what a regularity audit is, followed by a reminder that the management team at the audited body is responsible for preparing the financial statements.

3. STATUS OF PRIOR YEAR RECOMMENDATIONS

It is important that the number of prior year's recommendations is shown as well as the number actually implemented. A brief analysis of those not yet implemented should also be presented along with explanations, if any, for their non-implementation.

4. AUDIT SCOPE

This section explains the audit objectives and scope.

5. AUDIT APPROACH

This outlines the approach the audit team adopted during the audit. This will often consist of a standard set of statements. However, the auditors should always be aware of any unusual situations that might arise and vary the wording accordingly. Guidance must not be understood as restrictive and auditors should always be prepared to use their own professional judgement.

5. AUDITOR'S RESPONSIBILITY

A section stating that the responsibility of the auditor is to express an opinion based on the audit of the financial statements, and describing an audit as involving procedures to obtain audit evidence about the amounts and disclosures in the financial statements, the procedures selected being dependent on the auditor's judgement as to, inter alia, the risks of material misstatement of the financial statements, whether due to fraud or error. In making the risk assessment, the auditor should consider internal controls relevant to the entity's preparation of the financial statements and design audit procedures that are appropriate in the circumstances. This section should also refer to the evaluation of the appropriateness of the accounting policies used and the reasonableness of the accounting estimates made by the management, as well as the overall presentation of the financial statements. It should be stated whether the auditor believes that the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

6. AUDIT OPINION

This should give the audit opinion along with a brief summary of the reasons for that opinion. The auditor has to sign and date this opinion.

A number of opinions may be used, following standardised wording. Further guidance is provided below and in ISSAI #2700.

7. BACKGROUND

A brief background of the audited body should be presented here.

8. GOVERNANCE AND MANAGEMENT OF THE AUDITED BODY

The user will need to understand the audited body's governance arrangements. This will vary depending on the differing types of organisations (e.g. Ministries, Municipalities, and State-Owned Enterprises) that may be audited.

9. FINANCING

This will also vary depending on the types of organisations being audited.

10. KEY AUDIT FINDINGS AND RECOMMENDATIONS

This is the crux of the report. It is important that this section in particular be properly organised, with a set of clear, numbered findings, each of which is followed by a conclusion and a recommendation.

There are several important factors to bear in mind when preparing this section. Firstly, only material items should be included here. Non-material items that nevertheless require some corrective management action should be outlined in a Management Letter. Otherwise the reader will be faced with a confusing mix of material and non-material items and will find it difficult to distinguish which is which.

Secondly, the auditor must present sufficient information for the reader to realise why a certain conclusion has been made. In this respect, it can be helpful to:

- Mention the sample size that was used and the number of "failures" that were identified when deciding whether or not a system's controls function adequately or not;
- Mention numerical or monetary values so that the reader can see why the auditors has decided that a misstatement is material; and
- Include the key analyses in narrative form.

12.4 Management Letter

During the course of the audit, the auditors may discover issues which, whilst not material enough to materially affect the financial statements, nevertheless need to be reported to management. The management letter should:

- Focus on essentials and be brief:
- Be forwarded to the audited entity's management in a draft version for confirmation as to factual accuracy;
- If it exceeds more than two pages, commence with a brief summary highlighting the most important observations and recommendations;
- Provide the audited body with an opportunity to submit a report on the actions it has taken or intends to take as a result of the observations made;
- Include specific recommendations that are possible to follow up at a later stage; and
- Paint a true and fair overall picture. As applicable, it is important to be positive and highlight improvements made as a result of previous recommendations, in addition to any problems identified.

The aim of a management letter is to highlight essential information for the accountable managers, and which requires action to be taken on their part. Normally a response to the letter should be requested, describing the actions that management intends to take in response. The only exception to this is if the report is specifically designed to be for information only.

Since the management letter is also addressed to persons who may not be familiar with the specific details of all operations, the content shall be formulated in such a way that persons without detailed knowledge of the operations should be able to understand it. Emphasis should be given to observations of significant deficiencies in the design or effectiveness of internal controls so that management can take the appropriate corrective action(s). Confirmation can also be sought from management regarding the various circumstances that may be important for planning purposes.

Examples of these topics can include management accountability, management intentions with regards to various issues, and the measures planned by management to remedy deficiencies that have been identified.

12.5 Following-Up on Audit Recommendations

Since the SAI aims at improving public governance it is important that the governing authority implements measures in reaction upon the recommendations of the SAI.

Therefore, the SAI shall adopt a strategy to follow up on its recommendations. A follow-up process facilitates the effective implementation of corrective action and provides useful feedback to the audited entity, the users of the audit report and the auditor (for future audit planning).

Follow-up focuses on whether the audited entity has adequately addressed the matters raised, including any wider implications. Insufficient or unsatisfactory action by the audited entity may call for a further report by the SAI.

Follow-up by the SAI on the implementation of recommendations can take two forms:

- The audited entity is required to send a report on the implementation of the recommendations within a period stated in the audit report; or

- The SAI carries out follow-up audits as a part of a subsequent audit of the same entity or as a separate assignment.

Figure 40: Summary of Follow Up Action on Audit Qualification

Accounting year	Total number of basis for qualified opinion	No. of basis for qualified opinion implemented	No. of basis for qualified opinion partially implemented	Balance of basis for qualified opinion to be implemented
Guide	*Refer from the Paragraph on 'Basis of Qualified Opinion' in the auditor's report on FS.*	*Inquire the management or review evidence (documents) of qualifications if resolved.*	*Review evidence and apply professional judgement to record the status of instances under 'Basis of qualified opinion' as partially implemented*	*After considering the status of fully implemented and partially implemented, record balance to be implemented here.*
20….				
20……				
20….				

Figure 41: Summary of Follow Up Action on Management Report

Accounting Year	Total number of audit observations in the management report	No. of audit observations implemented	No. of audit observations partially implemented	Balance of audit observations to be implemented
Guide	*SAIs may have different practices or reporting audit unresolved observations (generally referred as management report)*	*Inquire the management or review evidence (documents) of audit observations if resolved.*	*Review evidence and apply professional judgement to record the status of audit observations as partially implemented*	*After considering the status of fully implemented and partially implemented, record balance to be implemented here.*
20X1				
20X2				

Figure 42: Detailed Follow Up Report

Observation Reference No.	Audit observations in brief (from the management report)	Management's response – current status	SAIS's further comments
Guide	*Extract an observation in brief from the management report*	*Request for written response from the management along with supporting documents of actions being taken on audit observations*	*Indicate as implemented, not implemented, partially implemented. State further comments for status having 'partially implemented' and 'not implemented'*
00.01			
00.02			
Reference No.	**Basis for qualified opinion in brief**	**Management's response – current status**	**SAIS's further comments**
Guide	*Extract from this from the auditor's report on financial statement*	*Request for written response from the management along with supporting documents of actions being taken on audit observations*	*Indicate as implemented, not implemented, partially implemented. State further comments for status having 'partially implemented' and 'not implemented'*
20X1			
20X2			

12.6 Considerations Related to the Reporting of Suspected Unlawful Acts

Detecting potential unlawful acts, including fraud, is not the main objective of an audit. However, including and assessing fraud risk factors is part of the audit and any indications of unlawful acts, including fraud, must be reported as required by legislation (ISSAI #2240).

12.7 Case Study

A detailed Case Study has been prepared on how to audit Annual Financial Statements and how to report on them.

Part 1 of the Case Study covers “How to Audit AFS” and Part 2 of the Case Study covers “How to Form an Opinion”. They are contained in the separate volume of templates and case studies.

Chapter 13: Sampling and Analytical Review

There are no new specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

13.1 Introduction

This chapter examines sampling and analytical review.

13.2 Audit Sampling (ISSAI #2530)

13.2.1 Introduction

Audit sampling is a type of analytical procedures meant to either:

- test the reliability of a population with a large number of items; or
- determine the (most likely) total amount of errors in the population.

The **main characteristics** of are:

- Random selection of the sample items; and
- The use of probability theory to evaluate sample results, including measurement of sampling risk.

Audit sampling is the application of audit procedures to less than 100% of items within a population of audit relevance where all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population. Sampling is a method broadly used when large database of information and transactions have to be audited. It is effective when data is recorded in information systems under the same rules, characteristics and allows for random selection of items or monetary units.

The objective of the auditor, when using audit sampling, is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

More guidance on audit sampling as well as instruction how to apply sampling can be found in ISSAI #2530 and more specific the annex to ISA #530.

13.2.2 Definitions

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

For purposes of this manual **"error"** means control deviations, when performing tests of control, or misstatements, when performing substantive procedures. Similarly, total error is used to mean either the rate of deviation or total misstatement.

"Anomalous Error" means an error that arises from an isolated event that has not recurred other than on specifically identifiable occasions and is therefore not representative of errors in the population.

"Population" means the entire set of data from which a sample is selected, and about which the auditor wishes to draw conclusions. For example, all of the items in an account balance or a class of transactions constitute a population. 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 SAI's conclusion, based on a sample, may be different from the conclusion reached if the entire population were subjected to the same audit procedure.

There are two types of sampling risk:

- The risk that the SAI will conclude, in the case of a test of control, that control risk is lower than it actually is, or in the case of a substantive test, that a material error does not exist when in fact it does. This type of risk affects audit effectiveness, and is more likely to lead to an inappropriate audit opinion; and
- The risk that the SAI will conclude, in the case of a test of control, that control risk is higher than it actually is or, in the case of substantive test, that a material error exists when in fact it does not. This type of risk affects audit efficiency, as it would usually lead to additional work to establish that the initial conclusions were incorrect.

The mathematical complements of these risks are termed **confidence levels.**

"Non-sampling Risk" arises from factors that cause the SAI to reach an erroneous conclusion, for any reason not related to the size of the sample. For example, most audit evidence is persuasive rather than conclusive, and the SAI might use inappropriate procedures, or the SAI might misinterpret evidence, and fail to recognise an error.

"Sampling Unit" means the individual items constituting a population for example cheques listed on deposit slips, credit entries on bank statements, invoices or accounts receivable balances, or a monetary unit.

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

- Random selection of a sample, and
- Use of probability theory to evaluate sample results, including measurement of sampling risk.

A sampling approach that does not have these characteristics is considered non-statistical sampling.

"Stratification" is 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" means the maximum error in a population that the SAI is willing to accept.

13.2.3 Audit Evidence

Audit Evidence is obtained from an appropriate mix of tests of control and substantive procedures. The type of test to be performed is important for an understanding of the application of audit procedures in gathering audit evidence.

13.2.4 Tests of Control

Based on the SAI's understanding of the accounting and internal control systems, the SAI identifies the characteristics or attributes that indicate performance of a control, as well as possible deviation conditions that indicate departures from adequate performance. The presence or absence of attributes can then be tested by the SAI.

Audit sampling for tests of control is generally appropriate when application of the control leaves documentary evidence of performance, for example, initials of the credit manager on a sales invoice indicating credit approval, or evidence of authorisation of data input to a micro-computer-based data processing system.

13.2.5 Substantive Procedures

Substantive procedures are concerned with amounts and are of two types: analytical procedures and tests of details of transactions and balances. The purpose of substantive procedures is to obtain audit evidence to detect material misstatements in the financial statements.

When performing substantive tests of details, audit sampling and other means of selecting items for testing and gathering audit evidence may be used to verify one or more assertions about a financial statement amount, for example, the existence of account receivable, or to make an independent estimate of some amount, for example, the value of obsolete inventories.

13.2.6 Risk Consideration in Obtaining Evidence

In obtaining evidence, the SAI should use professional judgement to assess audit risk, and design audit procedures to ensure this risk is reduced to an acceptably low level.

Audit Risk is the risk that the SAI gives an inappropriate audit opinion when the financial statements are materially misstated.

Audit risk consists of:

- **inherent risk**: the susceptibility of an account balance to material misstatement, assuming there are no related internal controls;
- **control risk:** the risk that a material misstatement will not be prevented or detected and corrected on a timely basis by the accounting and internal control systems; and
- **detection risk:** the risk that the material misstatements will not be detected by the SAI's substantive procedures.

These three components of audit risk are considered during the planning process in the design of audit procedures, in order to reduce audit risk to an acceptably low level.

Sampling risk and non-sampling risk can affect the components of audit risk.

For example, when performing tests of control, the SAI may find no errors in a sample, and conclude that control risk is low, when the rate of error in the population is, in fact, unacceptably high (sampling risk).

Or there may be errors in the sample that the SAI fails to recognise (non-sampling risk).

With respect to substantive procedures, the SAI may use a variety of methods to reduce detection risk to an acceptable level. Depending on their nature, these methods will be subject to sampling and/or non-sampling risks.

For example, the SAI may choose an inappropriate analytical procedure (non-sampling risk) or may find only minor misstatements in a test of details when, in fact, the population misstatement is greater than the tolerable amount (sampling risk). For both tests of control and substantive tests, sampling risk can be reduced by increasing the sample size, while non-sampling risk can be reduced by proper engagement planning, supervision, and review.

13.2.7 Procedures for Obtaining Evidence

Procedures for obtaining audit evidence include inspection, observation, enquiry and confirmation, computation and analytical procedures. The choice of an appropriate procedure is a matter of professional judgement in the circumstances. Application of these procedures will often involve the selection of items for testing from population.

13.2.8 Selecting Items for Testing to Gather Audit Evidence

When designing auditing procedures, the SAI should determine appropriate means of selecting items for testing. The means available to the SAI are:

- Selecting all items (100% examination);
- Selecting specific items; and
- Audit sampling.

The decision as to which approach to use will depend on the circumstances, and the application of any one or combination of the above means may be appropriate in particular circumstances. While the decision as to which means, or combination of means, to use is made on the basis of audit risk and audit efficiency, the SAI needs to be satisfied that methods used are effective in providing sufficient appropriate audit evidence to meet the objectives of the test.

13.2.9 Selecting All Items

The SAI may decide that it will be most appropriate to examine the entire population of items that make up an account balance or class of transactions, or a stratum within that population. 100% examination is unlikely in the case of tests of control; however, it is more common for substantive procedures.

For example, 100% examination may be appropriate when the population constitutes a small number of large value items, when both inherent and control risks are high, and other means do not provide sufficient appropriate audit evidence, or when the repetitive nature of a calculation or other process performed by a computer information system makes a 100% examination cost- effective.

13.2.10 Selecting Specific Items

The SAI may decide to select specific items from a population based on such factors as knowledge of the client’s operations, preliminary assessments of inherent and control risks, and the characteristics of the population being tested. The judgemental selection of specific items is subject to non-sampling risk.

Specific items selected may include:

- **High Value or Key Items:** The SAI may decide to select specific items within a population because they are of high value, or exhibit some other characteristics, for example, items that are suspicious, unusual, particularly risk-prone or that have a history of error;
- **All Items over a Certain Amount:** The SAI may decide to examine items whose values exceed a certain amount so as to verify a large proportion of the total amount of an account balance or class of transactions;
- **Items to Obtain Information:** The SAI may examine items to obtain information about matters such as the entity's operations, the nature of transactions, accounting and internal control systems;
- **Items to Test Procedures:** The SAI may use judgement to select and examine specific items to determine whether or not a particular procedure is being performed; and
- **Extent of Tests of Control:** The SAI may use judgemental tests of detail control, of daily control, of monthly control and yearly control.

While selective examination of specific items from an account balance or class of transactions will often be an efficient means of gathering audit evidence, it does not constitute audit sampling. The results of procedures applied to items selected in this way cannot be projected to the entire population. The SAI considers the need to obtain appropriate evidence regarding the remainder of the population when that remainder is material.

13.2.11 Audit Sampling

The SAI may decide to apply audit sampling to an account balance or class of transactions. Audit sampling is discussed in detail under the heading of design of the sample.

13.3 Statistical versus Non-statistical Sampling Approaches

The decision whether or not to use a statistical or non-statistical sampling approach is a matter for the SAI's judgement regarding the most efficient manner to obtain sufficient appropriate audit evidence in the particular circumstances.

For example, in the case of tests of control the SAI's analysis of the nature and cause of errors will often be more important than the statistical analysis of the mere presence or absence of errors, that is, the count of errors. In such a situation non-statistical sampling may be most appropriate.

When applying statistical sampling, the sample size can be determined using either probability theory or professional judgement. Moreover, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Often, while the approach adopted does not meet the definition of statistical sampling, elements of a statistical approach are used, for example random selection using computer-generated random numbers. However, only when the approach adopted has all the characteristics of statistical sampling are statistical measurements of sampling risk valid.

13.4 Design of the Sample

When designing an audit sample, the SAI should consider the objectives of the test, and the attributes of the population from which the sample will be drawn.

The SAI first considers the specific objectives to be achieved, and the combination of audit procedures that is likely to achieve those objectives best. Consideration of the nature of the audit evidence sought and possible error conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes an error and what population to use for sampling.

The SAI considers what conditions constitute an error by reference to the objectives of the test. A clear understanding of what constitutes an error is important to ensure that all, and only, those conditions that are relevant to the test objectives are included in the projection of errors. For example, in a substantive procedure relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date, but received shortly after that date by the entity would not be considered an error. Also, a miss-posting between customer accounts does not affect the total accounts receivable balance. Therefore, it is not appropriate to consider this an error in evaluating the sample results of this particular procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the likelihood of fraud or the adequacy of the allowance for doubtful accounts.

When performing tests of control, the SAI generally makes a preliminary assessment of the rate of error the SAI expects to find in the population to be tested and the level of control risk. This assessment is based on the SAI's prior knowledge or the examination of a small sample of items from the population. Similarly, for substantive tests, the SAI generally makes a preliminary assessment of the amount of error in the population. These preliminary assessments are useful for designing an audit sample and in determining sample size (see Annex 18). For example, if the expected rate of error is unacceptably high, tests of control will normally not be performed. Or, when performing substantive procedures, if the expected amount of error is high, 100% examination or the use of a large sample size may be appropriate.

13.5 Population

It is important for the SAI to ensure that the population is:

- **Appropriate to the objective of the sampling procedure**: which will include consideration of the direction of testing. For example, if the SAI's objective is to test for overstatement of accounts payable, the population could be defined as the accounts payable listing. On the other hand, when testing for understatement of accounts payable, the population is not the accounts payable listing but rather subsequent disbursements, unpaid invoices, suppliers' statements, unmatched receiving reports or other populations that would provide audit evidence of understatement of accounts payable, and
- **Complete**: for example, if the SAI intends to select payment vouchers from a file, conclusions cannot be drawn about all vouchers for the period unless the auditor is satisfied that all vouchers have in fact been filed. Similarly, if the SAI intends to use the sample to draw conclusions about the operation of an accounting and internal control system during the financial reporting period, the population needs to include all relevant items from throughout the entire period. A different approach may be to satisfy the population and use sampling only to draw conclusions about the control during, say, the first 10 months of a year, and to use alternative procedures or a separate sample regarding the remaining two months.

13.6 Stratification

Audit efficiency may be improved if the SAI stratifies a population by dividing it into discrete sub-populations that have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and, therefore, allow sample size to be reduced without a proportional increase in sampling risk. Sub-populations need to be carefully defined so that any sampling unit can only belong to one stratum.

When performing substantive procedures, an account balance or class of transactions is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items that may contain the greatest potential monetary error in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of error, for example, when testing the valuation of accounts receivable, balances may be stratified by age.

The results of procedures applied to a sample of items with a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the SAI will need to consider risk and materiality in relation to whatever other strata make up the entire population. For example, 20% of the items in a population may make up 90% of the value of an account balance. The SAI may decide to examine a sample of these items. The SAI evaluates the results of this sample and concludes on the 90% of value separately from the remaining 10%, on which a further sample or other means of gathering evidence will be used, or which may be considered immaterial.

13.7 Value Weighted Selection

It will often be efficient in substantive testing, particularly when testing for overstatements, to identify the sampling unit as the individual monetary units, for example, dollars, that make up an account balance or class of transactions.

Having selected specific monetary units from within the population, for example the accounts receivable balance, the SAI then examines the particular items, for example, individual balances, that contain those monetary units.

This approach to defining the sampling unit ensures that audit effort is directed to the larger value items because they have a greater chance of selection and can result in smaller sample sizes. This approach is ordinarily used in conjunction with the systematic method of sample selection and is most efficient when selecting from a computerised database.

13.8 Sample Size

In determining the sample size, the SAI should consider whether or not sampling risk is reduced to an acceptably low level.

Sample size is affected by the degree of sampling risk that the SAI is willing to accept. The lower the risk the SAI is willing to accept, the greater the sample size will need to be.

The sample size can be determined by the application of a statistically based formula, or through the exercise of professional judgement objectively applied to the circumstances.

13.9 Selecting the Sample

The SAI should select items for the sample with the expectation that all sampling units in the population have a chance of selection.

Statistical sampling requires that sample items be selected at random so that each sampling unit has a known chance of being selected. The sampling units might be physical items (such as invoices) or monetary units.

With non-statistical sampling, the SAI uses professional judgement to select the items for a sample. Because the purpose of sampling is to draw conclusions about the entire population, the SAI endeavours to 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 principal methods of selecting samples are the use of random number tables or computer programmes, systematic selection and haphazard selection.

13.10 Performing the Audit Procedure

The SAI should perform audit procedures appropriate to the particular test objective on each item selected.

If a selected item is not appropriate for the application of the procedure, the procedure is ordinarily performed on a replacement item. For example, a voided cheque may be selected when testing for evidence of payment authorisation. If the SAI is satisfied that the cheque had been properly voided so that it does not constitute an error, an appropriately chosen replacement is examined.

Sometimes, however, the SAI is unable to apply the planned audit procedures to a selected item, because, for instance, documentation relating to that item has been lost. If suitable alternative procedures cannot be performed on that item, the SAI ordinarily considers that item to be in error. An example of a suitable alternative procedure might be the examination of subsequent receipts when no reply has been received in response to a positive confirmation request.

13.11 Nature and Cause of Errors

The SAI should consider the sample results, the nature and cause of any errors identified and their possible effect on the particular test objective and on other areas of the audit.

When conducting tests of control, the SAI is primarily concerned with the design and operation of the controls themselves and the assessment of control risk. However, when errors are identified, the SAI also needs to consider matters such as:

- The direct effect of identified errors on the financial statements; and
- The effectiveness of the accounting and internal control system and their effect on the audit approach when, for example, the errors result from management override of an internal control.

In analysing the errors discovered, the SAI may observe that many have a common feature, for example, the type of transaction, location, product line or period of time. In such circumstances, the SAI may decide to identify all items in the population that possess the common feature and extend audit procedures in that stratum. In addition, such errors may be intentional, and may indicate the possibility of fraud.

Sometimes the SAI may be able to establish that an error arises from an isolated event that has not recurred other than on specifically identifiable occasions and is therefore not representative of similar errors in the population (an anomalous error).

To be considered an anomalous error, the SAI has to have a high degree of certainty that such error is not representative of the population. The SAI obtains this certainty by performing additional work.

The additional work depends on the situation but is adequate to provide the SAI with sufficient appropriate evidence that the error does not affect the remaining part of the population. One example is an error caused by a computer breakdown that is known to have occurred on only one day during the period.

In that case, the SAI assesses the effect of the breakdown, for example, by examining specific transactions processed on that day, and considers the effect of the cause of the breakdown on audit procedures and conclusions. Another example is an error that is found to be caused by use of an incorrect formula in calculating all inventory values at one particular department. To establish that this is an anomalous error, the SAI needs to ensure that the correct formula had been used at the other departments.

13.12 Projecting Errors

For substantive procedures the SAI should project monetary errors found in the sample to the population and should consider the effect of the projected error on the particular test objective and on the other areas of the audit. The SAI projects the total error for the population to obtain a broad view of the scale of errors, and to compare this to the tolerable error. For substantive procedures, tolerable error is the tolerable misstatement, and will be an amount less than or equal to the SAI's preliminary estimate of materiality used for the individual account balances being audited.

When an error has been established as an anomalous error, it may be excluded when projecting sample errors to the population. The effect of any such error, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous errors. If an account balance or class of transactions has been divided into strata, the error is projected for each stratum separately. Projected errors plus anomalous errors for each stratum are then combined when considering the possible effect of errors on the total account balance or class of transactions.

For tests of control, no explicit projection of errors is necessary, since the sample error rate is also the projected rate of error for the population as a whole.

13.13 Evaluating the Sample Results

The SAI should evaluate the sample results to determine whether or not the preliminary assessment of the relevant characteristic of the population is confirmed or needs to be revised. In the case of a test of controls, an unexpectedly high sample error rate may lead to an increase in the assessed level of control risk, unless further evidence substantiating the initial assessment is obtained. In the case of a substantive procedure, an unexpectedly high error amount in a sample may cause the SAI to believe that an account balance or class of transactions is materially misstated, in the absence of further evidence that no material misstatement exists.

If the total amount of projected error plus anomalous errors is less than but close to that which the SAI deems tolerable, the SAI considers the persuasiveness of the sample results in the light of other audit procedures. The total of projected error plus anomalous error is the auditor's best estimate of error in the population. However, sampling results are affected by sampling risk. Thus, when the best estimate of error is close to the tolerable error, the SAI recognises the risk that a different sample would result in a different best estimate that may exceed the tolerable error. Considering the results of other audit procedures helps the auditor to assess this risk, while the risk is reduced if additional audit evidence is obtained.

If the evaluation of sample results indicates that the preliminary assessment of the relevant characteristics of the population needs to be revised, the SAI may:

- Request management to investigate identified errors and the potential for further errors, and to make any necessary adjustments, and/or

- Modify planned audit procedures. For example, in the case of a test of control, the SAI might extend the sample size, test an alternative control or modify related substantive procedures, and/or
- Consider the effect on the audit report.

13.14 Sampling and Testing

13.14.1 Introduction

The objective of an audit is to form an opinion on a set of financial statements and the auditor's approach will involve sampling and testing in various areas.

The techniques employed are based on an assumption that examination of a portion of the accounting entries or other data will reveal the same characteristics as would an examination of all items.

Testing can be broadly divided into two areas: compliance testing and substantive testing.

13.14.2 Compliance Testing

Compliance tests are tests to determine whether the prescribed accounting systems and internal controls actually exist and are being complied with.

They are usually concerned with questions such as:

- Were the necessary procedures performed?;
- How well were they performed?; and
- By whom where they performed?

The only method of sampling to be used for compliance testing is systematic sampling. This consists of selecting every *n*th item (e.g. every 20th item). Providing that the method of filing does not create a pattern and you start from a random point and cover all the items this will approximate to a random sample.

Conclusions will be drawn from this on the reliability or otherwise of the system. This will in turn lead to decisions with regard to the level of substantive tests required.

13.14.3 Substantive Testing

Substantive tests are tests to obtain evidence as to the validity and propriety of the accounting treatment of transactions and balances; the legality and prudence of the financial operations or, conversely, the nature and extent or errors and irregularities.

Substantive tests are of two types:

- Detailed tests of particular transactions and balances; and
- Analytical Reviews (q.v.) of significant ratios and trends.

A number of different forms of sampling can be used for substantive testing: random sampling, block or cluster sampling, stratified sampling, judgmental sampling and statistical sampling (Discovery and Monetary Unit).

13.14.4 Random Sampling

Items selected are drawn at random from the entire population so that each item has an equal chance of selection. Random sampling works best when each of the items in the population bears some sort of serial number. A table of random numbers, or a random number computer program, should be used to select the items.

13.14.5 Block or Cluster Sampling

Selects samples from a period (a week or a month) or a block of, say, one hundred items. It will rarely provide a representative sample and should only be used for small blocks throughout the period of the audit and then only in conjunction with other sampling methods.

13.14.6 Stratified Sampling

Where transactions or records vary in materiality or relative risk, they may be grouped and each group sampled separately.

Thus, items could be grouped: below O$10,000; O$10,000 to O$100,000 and over O$100,000 with differing sampling methods used for each.

13.14.7 Judgmental Sampling

This is where an auditor uses his experience or judgment in determining which items are to be examined. However, this introduces personal bias and it is hard to prove that the sample is representative. Its most useful application is in the selection of items from, say, the general ledger for further examination. They are selected on the basis of audit "nose" and "feel" for items which appear unusual.

13.15 Statistical Sampling

13.15.1 Introduction

The rest of this section is concerned with **statistical sampling.** The use of statistical sampling will enable an auditor to demonstrate that he has exercised "due care" during his audit examination.

An understanding of the mathematical basis underlying the sampling plans is not essential to the understanding of the basic technique.

13.15.2 Basic Principles of Statistical Sampling

Statistical sampling provides a means for measuring mathematically the degree of uncertainty that arises when full checking of a population is not carried out. Such quantification is not possible when samples have been selected using a judgment technique.

The main elements of statistical sampling are:

- The use of statistical methods in deciding the size and nature of the population;
- The use of random selection methods to choose the sample from the population; and
- The use of statistical methods in evaluating the results of the test.

13.15.3 Population Definition

A population is a homogenous collection of items from which the sample will be drawn and about which the sample will provide information.

Conclusions are required for the whole population under review and care is required in selecting the sample to ensure that all items in the population have an equal chance of selection. To achieve the objective of certain audit tests it may be necessary to stratify the population.

13.15.4 Confidence Levels and Audit Risk

There are two inherent risks in auditing:

- That material errors will occur in the accounting process; and
- That such errors will not be detected by the auditor’s examination.

The auditor relies on internal control to reduce the first risk and on his tests and other procedures to reduce the second. However, if the auditor does not carry out a 100% check, he must accept that an element of risk will remain. The risk taken is that the particular test may not reveal all material errors. The risk is minimised by carrying out a programme of audit procedures, many of which are overlapping in nature, before audit opinion is given on the final accounts.

The confidence level is the measure of the amount of risk that the auditor is prepared to accept.

Based upon probability theory it is possible to conclude that in 95 out of 100 cases where an auditor was testing a population with an error rate of 3% he would find errors and would realise that the controls were not wholly reliable. However, in 5 cases out of 100 he would find no error and would conclude that the control was working satisfactorily.

This conclusion would be stated for compliance and weakness testing as follows:

> *“I am 95% confident that the error rate in the population is not greater than 3% otherwise I would have found at least one error in my sample.”*

The same conclusion would be stated for substantive testing as”

> *“I am 95% confident that the population is not overstated by more than VT x.”*

13.15.5 Random Selection

The principle of random selection is that the characteristic of the sample will be representative of the whole population. Differences between the characteristics of the sample and the population are known as sampling errors. A scientific assessment of the extent of the sampling error or risk can only be made providing the sample is randomly selected. Microsoft Excel can be used to generate random number tables.

Non-sampling errors are human errors which may occur even if a complete check is performed due to boredom or poor supervision.

13.15.6 Statistical Conclusions

The statistical evaluation is carried out by considering the errors found in the sample and extrapolating these to draw a conclusion expressed in terms of the maximum potential error. In fact, the statistical evaluation is measured in terms of a range being the upper and lower limit of potential error (i.e. Maximum potential error rate is 8%).

This means that the error rate in the population is between 3% and 8%. The lower limit of potential error is ignored and it is the upper limit which is of concern. However, it must be remembered that the conclusions are conservative as the maximum potential error is the maximum error which is statistically possible, expressed in terms of the confidence level set.

13.16 Sampling Plans

13.16.1 Introduction

For most auditing purposes the use of two types of sampling plans will suffice:

- **Discovery Sampling:** for compliance and weakness testing where the point of concern is the number of non-compliances of key internal controls regardless of their monetary value; and
- **Monetary Unit Sampling** for use in restricted situations where a statistical evaluation of the potential monetary error is required.

13.16.2 Discovery Sampling

Discovery sampling is sampling aimed at disclosing the number of errors in a population regardless of their monetary value. The objective is to see whether a specific attribute is present in the population. If no errors are found in the sample tested it is possible to place reliance on the control being tested.

The tolerable rate is the amount of error or noncompliance which, if present in the population, will be acceptable to satisfy the audit objectives.

The tolerable error rate, the confidence level and the sample size are inter-related variables and setting two of the variables enables the third to be calculated. Conversely, any change in one of the variables will cause a change in one or both of the other two variables. For example, an increase in the required confidence level from 90% to 95% will result in an increase in the sample size and/or an increase in the tolerable error rate.

The relationship between the variables is derived from mathematical probability theory and may be expressed as follows:

Sample Size = **<u>Confidence Factor for No Errors</u>**

Tolerable Error Rate

Assuming that:

- The population is greater than 1,000; and
- The error rate in the population is low.

The following procedure should be followed:

- Select the **Degree of Confidence** required for the test;
- Determine the **Tolerable Error Rate (TER**);
- From a table of Confidence Factors select the **Confidence Factor** for no errors applicable to the confidence required;
- **Calculate Sample Size** using the following formula:

  Sample Size = <u>Confidence Factor for No Errors</u>

  TER

- Determine the **number of errors** in the sample;

- From the cumulative table of Confidence Factors determine the **Confidence Factor** for the number of errors at the confidence level set; and
- Calculate the **Maximum Potential Error Rate (MPER)** using the following formula:

$$\textbf{MPER} = \frac{\textbf{Confidence Factor for number of errors located}}{\textbf{Sample Size}}$$

The Maximum Potential Error Rate may also be expressed in terms of the maximum number of items in the population which are in error. For example:

Population: 10,000

Confidence Level: 95%

Tolerable Error Rate: 1%

$$\text{Sample Size} = \frac{3}{1\%} = 300 \text{ items}$$

Errors found in Sample = 3

$$\text{MPER} = \frac{7.77}{300} = 2.6\%$$

Maximum Number of Errors in Population:

= 2.6% of 10,000 = 260

It is important to bear the following in mind when using discovery sampling:

- The table of **Confidence Factors** is based upon the Poisson Distribution which is an approximation;
- The plan recognises the danger of accepting high error rates but may lead to the rejection of populations containing relatively low error rates;
- The plan recognises that even if a sample contains no errors it cannot be asserted that the population contains no errors, only that the error rate is unlikely to be high; and
- The plan gives a high chance of rejecting populations using relatively small samples.

The errors of concern with discovery sampling are non-compliance with key accounting controls. The non-compliance of any key control is a serious matter and the tolerable error rate does not suggest that such non-compliances are acceptable. However, the sample size required for a tolerable error rate of zero would be infinity (restricted to the population size).

The objectives of the sampling plan must be clearly understood and are:

- To define the uncertainty of sampling in terms of confidence and risk; and

- To estimate the population error rate.

All non-compliance must be fully investigated. The size of the maximum potential error is less important than why the individual errors occurred.

The point at which the maximum potential error rate (MPER) becomes unacceptable is difficult to quantify as:

- The MPER is a conservative estimate of the population error rate and, frequently, the population's actual error rate will be low;
- The impact on the accounts of the MPER will vary depending on whether non-compliances have resulted in monetary errors; and
- The sampling plan does not distinguish between material and non-material items but gives equal weight to all items.

However, when the rate of error in the sample is large, the effect of using discovery sampling is that the population is rejected as being unacceptable. A rejected population represents a non-compliance with a key control in the system and the action to be taken will be:

- Assess the reasons for the non-compliance and consider if material error is likely in the accounts; and
- Devise suitable substantive tests to ensure the non-compliance does not affect the final accounts.

With judgment auditing the location of errors in a sample often results in an extension of the sample to provide further assurance of the extent of the errors. With discovery sampling an extension of the sample size is never required as the original sample is assumed to be representative of the population and the MPER calculated is representative of all possible samples. Furthermore, the sample size is exactly the one necessary to achieve the degree of confidence required.

13.16.3 Monetary Unit Sampling

Monetary Unit sampling is aimed at disclosing the monetary significance of audit test results and is appropriate in restricted circumstances where a statistical evaluation of monetary error is required (see Annex 19).

The technique is restricted by the need for cumulative additions and is, therefore, most appropriate where the selection of the sample can be achieved using a computer interrogation.

Monetary Unit sampling involves the same sample principles as discovery sampling, the sampling unit consisting of individual O$1 units. As is discovery sampling:

$$\text{Sample Size} = \frac{\text{Confidence Factor for No Errors}}{\text{Tolerable Error Rate}}$$

$$\mathbf{MPER} = \frac{\textbf{Confidence Factor for number of errors located}}{\textbf{Sample Size}}$$

However,

Maximum Potential Error (O$) (MPE) = Population Value x MPER

but: Population = Sample Size x Sampling Interval

substituting:

$$MPE = \text{Sample Size} \times \text{Sampling Interval} \times \frac{\text{Confidence Factor - number of errors located}}{\text{Sample Size}}$$

Therefore,

MPE = Sampling Interval x Confidence Factor for Number of Errors located.

Monetary precision is the monetary error rate in the population which will be tolerated by the auditor. In effect it is an expression of the uncertainty of the sampling plan. It is determined by an assessment of materiality in relation to the accounts as a whole.

In monetary unit sampling it is more convenient to express the formulae in terms of the sampling interval rather than sampling size.

$$\text{Sampling Interval} = \frac{\text{MPE}}{\text{Confidence Factor for No Errors}}$$

Therefore:

$$\text{Sampling Interval} = \frac{\text{Monetary Precision}}{\text{Confidence Factor for No Errors}}$$

To select the sample, the population is added cumulatively and a random number between 0 and the sampling interval chosen. The first item is selected when the cumulative total exceeds this random number.

The sampling interval is then added repeatedly to the opening random number to give the target total, further items are selected when the cumulative total exceeds the target total by an amount less than the sampling interval.

For example, assume that the sampling interval was O$5,000 and the random number O$3,000 and that the sales ledger balances were as follows:

	Item	Cumulative Total	Target Total	Item Selected
1	1,000	1,000	3,000	No
2	3,200	4,200	8,000	Yes
3	10,000	14,200	13,000	Yes
4	6,000	20,200	18,000	Yes
5	500	20,700	23,000	No

The following points arise from the above example and apply to Monetary Unit sampling in general:

- Items 3 and 4 are automatically selected as they are greater than the sampling interval;
- The method is time consuming as the cumulative additions need to be performed (a subsidiary benefit is that you are checking the cast of the accounts);

- Negative items must either be regarded as positive or ignored and treated as a separate population;
- O$0 balances require separate investigation as the sampling plan is testing the population as it exists; and
- The method is valid provided that the population does not contain errors which repeat at the same interval. Where this is suspected then more than one random number should be selected.

In the event of no monetary errors or overstatement from a test the conclusion would be that the auditor is x% confident that errors do not exceed the monetary precision that was originally set. The most likely error would be nil.

Monetary errors of overstatement from a test must be analysed between:

- **Top Stratum:** those items in the population which are greater than the sampling interval and which are, therefore, certain to be selected in the sample. Errors in top stratum items are therefore quantifiable in absolute terms and are considered separately as there is no statistical uncertainty to their value; and
- **Sub Stratum:** the remainder of the population of which the evaluation error is not certain.

The maximum potential error in a population may be analysed into its components:

- **Basic Precision:** assumed error in the population if no errors are found in the sample;
- **Most Likely Error:** extension of the errors found in the sample over the whole population assuming the errors are occurring uniformly; and
- **Precision Gap Widening:** statistical addition to the possible errors in the population due to errors occurring in the sample.

The sampling plan assumes the incidence of error in the population is rare. The precision adjustment factors for overstatement are conservative and the resultant maximum potential error of overstatement is the maximum that is statistically possible.

The maximum potential error is restricted to the value of the substratum items. Where a large number or errors exist in a population the maximum potential error will often exceed the total of the sub stratum demonstrating that the population contains an unacceptable error rate.

An item in the population may be overstated between zero and the full value of the item. Thus, in evaluating errors of over-statement it is essential to apply what is known as a tainting. For example:

	Stated Value of Item	Corrected Value	Error	Tainting
1	1,200	1,000	200	0.16
2	5,000	4,500	500	0.1

Tainting represents the amount of overstatement of the O$1 sampling unit selected. Although some items in the population are made up of several O$1 units, this is ignored in evaluating the number of errors found. In the selection process it is the O$1 unit actually selected that is being considered not the other O$1 units which make up the item. Where an item exceeds the sampling interval the item must be top stratum and evaluated separately.

Errors of under-statement have no upper limit and cannot be effectively evaluated by the sampling plan as the statistical principles are based on a known population size which is not the case in the event of an under-statement. This problem is not restricted to statistical sampling but applies to any form of testing, including 100% examination. Under-statements, however, are recognised as having a contra effect to over-statements and are treated in a similar way as the adjustment of actual errors of over-statement found in the sample.

The evaluation of under-statements falls into two categories:

- **Top stratum under-statements** which are quantifiable in absolute terms; and
- **Sub stratum under-statements** which are not quantifiable statistically as they have no upper limit.

There is a detailed example using monetary unit sampling below:

- **Information:**

Population:	Stock
Value:	O$500,000
Confidence Level:	90%
Threshold of Materiality:	25,000
Monetary Precision (65%):	16,250

Sampling Interval = $\frac{16,250}{2.3}$ = 7,065

Errors Located:

#	Reported Value	Correct Value	Error	Tainting
1	10,000	9,000	1,000	Top Stratum
2	4,500	3,000	1,500	0.3
3	3,500	4,500	(1,000)	
4	2,500	2,000	500	0.2

- Evaluation:

Over-statements:	0.3 x 7,065 x 1.59	= 3,370
	0.2 x 7,065 x 1.44	= 2,035
	Top Stratum	= 1,000
Basic Monetary Precision:		O$16,250

Maximum Potential Error of Overstatement:	O$22,655
less: Under-statement Not Corrected	(1,000)
Over-statement Error Corrections	(3,000)
Corrected MPE of Over-statement:	O$18,655

- **Conclusions:** The initial conclusion to be drawn from the sample is:

  "I am 90% confident that the maximum potential error of over-statement on stock does not exceed O$22,655."

If the client amends the stock valuation for the actual errors of over-statement and regards the error of understatement as having a contra effect then the corrected MPE of over-statement would be reduced to O$18,655.

13.17 Analytical Review

13.17.1 Analytical Review as a Substantive Procedure

The auditor's reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions may be derived from detailed testing, from analytical review or, more commonly, from a combination of both. The decision about which procedures to use to achieve a particular audit objective is based on the auditor's judgment about the expected efficiency and effectiveness of the available procedures in reducing detection risk for specific financial statement assertions.

When using analytical review as a substantive procedure, the auditor will need to consider a number of factors:

- Objectives of the analytical review, and the extent to which the results can be relied upon;
- Nature of the audited body and the degree to which information can be disaggregated, for example, analytical review may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified audited body, than when applied to the financial statements of the audited body as a whole;
- Availability of information, both financial, such as budgets or forecasts, and non-financial, such as the number of employees;
- Reliability of the information available, for example, that budgets are prepared with sufficient care to be relied on;
- Relevance of the information available, for example, that budgets have been established as results to be expected, rather than as goals to be achieved;
- Source of the information available, for example, sources independent of the audited body are ordinarily more reliable than internal sources;
- Comparability of the information available, for example, raw audited body data may need to be supplemented to be comparable to that of an audited body in a similar position;
- Knowledge gained during previous audits, together with the auditor's understanding of the effectiveness of the accounting and internal control systems and the types of problems that, in prior periods, have given rise to accounting adjustments; and
- Other relevant factors arising from the auditor's knowledge of the audited body.

When using Analytical Review, the auditor must always attempt to predict the figures he expects to see in the financial statements as a way of deciding whether the figures given in the statements are reasonable. A similar approach should be taken to the analytical review of <u>any</u> financial or statistical information reviewed during an audit.

Analytical Review usually involves the following stages:

i) Identify a reasonable base against which the amount being audited can be compared;

ii) Identify any factors which would lead to a change in that base;

iii) Adjust the base figure to allow for those factors;

iv) Compare the amount to be audited with the adjusted figure;

v) Investigate the reasons for any significant discrepancy;

vi) Record the results; and

vii) Confirm the impact on the proposed substantive transaction testing.

Taking payroll, for example, there are a number of ways in which it is possible to use analytical review. It is possible to assess the overall reasonableness of the total value of payroll expenditure in a number of ways:

- If the auditor knows the number of police working in a given province then by using the published scale for police salaries it is possible to predict the expected total salary payroll for that province;
- If the total salary paid in the previous year is known, salary rates have increased by 10% and police numbers are approximately the same, the total salary cost can be expected to increase by 10%; and
- If two provinces are compared, one of which has twice as many police as the other, then the total salary cost of the larger province should be double that of the smaller.

If the auditor finds a significant difference between the figures in the financial statements and the figures suggested from an analytical review, the reasons for the difference must be fully investigated. If no satisfactory explanation of the difference is obtained then the auditor must give this area particular attention during the audit.

In particular, wherever possible the auditor should compare the figures reported in the financial statements with the same figures in the financial statements for the previous year and with the budget for the current year.

13.17.2 Analytical Review at the end of the Audit

Analytical review is an important element in audit planning. The auditor should also apply analytical review at or near the end of the audit when forming an overall conclusion, including as to whether or not the financial statements as a whole are consistent with the auditor’s knowledge of the audited body.

The conclusions drawn from the results of analytical review are used to corroborate conclusions formed during the audit of individual components or elements of the financial statements and assist in arriving at the overall conclusion as to the reasonableness of those financial statements. Analytical review may also identify areas requiring further audit attention.

13.17.3 Reliance on Analytical Review

The extent to which the auditor may rely on the results of analytical review depends on a number of factors:

- **Materiality** of the items involved, for example, when particular transaction types are material, the auditor should not rely exclusively on analytical review in forming conclusions. If items are not individually material, more reliance can be placed on analytical review;
- **Other audit procedures** directed toward the same audit objectives, for example, other procedures performed by the auditor in reviewing the payroll, such as the

review of the number of staff on the payroll in relation to the payroll expense;

- **Accuracy** with which the expected results of analytical review can be predicted, for example, the auditor will ordinarily expect greater consistency in comparing recurring payments from one period to another than those which fluctuate widely, for example expenditure on capital projects; and
- **Assessments of inherent and control risks**, for example, if internal control over payroll is weak, and the control risk therefore high, more reliance should be placed on detailed testing of transactions and balances than on analytical review when drawing conclusions on payroll expenditure.

The auditor should consider testing the controls, if any, over the sources of the information used in analytical review. If controls are effective, there can be greater confidence in its reliability and in the results of analytical review.

Controls over non-financial information may be tested in conjunction with tests of accounting-related controls. For example, controls over payroll processing may include controls over the recording of staff numbers. In these circumstances, the auditor could test the controls over the recording of staff in conjunction with tests of the controls over the processing of the payroll.

13.17.4 Investigating Unusual Items

When analytical review identifies significant fluctuations or relationships that are inconsistent with other relevant information, or that deviate from predicted amounts, the auditor should investigate and obtain adequate explanations and appropriate corroborative evidence.

The investigation of unusual fluctuations and relationships ordinarily begins with enquiries of the audited body, followed by:

- **Corroboration** of audited body's responses, for example, by comparing them with the auditor's knowledge of the audited body, and other evidence obtained during the course of the audit; and
- **Consideration** of the need to apply other audit procedures based on the results of such enquiries, if the audited body is unable to provide an explanation, or if the explanation is not considered adequate.

13.18 "Simple Sampling"

13.18.1 Introduction

It may be that you are unable to make use of the sampling techniques detailed above for a number of reasons.

This section provides a simple way of sampling which does not require sophisticated software but merely a basic knowledge of Microsoft Excel which all auditors should have.

13.18.2 First Step

Identify a block of revenue or expenditure which you wish to sample. As far as practicable, make sure it is typical of the item concerned. Ideally, we will be looking for between 80 and 100 items for the initial work (although for the examples below we will only use 20 items for economy of space). Hopefully, you can copy these directly from the accounting records bit, if not, you will just have to copy type them into Excel. At this point you should have something like Table 19 (although you may well have more detail).

Table 19: Simple Sampling Step One

	Date	Company	Invoice No.	O$
1	01/02/2020	A	12345	750
2	01/02/2020	B	34567	900
3	01/02/2020	C	98765	21,350
4	01/02/2020	F	95647	7,000
5	08/02/2020	G	34529	390
6	08/02/2020	H	92417	5,234
7	08/02/2020	I	94526	725
8	08/02/2020	D	54367	29,500
9	15/02/2020	B	34568	900
10	15/02/2020	G	21321	18,350
11	15/02/2020	H	21009	125
12	15/02/2020	I	29703	6,741
13	22/02/2020	A	12345	750
14	22/02/2020	F	22234	570
15	22/02/2020	R	82506	1,525
16	22/02/2020	T	23469	14,510
17	29/02/2020	E	23487	42,500
18	29/02/2020	S	95472	8,705
19	29/02/2020	V	80052	4,723
20	29/02/2020	B	34569	900

13.18.3 Second Step

Sort the items into monetary order with the largest value at the top. The data will now look like Table 20.

Table 20: Simple Sampling Step Two

	Date	Company	Invoice No.	O$
8	08/02/2020	D	54367	29,500
3	01/02/2020	C	98765	21,350
10	15/02/2020	G	21321	18,350
16	22/02/2020	T	23469	14,510
18	29/02/2020	S	95472	8,705
4	01/02/2020	F	95647	7,000
12	15/02/2020	I	29703	6,741
6	08/02/2020	H	92417	5,234
19	29/02/2020	V	80052	4,723
15	22/02/2020	R	82506	1,525
2	01/02/2020	B	34567	900
9	15/02/2020	B	34568	900
20	29/02/2020	B	34569	900
1	01/02/2020	A	12345	750
13	22/02/2020	A	12345	750
7	08/02/2020	I	94526	725
14	22/02/2020	F	22234	570
5	08/02/2020	G	34529	390
11	15/02/2020	H	21009	125

13.18.4 Third Step

You can now select items to audit – you will want to see the original invoices/payment vouchers/ receipts etc. You could make the following selections:

- **All items over a specified amount (large items):** these will be more material to the audit and should be checked 100%. This could be over O$20,000;
- **All items where the monetary amount is identical:** check for duplicate payments; and
- **Every, say 4th item:** to undertake detailed audit tests on the items selected. If you find significant errors, then select more for testing.

These tests will provide a simplistic view as to whether the systems are sound. Of course, this should only be used as a temporary measure until such time as more, statistical sampling can be employed.

13.18.5 Fourth Step

You could re-arrange the table by invoice number or order number. Something to look for is management trying to avoid purchasing regulations by splitting orders. Thus, rather than obtain written quotations for an amount of over, say, O$1,000, they place three orders for O$ 900 buying nearly three times the legal amount for telephone quotations. The fact that the invoice numbers are in sequence is *prima facie* evidence that his has occurred.

This could also help identify duplicates payments if the amounts differed slightly – to avoid being detected as above.

Table 21: Simple Sampling Step Three

	Date	Company	Invoice No.	O$
1	01/02/2020	A		750
13	22/02/2020	A		750
11	15/02/2020	H	21009	125
10	15/02/2020	G	21321	18,350
14	22/02/2020	F	22234	570
16	22/02/2020	T	23469	14,510
17	29/02/2020	E	23487	42,500
12	15/02/2020	I	29703	6,741
5	08/02/2020	G	34529	390
2	01/02/2020	B	34567	900
9	15/02/2020	B	34568	900
20	29/02/2020	B	34569	900
8	08/02/2020	D	54367	29,500
19	29/02/2020	V	80052	4,723
15	22/02/2020	R	82506	1,525
6	08/02/2020	H	92417	5,234
7	08/02/2020	I	94526	725
18	29/02/2020	S	95472	8,705
4	01/02/2020	F	95647	7,000
3	01/02/2020	C	98765	21,350

Chapter 14: Documentation and Communications

This chapter examines: Introduction; Documentation; Review; Communications; and Audit Exit Meeting.

There are no new specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

14.1 Introduction

This chapter of the manual looks at the topics of documentation to be used and communications to be undertaken during the audit process. It is important to ensure that the audit methodology used for working papers is taken into account when reading this section. For instance, many SAIs in the Pacific are now utilising electronic working papers. Therefore, the principles required in this Chapter should be applied to your audit practice. Also, it is important that if you utilise a shared network for your SAI, that the file management is such that it follows these principles.

14.2 Documentation

14.2.1 Overview

Every aspect of the evidence-gathering process must be documented and any facts and figures mentioned in the reports have to be sufficiently supported by documentation. The criteria of sufficiency and completeness entail that an experienced auditor, with no previous connection to the audit in question, can understand what work was performed in support of the conclusions.

The entire audit process must be documented, on a timely basis, covering the work completed, evidence obtained, judgements made and reviews performed. Hard copy and electronic versions of this audit documentation must be stored in accordance with legislation.

The auditor has to document all steps in the audit process in such a way that the audit documentation is sufficient to enable an experienced auditor, with no prior knowledge of the audit, to understand the nature, timing and extent of the audit procedures performed to comply with the relevant standards and the applicable legal and regulatory requirements, the results of those procedures and the audit evidence obtained, as well as significant matters arising during the audit, the conclusions reached in their regard, and significant professional judgments made in reaching those conclusions.

In other words, on the basis of the audit documentation another auditor should arrive at the same conclusions, opinion and recommendations as the SAI.

The documentation should be prepared at the appropriate time.

Adequate audit documentation is important for several reasons. It will:

- confirm and support the auditor's opinions and reports;
- serve as a source of information for preparing reports or answering any enquiries from the audited organisation or any other party;

- serve as evidence of the auditor's compliance with the auditing standards;
- facilitate planning, supervision and review;
- help with the auditor's professional development;
- help to ensure that delegated work has been satisfactorily executed; and
- provide evidence of work done for future reference.

ISSAI requires the auditor to 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.

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

- The identifying characteristics of the specific items or matters tested;
- Who performed the audit work and the date such work was completed;
- Who reviewed the audit work performed and the date and extent of such review; and
- Discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

The auditor shall include in the audit documentation:

- Relevant discussions among the engagement team and the significant decisions reached;
- Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;
- The identified and assessed risks of material misstatement at the financial statement level and at the assertion level; and
- The risks identified, and related controls about which the auditor has obtained an understanding.

More general guidance on the audit documentation can be found in ISSAI #2230. Specific guidance related to the steps in the audit process and audit procedures can be found in many of the other ISSAI under the heading "documentation".

14.2.2 Permanent Files

See section 9.9.

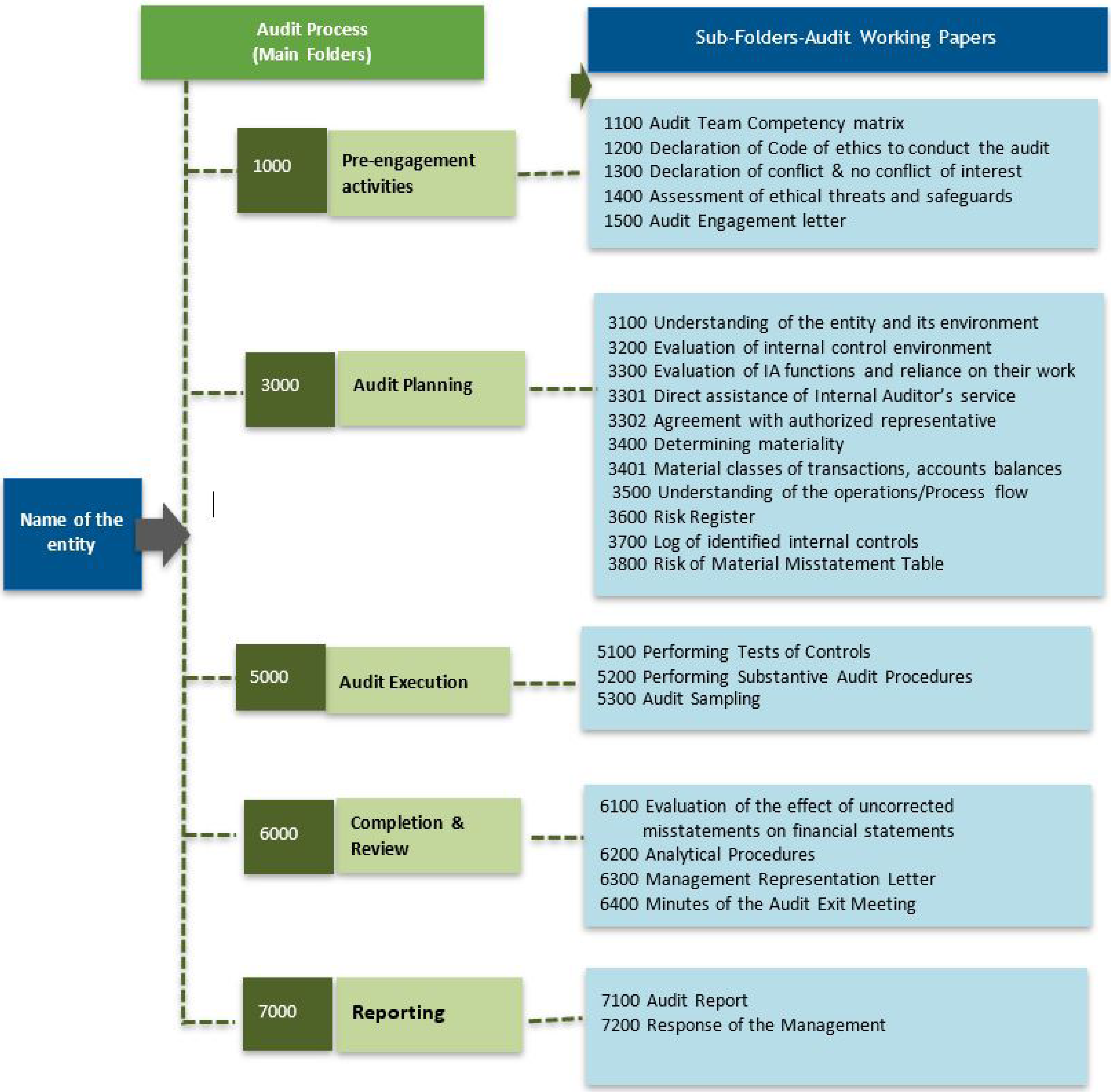
14.2.3 Current Files

The current files include all working papers applicable to the audit year. The audit team should refer to the previous year's files in order to see what problems have arisen and how they have been overcome. The auditor may record suggestions for improving on the audit files, marked for the attention of the next year's team. Older current files will usually be stored for several years in case of a complaint or a need to refer back to the audit. Annex 20 sets out the contents of the current file.

The current file should include:

- **The Planning Memorandum and Associated Working Papers;**
- **Audit Programmes:** The audit programme is kept in the relevant section with that section's working papers (e.g. accounts receivable);
- **General information:** This includes for instance staff scheduling and budgets, abstracts or copies of minutes of the board of directors' meetings, abstracts of contracts or agreements not included in the permanent files, notes of discussions with the audited entity, working-paper review comments, subsequent events analysis, and audit conclusions;
- **Adjusting the Reclassification Entries:** When the auditor discovers material misstatements in the accounting records, the financial statements must be corrected. For example, if the audited entity failed to reduce inventory properly for obsolete raw materials, the auditor may suggest an adjusting entry to reflect the realisable value of the inventory. Reclassification entries are frequently made in the statements to present accounting information properly even when the general ledger balances are correct. The auditor should keep in mind that several immaterial misstatements that are not adjusted could result in an overall material misstatement when the misstatements are combined. It is common for auditors to summarise on a separate working paper all adjusting and reclassification entries that have not been recorded. They can be posted to the accounts in the books or the working papers to determine their cumulative effect;
- **Supporting Schedules:** The largest portion of working papers includes the detailed schedules prepared by the audited entity or the auditors in support of specific amounts on the financial statements. The following are the major types of supporting schedules:
  - **Analysis***:* An analysis is designed to show the activity in a general ledger account during the audit year, tying together the beginning and ending balances;
  - **Reconciliation of Amounts:** A reconciliation supports a specific amount and is normally expected to tie the amount recorded in the audited entity's records to another source of information. Examples include the reconciliation of bank balances with bank statements;
  - **Tests of Reasonableness:** A test of reasonableness schedule, as the name implies, contains information that enables the auditor to evaluate whether the audited entity's balance appears to include a misstatement considering the circumstances in the engagement;
  - **Summary Procedures:** Another type of schedule summarises the results of a specific audit procedure performed;
  - **Examination of Supporting Documents:** A number of special-purpose schedules are designed to show detailed tests performed, such as examination of documents during tests of transactions or cut-off;
  - **Informational:** These schedules include information for tax returns and data such as time budgets and the audited entity's working hours, which are helpful in managing the audit; and
  - **Outside documentation:** Much of the content of the working papers consists of the outside documentation gathered by auditors, such as confirmation replies and copies of audited entity agreements.

Figure 43: Audit Working Paper Documentation



Note: This is a suggested format for structuring and arrangement of electronic audit working papers that would facilitate the process of systematic archiving, review and retrieval.

14.3 Review

A thorough review helps ensure that the audit work has been performed and documented in accordance with the audit standards and the Court's policies. Reviewers usually consider whether:

- The working papers adequately document the work performed;
- The audit team properly implemented the audit plan, completing audit programmes for instance;
- The financial statements agree with the working papers;
- The working papers agree with the entity's accounting records;
- The original planning assumptions are valid in light of the subsequent audit work;

- The working papers contain sufficient relevant and reliable evidence that supports the conclusions and statements of assurance;
- The team conducted the audit in accordance with the Institution's policies and the Auditing Standards; and
- Judgements are reasonable.

Review should not be left until the completion of the audit. It should be conducted as soon as possible after each area of the audit has been completed and the working papers properly compiled. This enables directors and supervisors to exercise effective control over the audit, and any necessary changes can be made quickly.

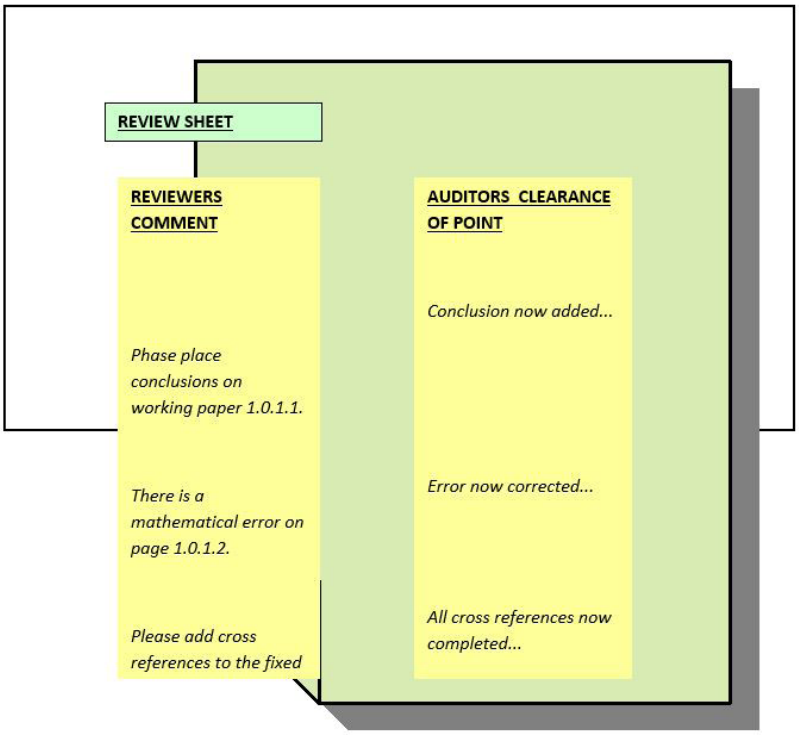
By reviewing the work, the reviewer takes responsibility for its quality and for the audit conclusions reached, i.e. whether material error exists in the financial statements. If reviewers are not satisfied with the work done, it is their responsibility to ensure that any deficiencies in the audit and in individual working papers are put right. There are two stages of review: the first stage and the second stage.

The First Stage Review is a detailed examination of each working paper. A senior officer in the audit group should conduct the review. The reviewer must not have prepared any of the working papers.

The first stage review includes detailed examination of essential elements of the audit, the documentation and evaluation of the systems and completed substantive test programmes and other information supporting the work done and the conclusion reached.

The reviewer should give evidence of their review by placing their initials and date on the working papers. Any review points requiring the auditor's attention should be clearly recorded on a "review sheet". The auditor's clearance of review points should also be recorded. The original reviewer should sign the review sheet once they are satisfied with the auditor's response to their review points (see illustration below).

Figure 49: Example of a Review Sheet



Second Stage Review is a selective examination of the working papers carried out in sufficient depth by a supervisor, manager or director. The extent of the second stage review will depend upon the experience and knowledge of the audit team, the complexity of the audit and the second stage reviewer's assessment of the risk to the institution.

The reviewer must be satisfied that:

- The audit conformed to the Court's audit policies and procedures;
- The working papers contain the necessary documentation to support the opinion on the financial statements; and
- The audit report is appropriately worded and dated.

The second stage reviewer should also determine that all reviews have been properly documented in the working papers. The second stage reviewer will in particular review any working papers prepared by the first stage reviewer.

The reviewers should give evidence of their review by placing their initials and date on the working paper. Any review points requiring the auditor's attention should be clearly documented, as should the auditor's clearance of those points.

14.4 Communications

Communication with management and those charged with governance of the entity **throughout the audit process** is very important and facilitates the proper conduct of the audit. For some public sector entities in some jurisdictions, management may include some or all of those charged with governance.

Subsequently, communications should continue during the planning phase, involving discussions with the appropriate level of management, and within the limits of the laws and regulations for preparing the audit strategy, timing, logistics, etc.

The engagement team needs to consider three aspects about communication:

- Determining appropriate persons within the entity's governance structure with whom to communicate (which could be performed at audit entry meeting-before audit commences).
- Determining the matters that need to be communicated (i.e. auditor's responsibility, planned scope and timing of the audit, significant findings from the audit, and auditor independence).
- Establishing the communication process (the process, form, timing and adequacy of communication).

The engagement team needs to organise an **audit entry meeting** with the entity's management and those charged with its governance as a communication process. As part of the specific agenda for this meeting, the engagement team may want to discuss the terms of audit engagement mentioned in the audit engagement letter.

Any significant difficulties encountered during the audit, as well as instances of material non-compliance are to be promptly communicated to the appropriate level of management during the performance phase.

During the reporting phase, written reports are to be issued on a timely basis, to their intended users, the audited entity and any others as appropriate.

The SAI is a supreme audit institute which means that the highest audit standards are applicable. That is why there has to be a well-established system of quality control. Communication with the auditee must be part of this system. That is why the SAI must send a draft report to the management governing the entity that is subject of the audit. Management must either agree with the facts or shall point out any incorrect and incomplete facts. Corrections of facts suggested by management should be supported by relevant and reliable evidence.

The auditor will assess the reaction of the management and correct the draft report where necessary. On the basis of the complete and correct fact he will draft his conclusions and recommendations as well as the audit opinion.

The auditor then sends the complete version of the draft report to the administrative level (e.g. the minister) for a formal reaction addressing the conclusions and recommendations. This reaction is added to the report after which it will be sent to Parliament and will be made public.

Further guidance on the communication with the entity subject to the audit can be found in ISSAI #200 and #400 (in general) as well as #2260 (specifically dealing with this topic).

As per ISSAI #2260:9, the objectives of the auditor on communication with those charged with governance are:

- To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- To obtain from those charged with governance information relevant to the audit;
- To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
- To promote effective two-way communication between the auditor and those charged with governance.

14.5 Audit Exit Meeting

An audit exit meeting is a not a requirement of ISSAI but is often used to ensure that the preliminary auditor's report, audit findings, management's response, and the final version of the financial statements are discussed and agreed with management and, where relevant, those charged with governance. This meeting also reduces the risks of misunderstanding between the management and the auditor at a later stage on issues reflected in the final audit report. Some refer to this as the audit clearance meeting.

Other matters relevant to the audit can also be discussed, such as difficulties encountered during the audit process, so they can be addressed in the next audit, details of any ethical matters that can be clarified with management, etc.

The auditor and management should maintain the minutes of the exit meeting detailing the discussions of the auditor's report and the specific audit findings, and the decisions reached on each discussion point. The minutes should then be dated and signed by representatives of the audit team and the management. The minutes of the audit exit meeting also become audit evidence, which is used as the basis to finalise the audit report.

Upon conducting the audit exit meeting, the audit team prepares the audit report considering the response provided by management and those charged with governance.

PART FOUR: QUALITY ASSURANCE

Chapter 15: How to Exercise Quality Assurance Over Financial Audits

This chapter examines: Introduction; Key Principles of Quality Control and Assurance; Assigning Responsibility for Quality Control; The Importance of Quality; Quality Characteristics; Quality Control; Quality Monitoring; and Quality Assurance.

There are no new specific internet links in this chapter.

Whilst the steps to be undertaken are similar, customisation will be necessary to cite the appropriate audit standards.

15.1 Introduction

The existence of a good system of quality control is an important prerequisite for all stages of an audit. Quality control among other things has to guarantee that audits will be performed according to the adopted professional standards, that the proper methods and techniques will be applied, that sufficient work has been done to be able to give an opinion and that the gathered and evaluated evidence will substantiate that opinion. In that respect it is better to speak about "**quality assurance"**.

Senior management is responsible for a good functioning system of quality control within the SAI. It should establish policies and procedures designed to promote an internal culture recognising that quality is essential in performing all of its work. Such policies and procedures should be set by the Head of the SAI who retain overall responsibility for the system of quality control.

ISSAI #140[57] provides essential guidance on this matter. It also provides a gap analysis tool to assess if the SAI meets all the relevant demands.[58] The SAI should periodically apply this tool to assess if it (still) meets the standard and what steps should be taken if not. More guidance on the application of quality control in the audits can be found in ISSAI #2220.

In the Pacific there is scarce resources and staff numbers to establish a separate quality unit to conduct this. However, there are options that SAIs can undertake to ensure a quality assurance mechanism is in place. The important matter is to ensure the key principles have been considered and adapted accordingly.

Refer to PASAI's Quality Assurance Manual for more details or guidance. However, please be aware that this manual will also be updated in the near future. Accordingly, it is recommended that you take no substantive work based on this manual but only use it for interim solutions.

15.2 Key Principles of Quality Control and Assurance

In compliance with INTOSAI P #10, the SAI should meet the following key principles for quality control and assurance:

- **Leadership responsibilities for quality within the organisation:**

  Key principle: The SAI should establish policies and procedures designed to promote an internal culture recognising that quality is essential in performing all of its work. Such policies and procedures should be set;

57 ISSAI #140 refers to the (extensive) International Standards for Quality Control.
58 http://www.issai.org/media/13542/issai_40_gap_analysis_chart.docx.

- Relevant ethical requirements:

  Key principle: The SAI should establish policies and procedures designed to provide it with reasonable assurance that the SAI, including all personnel and any parties contracted to carry out work for the SAI, comply with relevant ethical requirements;

- Acceptance and continuance of client relationship and specific engagements:

  ***Key principle*:** The SAI should establish policies and procedures designed to provide the SAI with reasonable assurance that it will only carry out audits and other work where the SAI:

  - is competent to perform the work and has the capabilities; including time and resources, to do so;
  - can comply with relevant ethical requirements; and
  - has considered the integrity of the organisation being audited and has considered how to treat the risk to quality that arises.

- **Human Resources:**

  ***Key principle*:** The SAI should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient resources (personnel and, where relevant, any parties contracted to carry out work for the SAI) with the competence, capabilities and commitment to ethical principles necessary to: - carry out its work in accordance with relevant standards and applicable legal and regulatory requirements; and enable the SAI to issue reports that are appropriate in the circumstances.

- Engagement Performance:

  ***Key principle*:** The SAI should establish policies and procedures designed to provide it with reasonable assurance that its audits and other work are carried out in accordance with relevant standards and applicable legal and regulatory requirements, and that the SAI issues reports that are appropriate in the circumstances. Such policies and procedures should include: - matters relevant to promoting consistency in the quality of the work performed; supervision responsibilities; and review responsibilities.

- Monitoring:

  ***Key principle*:** The SAI should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant and adequate and are operating effectively. The monitoring process should: - include an ongoing consideration and evaluation of the SAI's system of quality control, including a review of a sample of completed work across the range of work carried out by the SAI; require responsibility for the monitoring process to be assigned to an individual or individuals with sufficient and appropriate experience and authority in the SAI to assume that responsibility; require that those carrying out the review are independent (i.e. they have not taken part in the work or any quality control review of the work).

15.3 Assigning Responsibility for Quality Control (QC)

The Head of the SAI will retain **overall responsibility** for the system of quality control regardless of the system in place to ensure Quality Control. In the PASAI region, most

SAI are not large enough to be able to have a dedicated team working full time on Quality Control. Accordingly, it is **recommended** that the day to day responsibility rests with a senior officer (often the Deputy Head) who should be assisted by an *ad hoc* Quality Assurance Review Committee (QARC).

The **operational responsibility** should be assigned within the team that will plan and conduct the audit on a certain entity (Financial Audit), subject matter (Compliance Audit) or programme (Performance Audit). The most logical person would be the Team Leader or Audit Manager. Before the start of the audit assignment, a quality control procedure should be in place and it must be clear who will be performing it and how.

He/she should see to it that quality control procedures are implemented at the engagement level in order to provide reasonable assurance that the audit complies with professional standards and the applicable legal and regulatory requirements, and that the auditor's report is appropriate in the circumstances.

Under such a system, the senior officer responsible for QC should design the quality control process, to maintain it and to periodically evaluate it. He/she should also scrutinise the audit files to assess the compliance to the quality control procedures and the quality of the work performed including the quality of the conclusions.

This should be done **before** presenting the report to the auditee or after. A quality review before presenting the results to the auditee is an extra safeguard that the audit has been performed according to professional standards, that the report reflects the factual situation and that the conclusions are valid.

In terms of being a learning organisation the review could be done afterwards. The senior officer responsible for QC should give feed back to the respective audit team and also use the results for evaluation purposes.

15.4 The Importance of Quality

The SAI should have a Quality Management Guide that will provide detailed guidance on the procedures of quality control and that will reflect the importance of quality. This guide should comprise all the elements of ISSAI #2220 and more specific the ISA #220 part of it as far as they would be applicable for the public sector. Part of the guide would be the general quality management policy. This policy should at least state that:

- quality is the responsibility, and in the interest, of all employees;
- auditors must work continuously on maintaining and improving audit quality;
- as the SAI requires compliance and quality in the delivery of public services by its clients, so the SAI itself must strive to serve as a model for its clients; and
- quality procedures and processes are based on internationally recognised auditing standards and international good practices.

It is therefore the responsibility of each member of the organisation to strive for quality so that the end products of the SAI are of the greatest possible value to its clients and key stakeholders. This applies to each staff member, from front-line auditors to support staff.

The quality framework should include the following main components:

- **Quality Control:** means getting it right the first time by ensuring that quality procedures are embedded in auditing procedures;
- **Quality Monitoring:** involves an independent review of individual audits by the senior officer responsible for Quality Control (Assurance), to ensure that quality

control procedures are being fulfilled effectively and in accordance with this manual and the detailed quality guidance; and

- **Quality Assurance:** involves an independent external assessment of the quality control and quality monitoring procedures set up and implemented at the SAI.

15.5 Quality Characteristics

Quality is an essential or distinctive characteristic or attribute. It is the degree to which a set of characteristics, inherent to a product, fulfils its requirements. In the case of the quality of the different audits conducted by the SAI, the general quality characteristics include the following points.

- **Scope:** Did the audit plan properly address all issues needed for a successful and effective audit? Did the execution of the audit satisfactorily complete all the required components of the task plan? Was the report in line with the stakeholders' requirements?
- **Reliability:** Did the audit findings and conclusions truly reflect actual conditions with respect to the matter being examined? Are the conclusions on the assertions in the audit report fully supported by the data and evidence gathered in the audit?
- **Objectivity:** Was the audit carried out in an impartial and fair manner? The auditors should base their assessment and opinions purely on the facts and on proper analysis of the evidence.
- **Timeliness:** Were the audit results delivered in a timely manner? This may involve meeting a statutory deadline or delivering audit results when they are needed for a policy decision, or when they will be most useful in correcting management weaknesses.
- **Clarity:** Was the audit report clear and concise in presenting the results of the audit? This typically involves ensuring that the scope, findings and any recommendations can be easily understood by users of the audit report. These users may not be experts in the matters that are being addressed but may still need to act in response to the report's findings.
- **Significance:** How important is the matter that was examined in the audit? This can be assessed from several perspectives, such as the auditees' financial outlay and the effects of the auditees' performance on the public at large or on major national policy issues.

More characteristics concerning ethical and engagement elements of quality control named and explained in ISSAI #2220. The ethical elements reflect the demands as mentioned in paragraph 5.2.

15.6 Quality Control

Quality Control is about **"getting things right the first time"**. This is achieved by embedding quality procedures and processes into the audit work itself, at all stages of the audit: planning, fieldwork, reporting and follow-up. Prior to considering detailed quality control procedures, there are several important aspects of working practices that underpin operational quality: documentation and supervision.

Quality Control needs to exist both within the individual audit which is where supervision and effective documentation are required. It also has to exist more generally within the SAI which is where Quality Monitoring comes into play.

Documentation involves two key aspects, audit evidence and working papers:[59]

- Auditors are required to obtain **sufficient and relevant evidence** to be able to draw reasonable conclusions. It is important for audit evidence to be reliable and sufficient to support the conclusions and any opinions that may be expressed; and
- **Working papers:** which are the documents that auditors prepare to record the performance of their work. Working papers should be sufficiently complete and detailed to enable an experienced auditor with no previous connection to the audit to gain a basic understanding of the work performed and conclusions reached.

Supervision is also a critical part of the process:

- The Team Leader of each audit team has a key role in this by reviewing the quality of working papers and ensuring that they have been prepared with due care and attention and are sufficient to support any conclusions drawn. They must also ensure that all auditors have the necessary skills for the job at hand, that the audit guidance and programmes have been understood and that the work is carried out in accordance with those programmes; and
- Supervision is done by reviewing the working papers against a checklist and providing written comments to the auditor, covering what has been accomplished and which areas need improvement.

15.7 Quality Monitoring

Quality monitoring is the internal review function established to ensure that quality control procedures are effective. Quality monitoring covers all audit work, from the planning stage through to reporting. Within SAI an *ad hoc* QARC should established. It should meet on a regular basis to monitor the quality of ongoing audit tasks.

The QARC should carry out its review in reference to standard checklists for the planning stage, fieldwork stage, and reporting stage. The review covers all the relevant reports and working papers and may involve interviewing members of the audit team about specific aspects of the audit.

The Committee should produce an annual report based on these individual quality monitoring reviews to form part of the SAI Annual Report.

15.8 Quality Assurance

Quality assurance is quite distinct from quality monitoring and concerns an independent “post-audit” review of the quality management arrangements, including the effectiveness of the quality control and quality monitoring procedures. It is generally achieved through a combination of internal and external reviews.

The purpose of an external review is to obtain a fully independent assessment of satisfaction of the required standards – against a regional or sectorial benchmark rather than internal expectations. This external “peer” review might be carried out by another SAI or by a commercial audit firm. At intervals of no more than five years the quality of the audits performed by the SAI has to be assessed.

The external review team will submit a report to the Head of the SAI outlining its key findings, areas for improvement, and actions required to achieve these improvements. In the future, the scope of this external assessment will be extended to include feedback from the audited bodies on how the audits were conducted and, on the benefits, gained from the audit process. The results of the assessment will be transmitted to Parliament as part of the SAI Annual Report.

PART FIVE: NEXT STEPS

Chapter 16: How to Customise and Develop your Financial Audit Manual

16.1 Introduction

As was indicated in the introduction, this manual is designed to be a draft manual for you to develop you own manual suited to the unique circumstances of your mandate. It is accompanied by a separate volume containing the Glossary, Templates and a Case Study for Financial Auditing

16.2 Process

How you customise the two volumes is up to you. However, we think that the following approach is a good basic method:

- **Customise Manual:** go through this manual and delete sections not relevant to your mandate; draft and add any new material which you consider necessary. This includes the Glossary and Acronyms;
- **Customise Templates:** similarly, go through the volume of templates and amend as necessary;
- **Pilot Audits:** test the draft volumes you produce by undertaking a number of pilot audits. Ensure that there is detailed feedback from each audit and that this is used to update the draft manual. You should add the actual templates used to your draft volume for future reference;
- **Final Manual and Templates:** you will then have a manual – and associated templates – which are specifically tailored to you needs and which can be used to undertake your planned audit work.

16.3 Caveat

There can be no substitute for referring to, and using, the auditing standards appropriate to your jurisdiction and following your own regulatory framework. Nothing in the manual is intended to attempt to override these; its purpose is purely to offer guidance to each SAI with a view to improving the quality of external audit in the region. This, in turn, will lead to improved governance and will benefit all the citizens of our countries.

Annex 1: Cash-Based IPSAS Financial Statement[60]

Financial Statement of the Federal Government of X Receipts and Payments for the year ended 31 December 2018		
(All figures in $00,000)	**2018**	***2017***
RECEIPTS	$00,000	*$00,000*
Taxation		
Income tax	200	*190*
Value-added tax	100	*80*
Property tax	50	*50*
Other taxes	40	*45*
Sub-total tax (1)	390	*365*
Transfers (grants)		
Multilateral Agencies	45	*40*
Bilateral Agencies	25	*23*
	70	*63*
Other Grants and Aid	20	*18*
Sub-total grants (2)	90	*81*
Other Borrowings		
Proceeds from borrowing	60	*63*
Capital Receipts		
Proceeds from disposal of plant and equipment	10	*7*
Trading Activities		
Dividends from Public Corporations	15	*12*
Other trading receipts	5	*5*
Sub-total (3)	90	*87*
Total receipts (sub-totals 1+2+3)	**570**	***533***
PAYMENTS		
Operations		
Wages, salaries and employee benefits	160	*155*
Supplies and consumables	110	*103*
Sub-total operations (1)	270	*258*
Transfers		
Grants	55	*58*
Other transfer payments	15	*10*
Sub-total transfers (2)	70	*68*
Capital Expenditures		
Purchase/construction of plant and equipment	140	*95*
Purchase of financial instruments	15	*6*
Loan and Interest Repayments		
Repayment of borrowings	35	*67*
Interest payments	10	*7*
Sub-total (3)	200	*175*
Total payments	**540**	***501***
Increase/(Decrease) in Cash (Receipts - Payments)	30	*32*
Cash at beginning of 2018	50	*18*
Cash at end of 2018	80	*50*

Financial Statement of the Federal Government of X Cash Flow for the year ended 31 December 2018		
(All figures in $00,000)	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES	$00,000	$00,000
Receipts		
Taxation		
Income tax	200	190
Value-added tax	100	80
Property tax	50	50
Other taxes	40	45
Sub-total tax (1)	390	365
External Assistance		
Multilateral Agencies	45	40
Bilateral Agencies	25	23
	70	63
Other Grants and Aid	20	18
Sub-total grants (2)	90	81
Trading Activities		
Other trading receipts	5	5
Sub-total trading (3)	5	5
Total receipts from operating activities Sub-totals 1 + 2+3	**485**	**451**
Payments		
Wages, salaries and employee benefits	160	155
Supplies and consumables	110	103
	270	258
Transfers		
Grants	55	58
Other transfer payments	15	10
	70	68
Other payments		
Interest payments	10	7
Sub-total other payments	10	7
Total payments (sub-totals 1+2+3)	**350**	**333**
Net cash flows from operating activities (Receipts - Payments)	**135**	**118**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of plant and equipment	-140	-95
Proceeds from sale of plant and equipment	10	7
Purchase of financial instruments	-15	-6
Net cash flows from investing activities	**-145**	**-94**
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	60	63
Repayment of borrowings	-35	-67
Distribution/dividend to government	15	12
Net cash flows from financing activities	**40**	**8**
Net increase/(decrease) in cash (Operating + investing + financing)	**30**	**32**
Cash at beginning of 2018	**50**	**18**
Cash at end of 2018	**80**	**50**

NB Both statements should show the previous year’s figures for comparison.

Annex 2: Accruals-Based IPSAS Financial Statement

Financial Statement of the Federal Government of X
Cash flow statement and budget comparison for the year ended 31 December 20x8

(All figures in $00,000)	20x8				20x7		
	Original Budget	Revised budget	Actual Results	Variance	Original Budget	Revised budget	Actual Results
CASH FLOWS FROM OPERATING ACTIVITIES							
Receipts							
Taxation							
Income tax	180	189	200	11	144	151	160
Value-added tax	90	94	100	6	72	75	80
Property tax	45	47	50	3	36	38	40
Other taxes	36	38	40	2	24	30	32
Sub-total tax (1)	351	368	390	22	276	294	312
Transfers and grants							
External Assistance							
Multilateral Agencies	40	42	45	3	32	33	36
Bilateral Agencies	112	117	125	8	90	94	100
	152	159	170	11	122	127	136
Other Grants and Aid	18	19	20	1	14	15	16
Sub-total grants (2)	170	178	190	12	136	128	152
Trading Activities							
Other trading receipts (3)	4	5	5	0	3	4	4
Total receipts from operating activities (sub-totals 1 + 2 + 3)	**525**	**551**	**585**	**34**	**415**	**426**	**468**
Payments							
Wages, salaries and employee benefits	180	189	200	11	144	151	160
Supplies and (X) consumables	117	123	130	7	94	98	104
Sub-total payments (1)	297	312	330	18	238	249	264
Transfers							
Grants	22	23	25	2	17	18	20
Other transfer payments	13	14	15	1	10	11	12
Sub-total grants (2)	35	37	40	3	27	29	32
Interest payments (3)	9	10	10				
Total operating payments (1 + 2 + 3)	**341**	**359**	**380**	**21**	**265**	**278**	**296**
Net cash flows from operating activities (total receipts - total payments)	**184**	**192**	**205**	**13**	**150**	**148**	**172**
CASH FLOWS FROM INVESTING ACTIVITIES							
Purchase of plant and equipment	-171	-180	-190	-10	-137	-144	-152
Proceeds from sale of plant and equipment	9	10	10	0	7	8	8
Purchase of financial instruments	-13	-14	-15	-1	-10	-11	-12
Net cash flows from investing activities	**-175**	**-184**	**-195**	**-11**	**-140**	**-147**	**-156**
CASH FLOWS FROM FINANCING ACTIVITIES							
Proceeds from borrowings	54	57	60	3	48	45	48
Repayment of borrowings	-31	-33	-35	-2	-25	-26	-28
Distribution/dividend to government	13	14	15	1	10	11	12
Net cash flows from financing activities	**36**	**38**	**40**	**2**	**33**	**30**	**32**
Net increase/(decrease) in cash (operating + investing + financing sub-totals)	**45**	**46**	**50**	**4**	**43**	**31**	**48**

Recommended Format for Financial Statements

Statement 1: Government of the Republic of Oceania

Statement of Consolidated Assets and Liabilities (Financial Position) as of 31 December 2019

	2019	2019	2018	2018
ASSETS				
Current Assets:				
Cash and cash equivalents	X		X	
Receivables	X		X	
Inventories	X		X	
Prepayments	X		X	
Investments	X		X	
Total Current Assets		**X**		**X**
Non-current assets:				
Receivables	X		X	
Investments	X		X	
Other financial assets	X		X	
Infrastructure, plant and equipment	X		X	
Land and buildings	X		X	
Intangible assets	X		X	
Other non-financial assets	**X**		**X**	
Total Non-current Assets		**X**		**X**
TOTAL ASSETS		**X**		**X**
LIABILITIES				
Current liabilities:				
Payables	X		X	
Short-term borrowings	X		X	
Current portion of borrowings	X		X	
Provisions	X		X	
Employee benefits	X		X	
Superannuation	X		X	
Total Current Liabilities		**X**		**X**

Non-current liabilities:				
Payables	**X**		**X**	
Borrowings	**X**		**X**	
Provisions	**X**		**X**	
Employee benefits	**X**		**X**	
Amounts Held in Trust for Third Parties	**X**		**X**	
Superannuation	**X**		**X**	
Total Non-current Liabilities		**X**		**X**
TOTAL LIABILITIES		**X**		**X**
NET ASSETS		**X**		**X**
NET ASSETS/EQUITY				
Capital contributed by other government entities	X		X	
Reserves	X		X	
Accumulated surpluses/(deficits)	X		X	
Total Net Assets/Equity		**X**		**X**

59 The demands for audit documentation are specified in ISSAI #2230. In the chapters concerning audit planning, conducting, reporting and follow up, the relevant demands will be addressed.

Statement 2a: Government of the Republic of Oceania

Statement of Consolidated Revenue and Expenditure (Financial Performance – Classification of Expenses by Nature) for the Year Ended 31 December 2019

Actual 2018		Actual 2019	Final Budget 2019	Original Budget 2019
	Operating Revenue:			
X	Taxes	X	X	X
X	Fees, fines, penalties and licenses	X	X	X
X	Revenue from exchange transactions	X	X	X
X	Transfers from other governments	X	X	X
X	Other operating revenue	X	X	X
X	**Total Operating Revenue**	**X**	**X**	**X**
	Operating Expenses:			
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)
(X)	Depreciation/amortisation expense	(X)	(X)	(X)
(X)	Other operating expenses	(X)	(X)	(X)
(X)	**Total Operating Expenses**	**(X)**	**(X)**	**(X)**
(X)	**Surplus/(deficit) from operating activities**	**(X)**	**(X)**	**(X)**
(X)	Finance costs	(X)	(X)	(X)
(X)	Transfer to Funds	(X)	(X)	(X)
X	Gain on sale: property, plant, equipment	X	X	X
(X)	**Total non-operating revenue/(expenses)**	**(X)**	**(X)**	**(X)**
X	**Net surplus/(deficit) for the period**	**X**	**X**	**X**

Statement 2b: Government of the Republic of Oceania

Statement of Consolidated Revenue and Expenditure (Financial Performance – Classification of Expenses by Function) for the Year Ended 31 December 2019

Actual 2018		Actual 2019	Final Budget 2019	Orig-inal Budget 2019
	Operating Revenue			
X	Taxes	X	X	X
X	Fees, fines, penalties and licenses	X	X	X
X	Revenue from exchange transactions	X	X	X
X	Transfers from other government entities	X	X	X
X	Other operating revenue	X	X	X
X	**Total Operating Revenue**	**X**	**X**	**X**
	Operating Expenses			
X	General public services	X	X	X
X	Defence	X	X	X
X	Public order and safety	X	X	X
X	Education	X	X	X
X	Health	X	X	X
X	Social protection	X	X	X
X	Housing and community amenities	X	X	X
X	Recreational, cultural and religion	X	X	X
X	Economic Affairs	X	X	X
X	Environmental protection	X	X	X
X	**Total operating expenses**	**X**	**X**	**X**
X	**Surplus/(deficit) from operating activities**	**X**	**X**	**X**
(X)	Finance costs	(X)	(X)	(X)
X	Gains on sale of property, plant and equipment	X	X	X
X	**Total non-operating revenue (expenses)**	**X**	**X**	**X**
X	**Net surplus/(deficit) before extraordinary items**	**X**	**X**	**X**
(X)	Extraordinary items	(X)	(X)	(X)
X	**Net surplus/(deficit) for the period**	**X**	**X**	**X**

NB The totals will agree those of Statement 2a.

Statement 2c: Government of the Republic of Oceania

Statement of Consolidated Revenue and Expenditure (By Ministry) for the Year Ended 31 December 2019

Actual 2018	Code and Ministry/Agency	Actual 2019	Final Budget 2019	Orig-inal Budget 2019
	REVENUE			
	Code: Ministry of Finance			
	Operating Revenue			
X	Taxes	X	X	X
X	Fees, fines, penalties and licenses	X	X	X
X	Revenue from exchange transactions	X	X	X
X	Transfers from other governments	X	X	X
X	Other operating revenue	X	X	X
X	**Total Operating Revenue**	**X**	**X**	**X**
	NB Operating Revenue shown only under MF; in practice every ministry with Operating Revenue will be shown separately.			
	Other Revenue			
X	Unclaimed Monies from Trust Fund	X	X	X
X	Transfers from other Funds	X	X	X
X	Grants	X	X	X
X	**Total Other Revenue**	**X**	**X**	**X**
	Total: Consolidated Fund Revenue			
X	Ministry Operating Revenue	X	X	X
X	Unclaimed Monies from Trust Fund	X	X	X
X	Transfers from other Funds	X	X	X
X	Grants	X	X	X
X	**Grand Total – Consolidated Fund Revenue**	**X**	**X**	**X**

60 NB Although referring to “Federal” government both this statement and that at Annex #2 apply equally to any form of public sector accounts.

	EXPENDITURE			
	Code 01: Cabinet of Ministers			
	Operating Expenditure:			
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)
(X)	Depreciation/amortisation expense	(X)	(X)	(X)
(X)	Other operating expenses	(X)	(X)	(X)
(X)	**Total Operating Expenditure**	**(X)**	**(X)**	**(X)**
	Code 02: Constitutional Court			
	Operating Expenditure:			
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)
(X)	Depreciation/amortisation expense	(X)	(X)	(X)
(X)	Other operating expenses	(X)	(X)	(X)
(X)	**Total Operating Expenditure**	**(X)**	**(X)**	**(X)**
	Code 03: Parliament			
	Operating Expenditure:			
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)
(X)	Depreciation/amortisation expense	(X)	(X)	(X)
(X)	Other operating expenses	(X)	(X)	(X)
(X)	**Total Operating Expenditure**	**(X)**	**(X)**	**(X)**

	Code 04: Office of the President			
	Operating Expenditure:			
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)
(X)	Depreciation/amortisation expense	(X)	(X)	(X)
(X)	Other operating expenses	(X)	(X)	(X)
(X)	**Total Operating Expenditure**	**(X)**	**(X)**	**(X)**
	Code 05 onwards: Operating Expenditure for every ministry and agency			
	Summary of Ministry Operating Expenditure:			
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)
(X)	Depreciation/amortisation expense	(X)	(X)	(X)
(X)	Other operating expenses	(X)	(X)	(X)
(X)	**Total Operating Expenditure**	**(X)**	**(X)**	**(X)**
	Repayment of Borrowing			
X	- Consolidated Fund	X	X	X
X	- Other Funds	X	X	X
X	**Total Repayment of Borrowing**	**X**	**X**	**X**
	Transfers			
X	- Other Funds	X	X	X
X	**Total Transfers**	**X**	**X**	**X**
	Total: Consolidated Fund Expenditure			
(X)	Ministry Operating Expenditure	(X)	(X)	(X)
(X)	Borrowing Repayments	(X)	(X)	(X)
(X)	Transfers	(X)	(X)	(X)
(X)	**Grand Total – Consolidated Fund Expenditure**	**(X)**	**(X)**	**(X)**
	SURPLUS (DEFICIT) FOR YEAR			
X	Grand Total CF Revenue	X	X	X
(X)	Grand Total CF Expenditure	(X)	(X)	(X)
X	**Surplus (Deficit) for Year**	**X**	**X**	**X**
	ACCUMULATED SURPLUS (DEFICIT)			
X	Accumulated Surplus (Deficit) 31 January	X	X	X
X	Surplus (Deficit) for Year	X	X	X
X	**Accumulated Surplus (Deficit) 31 December**	**X**	**X**	**X**

Statement 3: Government of the Republic of Oceania

Statement of Changes in Net Assets/Equity for the Year

Ended 31 December 2019

	Capital Contributed	Revaluation Reserve	Currency Translation Reserve	Accumulated Surpluses/ (Deficits)	Total
Balance as at 31/12/2017	X	X	(X)	X	**X**
Changes in Accounting Policy	(X)			(X)	(X)
Restated Balance	**X**	**X**	**X**	**X**	**X**
Surplus on Revaluation of Property		X			X
Deficit on Revaluation of Investments		(X)			(X)
Currency Translation Differences			(X)		(X)
Net gains and losses not recognised in the statement of financial performance		X	(X)		X
Net Surplus for Period				X	X
Balance as at 31/12/2018	**X**	**X**	**(X)**	**X**	**X**
Deficit on Revaluation of Property		(X)			(X)
Surplus on Revaluation of Investments		X			X
Currency Translation Differences			(X)		(X)
Net gains and losses not recognised in the statement of financial performance		(X)	(X)		(X)
Net Deficit for Period				(X)	(X)
Balance as at 31/12/2019	**X**	**X**	**(X)**	**X**	**X**

Statement 4: Government of the Republic of Oceania

Statement of Consolidated Cash Flow for Year Ended 31 December 2019

	2019	2018
Cash Flows From Operating Activities		
Receipts		
Taxation	X	X
Sales of goods and services	X	X
Grants	X	X
Interest received	X	X
Other receipts	X	X
	X	**X**
Payments		
Employee costs	(X)	(X)
Superannuation	(X)	(X)
Suppliers	(X)	(X)
Interest paid	(X)	(X)
Other payments	(X)	(X)
Net cash flows from operating activities	**X**	**X**
Cash Flows From Investing Activities		
Purchase of plant and equipment	(X)	(X)
Proceeds from sale of plant and equipment	X	X
Proceeds from sale of investments	X	X
Purchase of foreign currency securities	(X)	(X)
Net cash flows from investing activities	**(X)**	**(X)**
Cash Flows From Financing Activities		
Proceeds from borrowings	X	X
Repayment of borrowings	(X)	(X)
Distribution/dividend to government	(X)	(X)
Net cash flows from financing activities	**X**	**X**
Net increase/(decrease) in cash and cash equivalents	X	X
Cash and cash equivalents at beginning of period	X	X
Cash and cash equivalents at end of period	**X**	**X**

Statement 5: Government of the Republic of Oceania

Statement of Accounting Policies and Notes to the Financial Statements for the Year Ended 31 December 2019

Reporting Entity

The Financial Statements of the Government of Republic of Oceania have been prepared in accordance with the legal requirements of the country.

The Government reporting entity comprises:

- Central Government
  - Ministries
  - Agencies
- Local Government
  - Districts
  - Towns
  - Cities
  - Urban Settlements
  - Rural Settlements
- Funds
  - State Fisheries Fund; and
  - Social Security Fund.

It should not include the following in the consolidation, though details can be shown by way of notes to the accounts:

- Government Business Enterprises; or
- Trust Funds.

Accounting Policies

These financial statements comply with the International Public Sector Accounting Standards (IPSAS). The measurement base applied is historical cost adjusted for revaluations of certain property, plant and equipment and marketable securities held for trading purposes. The modified accrual basis of accounting has been used unless otherwise stated.

Reporting and Forecast Period

The reporting and forecast period for these financial statements is the year ended 31 December 2019.

The Original Budget is the original forecast for the financial year, as presented in the 2019 Budget on xx/xx/2018. The revised forecast has been prepared using actual data which was available at the time of the finalisation of the Budget forecasts (xx/xx/xxxx).

Revenue

Revenue levied through the Government's legal powers

The Government provides many services and benefits that do not give rise to revenue. Further, payment of tax does not, of itself, entitle a taxpayer to an equivalent value of services or benefits, as there is no direct relationship between paying tax and receiving Government services and transfers.

Such revenue is received through the exercise of the Government's legal power. Where possible, revenue is recognised at the time the debt to the Government arises. The Table below indicates such revenue; it should be updated for specific revenue sources.

Revenue Type	Revenue Recognition Point
Income Tax	When payment to individual is made
Excise duty	When goods are subject to duty
Road user charges and motor vehicle fees	When payment for the fee or charge is made
Other indirect taxes	When the debt to the Government arises
Other revenue	When the debt to the Government arises

Revenue earned through Operations

If revenue has been earned by the Government in exchange for the provision of outputs (products or services) to third parties, the Government receives its revenue through operations. Such revenue is recognised when it is earned.

Investment Income

Investment income is recognised in the period in which it is earned.

Gains

Realised gains arising from sales of assets or the early repurchase of liabilities are recognised in the Statement of Financial Performance in the period in which the transaction occurs.

Unrealised gains arising from changes in the value of property, plant and equipment are recognised as at balance date.

Expenses

General

Expenses are recognised in the period to which they relate.

Welfare Benefits

Welfare benefits are recognised in the period when an application for a benefit has been received and the eligibility criteria met.

Grants and Subsidies

Where grants and subsidies are discretionary until payment, the expense is recognised when the payment is made. Otherwise, the expense is recognised when the specified criteria have been fulfilled and notice has been given to the Government.

Losses

Realised losses arising from sales of assets or the early repurchase of liabilities are recognised in the Statement of Financial Performance in the period in which the transaction occurs.

Unrealised losses (excluding foreign-exchange losses) arising from changes in the value of property, plant and equipment, and investments and marketable securities held for investment and unlisted equity investments are recognised at balance date.

Foreign-currency transactions

Short-term transactions covered by forward exchange contracts are translated into Oceania Dollars using the forward rates specified in those contracts.

Other transactions in foreign currencies are translated into Oceania Dollars using the exchange rate on the date of the transaction. Exchange differences arising on settlement of these transactions are recognised in the Statement of Financial Performance.

Outstanding foreign-exchange contracts are translated at the closing exchange rate. Exchange gains and losses are included in the Statement of Financial Performance in the period in which they arise.

Depreciation

NB This section is included for completeness. It is not applicable under the modified accruals basis of accounting but will be required when the Government moves to full accrual accounting. Then the rates used should be those related to the Republic of Oceania's unique situation.

Depreciation should be charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its estimated useful life. Typically, the estimated useful lives of different classes of property, plant and equipment are as follows (again this will need to be customised for the OR unique situation):

Item	Period
Freehold buildings	25 to 60 years
Specialist military equipment	5 to 25 years
Other plant and equipment	3 to 25 years
Highways:	
Pavement (surfacing)	7 years
Pavement (other)	36 years
Bridges	90 to 100 years
Aircraft (excluding specialist military equipment)	10 to 20 years
Electricity distribution network	2 to 80 years
Electricity generation assets	25 to 55 years

Notes to the Accounts

Introduction

This section will contain all material relevant to the accounts which is not recorded elsewhere. Possible examples are included below. If data is not available for 2019, it should be shown by way of note to the accounts at some future date when it does become available. This section merely shows **how** the data can be presented if so desired – it is not prescriptive.

Contingent Liabilities

Government of the Republic of Oceania

Statement of Guarantees and Other Contingent Liabilities for Year Ended 31 December 2019

		Total Potential Exposure 2019	Exposure as at 31 December 2019	Exposure as at 31 December 2018
External Loans Guaranteed				
Borrower	**Lender**			
List all Borrowers	List all Lenders	X	X	X
Total External Loans Guaranteed		**X**	**X**	**X**
Domestic Loans Guaranteed				
Borrower	**Lender**			
List all Borrowers	List all Lenders	X	X	X
Total Domestic Loans Guaranteed		**X**	**X**	**X**
Other Contingent Liabilities				
Legal claim against the Government		X	X	X
Total Other Contingent Liabilities		**X**	**X**	**X**
Total Guarantees and Other Contingent Liabilities		**X**	**X**	**X**

Trust Funds

Trust Funds do not form part of the Government's funds and would not, normally, be included in the budget submitted for approval. In addition, they should also have separate bank accounts outside of the Single Treasury Bank account.

However, the Government is acting as a steward of such funds and should account for this stewardship. The most effective way of doing this is by way of a note to annual financial statements.

The following table should appear in the Notes to the Accounts for Trust Funds not included in other financial statements:

Government of the Republic of Oceania

Trust Fund Statement for Year Ended 31 December 2019

Fund	Opening Balance 1/1/2019	Receipts	Payments	Closing Balance 31/12/2019
Trust Fund A	X	X	(X)	**X**
Trust Fund B	X	X	(X)	**X**
Trust Fund C	X	X	(X)	**X**
TOTAL	**X**	**X**	**(X)**	**X**

Summary of Public Debt Liability

Another useful item to include in the Notes to the Accounts is a summary of public debt liability – how much is owed to whom.

Government of the Republic of Oceania

Public Debt Liability Statement for Year Ended 31 December 2019

Source of Borrowing	2019 Foreign Currency	2019 O$	2018 Foreign Currency	2018 O$
Domestic:		X		X
Bonds (%)		X		X
Treasury Bills		X		X
Total Domestic Borrowing		**X**		**X**
External Loans:				
Loans in SDR	**X**	**X**	**X**	**X**
- Project A				
Loans in US Dollars	X	X	X	X
- Project B (4.7%)	X	X	X	X
- Project C (5.24%)	**X**	**X**	**X**	**X**
Loans in Japanese Yen	X	X	X	X
- Project D (4.25%)	**X**	**X**	**X**	**X**
Etc.				
Total External Loans		**X**		**X**
Total Public Debt Liability		**X**		**X**

Other Statements

Other Statements can also be included in the Notes, if the government thinks it useful for the users of the accounts. Normally, materiality will be the main factor to be considered when deciding whether or not to include such Statements. However, Statements such as amount of On-lending and Write-offs are of interest in terms of transparency whatever the amounts.

There is no laid down format for such statements but they would generally follow the design of that of Public Debt Liability above.

Statements which could be considered for inclusion are:

- Statement of Investments;
- Statement of Sinking Funds;
- Statement on On-lending; and
- Statement of Write-offs.

Annex 3: International Accounting Standards

IAS	Name	Issued	Description	Associated SIC or IFRIC
1	Presentation of Financial Statements	2007*	Sets out the overall framework for presenting general purpose financial statements, including guidelines for their structure and the minimum content.	IFRIC #1;
2	Inventories	2005*	Prescribes the accounting for inventories.	IFRIC #20
7	Statement of Cash Flows	1992	Requires a statement of cash flows to present information about changes in cash and cash equivalents, classified as operating, investing and financing activities.	
8	Accounting Policies, Changes in Accounting Estimates and Errors	2003	Prescribes the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in estimates and correction of errors.	
10	Events after the Reporting Period	2003	Prescribes when financial statements must be adjusted for events after the end of the reporting period and what information must be disclosed.	
12	Income Taxes	1996*	Sets out the accounting for current and deferred tax.	SIC #25
16	Property, Plant and Equipment	2003*	Sets out the principles for accounting for property, plant and equipment (PP&E).	IFRIC #1; IFRIC #4; IFRIC #18; IFRIC #20; SIC #15; SIC #27; SIC #32
19	Employee Benefits *[Replaced Employee Benefits 1993]*	2011*	Sets out the accounting and disclosure requirements for employee benefits, including short-term benefits (wages, annual leave, sick leave, annual profit-sharing, bonuses and non-monetary benefits), pensions, post-employment life insurance and medical benefits, other long-term employee benefits (long-service leave, disability, deferred compensation, and long-term profit-sharing and bonuses); and termination benefits.	IFRIC #14
20	Accounting for Government Grants and Disclosure of Government Assistance	1984*	Prescribes the accounting for, and disclosure of, government grants and other forms of government assistance.	SIC #10

21	The Effects of Changes in Foreign Exchange Rates	2003*	Prescribes the accounting for foreign currency transactions and foreign operations.	IFRIC #16; IFRIC #22; SIC #7
23	Borrowing Costs	2007*	Prescribes the accounting when borrowings are made to acquire or construct an asset.	
24	Related Party Disclosures	2009*	Sets out disclosure requirements to make investors aware that the financial position and results of operations may have been affected by the existence of related parties.	
26	Accounting and Reporting by Retirement Benefit Plans	1987	Specifies the measurement and disclosure principles for the financial reports of retirement benefit plans.	
28	Investments in Associates and Joint Ventures	2011	Sets out the accounting when an entity has an investment in an associate or joint venture.	
29	Financial Reporting in Hyperinflationary Economies	1989	Sets out the requirements for entities reporting in the currency of a hyperinflationary economy.	IFRUIC #7
32	Financial Instruments: Presentation	2003*	Prescribes the accounting for classifying and presenting financial instruments as liabilities or equity and for offsetting financial assets and liabilities.	IFRIC #2
33	Earnings Per Share	2003*	Sets out the principles for measuring and presenting earnings per share (EPS).	
34	Interim Financial Reporting	1998	Prescribes the minimum content of an interim financial report and the recognition and measurement principles for an interim financial report.	IFRIC #10
36	Impairment of Assets	2004*	Sets out requirements to ensure that assets are carried at no more than their recoverable amount and to prescribe how recoverable amount and an impairment loss or its reversal are calculated.	IFRIC #10
37	Provisions, Contingent Liabilities and Contingent Assets	1998	Sets out recognition criteria and measurement bases for provisions, contingent liabilities and assets and the related disclosure requirements.	IFRIC #1; IFRIC #5; IFRIC #6; IFRIC #13; IFRIC #21
38	Intangible Assets	2004*	Prescribes the accounting treatment for recognising, measuring and disclosing intangible assets that are not dealt with in another IFRS Standard.	IFRIC #20; SIC #32

39	Financial Instruments: Recognition and Measurement NB Superseded by IFRS#9 where IFRS#9 is applied	2003*	Sets out the requirements for hedge accounting. An entity can elect to apply these requirements or those in IFRS 9.	IFRIC #9; IFRIC #10; IFRIC #16; IFRIC #19
40	Investment Property	2003*	Prescribes the accounting when property is held to earn rentals or for capital appreciation rather than being occupied by the owner for the production or supply of goods or services or for administrative purposes.	
41	Agriculture	2001	Prescribes the accounting for agricultural activity.	

** Where a pronouncement has been reissued with the same or a different name, the date indicated in the above table is the date the revised pronouncement was reissued (these are indicated by the asterisk).*

Annex 4: International Financial Reporting Standards

IFRS	Name	Date Issued	Effective Date	Description
1	First Time Adoption of IFRS	24/11/2008	01/07/2009	Sets out the procedures when an entity adopts IFRS Standards for the first time as the basis for preparing its general-purpose financial statements.
2	Share-based Payment	19/02/2004	01/01/2005	Sets out the accounting for transactions in which an entity receives or acquires goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of its shares or other equity instruments.
3	Business Combinations	10/01/2008	01/07/2009	An acquirer of a business recognises the assets acquired and liabilities assumed at their acquisition-date fair values and discloses information that enables users to evaluate the nature and financial effects of the acquisition.
4	Insurance Contracts	31/03/2004	01/10/2005	Prescribes the financial reporting for insurance contracts put in place pending the application of IFRS 17.
5	Non-Current Assets held for Sale and Discontinued Operations	31/03/2004	01/012005	Sets out the accounting for non-current assets held for sale and the presentation and disclosure of discontinued operations.
6	Exploration for and Evaluation of Mineral Resources	09/12/2004	01/01/2006	Prescribes the financial reporting for the exploration for and evaluation of mineral resources until the IASB completes a comprehensive project in this area.
7	Financial Instruments Disclosures	18/08/2005	01/01/2007	Prescribes disclosures to help the primary users of the financial statements evaluate the significance of financial instruments to the entity, the nature and extent of their risks and how the entity manages those risks.
8	Operating Segments	30/11/2006	01/01/2009	Requires entities to disclose segmental information that is consistent with how it is reported internally to the chief operating decision maker.
9	Financial Instruments	24/07/2014	01/01/2018	Sets out requirements for recognition and measurement of financial instruments, including impairment, derecognition and general hedge accounting. (See Also IFRIC #9, #10, #16 and #19.
10	Consolidated Financial Statements	12/05/2011	01/01/2013	Sets out the requirements for determining whether an entity (a parent) controls another entity (a subsidiary).
11	Joint Arrangements	12/05/2011	01/01/2013	Sets out principles for identifying whether an entity has a joint arrangement, and if it does whether it is a joint venture or joint operation.

12	Disclosure of Interests in Other Entities	12/05/2011	01/01/2013	Requires an entity to disclose information to help users of its financial statements evaluate the nature of, and risks associated with, its interests in other entities as well as the effects of those interests on its financial position, financial performance and cash flows.
13	Fair Value Measurement	12/05/2011	01/01/2013	Defines fair value and provides guidance, how to estimate it and the required disclosures about fair value measurements.
14	Regulatory Deferral Accounts	30/01/2014	01/01/2016	The Standard permits an entity that adopts IFRS Standards after IFRS 14 was issued to continue to account, with some limited changes, for 'regulatory deferral account balances' in accordance with its previous GAAP. IFRS 14 was issued as a temporary solution pending a more comprehensive review of rate regulation by the IASB (see the IASB project summary).
15	Revenue from Contracts with Customers	28/05/2014	01/01/2018	Prescribes the accounting for revenue from sales of goods and rendering of services to a customer. The Standard applies only to revenue that arises from a contract with a customer. Other revenue such as from dividends received would be recognised in accordance with other Standards.
16	Leases	13/01/2016	01/01/2019	Sets out the recognition, measurement, presentation and disclosure requirements for leases. A lessee recognises a leased asset and lease obligation for all leases. Lessors continue to distinguish between operating and finance leases.
17	Insurance Contracts	18/5/2017	01/01/2021	Establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts.
IFRIC 12*	Service Concession Arrangements	01/11/2006	01/01/2008	To address the accounting by private sector operators involved in the provision of public sector infrastructure assets and services. The Interpretation does not address the accounting for the government (grantor) side of such arrangements.
IFRIC 17*	Distributions of Non-cash Assets to Owners	01/11/2006	01/07/2009	To address the accounting when non-cash assets are distributed to owners.

* International Financial Reporting Interpretations Committee (IFRIC); IFRIC 12 and IFRIC 17 are summarised separately, because they draw from several Standards and are more complex than most Interpretations.

Annex 5: GAAP: Statements of Government Accounting Standards

GASB Statement No. 91, *Conduit Debt Obligations*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 05/19)

GASB Statement No. 90, *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 08/18)

GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 06/18)

GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 04/18)

GASB Statement No. 87, *Leases*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2019.
[Full Text] [Summary] [Status]
(Issued 06/17)

GASB Statement No. 86, *Certain Debt Extinguishment Issues*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 05/17)

GASB Statement No. 85, *Omnibus 2017*
Effective Date: The provisions of this Statement are effective for periods beginning after June 15, 2017. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 03/17)

GASB Statement No. 84, *Fiduciary Activities*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 01/17)

GASB Statement No. 83, *Certain Asset Retirement Obligations*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.
[Full Text] [Summary] [Status]
(Issued 11/16)

GASB Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of paragraph 7 in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements of paragraph 7 are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Earlier application is encouraged.
(Issued 03/16)
[Full Text] [Summary] [Status]

GASB Statement No. 81, *Irrevocable Split-Interest Agreements*
Effective Date: The requirements of this Statement are effective for periods beginning after December 15, 2016. Earlier application is encouraged.
(Issued 03/16)
[Full Text] [Summary] [Status]

GASB Statement No. 80, *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Earlier application is encouraged.
(Issued 01/16)
[Full Text] [Summary] [Status]

GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for the provisions in paragraphs 18, 19, 23–26, and 40, which are effective for reporting periods beginning after December 15, 2015. Earlier application is encouraged.
(Issued 12/15)
[Full Text] [Summary] [Status]

GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Earlier application is encouraged.
(Issued 12/15)
[Full Text] [Summary] [Status]

GASB Statement No. 77, *Tax Abatement Disclosures*
Effective Date: The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Earlier application is encouraged.
(Issued 08/15)
[Full Text] [Summary] [Status]
GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*

Effective Date: The provisions in Statement 76 are effective for reporting periods beginning after June 15, 2015. Earlier application is encouraged.
(Issued 06/15)
[Full Text] [Summary] [Status]

Statement No. 75
Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions
Effective Date: The provisions in Statement 75 are effective for fiscal years beginning after June 15, 2017. Earlier application is encouraged.
(Issued 06/15)
[Full Text] [Summary] [Status]

Statement No. 74
Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans
Effective Date: The provisions in Statement 74 are effective for fiscal years beginning after June 15, 2016. Earlier application is encouraged.
(Issued 06/15)
[Full Text] [Summary] [Status]

Statement No. 73
Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68
Effective Date: The provisions in Statement 73 are effective for fiscal years beginning after June 15, 2015—except those provisions that address employers and governmental non-employer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Earlier application is encouraged.
(Issued 06/15)
[Full Text] [Summary] [Status]

Statement No. 72
Fair Value Measurement and Application
Effective Date: The requirements of this Statement are effective for financial statements for reporting periods beginning after June 15, 2015. Earlier application is encouraged.
(Issued 02/15)
[Full Text] [Summary] [Status]

Statement No. 71
Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68
Effective Date: The provisions of this Statement should be applied simultaneously with the provisions of Statement 68.
(Issued 11/13)
[Full Text] [Summary] [Status]

Statement No. 70
Accounting and Financial Reporting for Nonexchange Financial Guarantees
Effective Date: The provisions of Statement 70 are effective for financial statements for reporting beginning after June 15, 2013. Earlier application is encouraged.
(Issued 04/13)

[Full Text] [Summary] [Status]

Statement No. 69

Government Combinations and Disposals of Government Operations

Effective Date: The provisions of Statement 69 are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. Early application is encouraged.

(Issued 01/13)

[Full Text] [Summary] [Status]

Statement No. 68

Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27

Effective Date: The provisions of Statement 68 are effective for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

(Issued 06/12)

[Full Text] [Summary] [Status]

Statement No. 67

Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25

Effective Date: The provisions of Statement 67 are effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

(Issued 06/12)

[Full Text] [Summary] [Status]

Statement No. 66

Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62

Effective Date: The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

(Issued 03/12)

[Full Text] [Summary] [Status]

Statement No. 65

Items Previously Reported as Assets and Liabilities

Effective Date: The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

(Issued 03/12)

[Full Text] [Summary] [Status]

Statement No. 64

Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53

Effective Date: The provisions of Statement 64 are effective for financial statements for periods beginning after June 15, 2011, with earlier application encouraged.

(Issued 06/11)

[Full Text] [Summary] [Status]

Statement No. 63

Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position

Effective Date: The provisions of Statement 63 are effective for financial statements for periods beginning after December 15, 2011, with earlier application encouraged.

(Issued 06/11)
[Full Text] [Summary] [Status]

Statement No. 62
Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements
Effective Date: The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.
(Issued 12/10)
[Full Text] [Summary] [Status]

Statement No. 61
The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34
Effective Date: The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.
(Issued 11/10)
[Full Text] [Summary] [Status]

Statement No. 60
Accounting and Financial Reporting for Service Concession Arrangements
Effective Date: For financial statements for periods beginning after December 15, 2011. The provisions of this Statement generally are required to be applied retroactively for all periods presented.
(Issued 11/10)
[Full Text] [Summary] [Status]

Statement No. 59
Financial Instruments Omnibus
Effective date: For periods beginning after June 15, 2010. Earlier application is encouraged.
(Issued 06/10)
[Full Text] [Summary] [Status]

Statement No. 58
Accounting and Financial Reporting for Chapter 9 Bankruptcies
Effective date: For periods beginning after June 15, 2009. Retroactive application is required for all prior periods presented during which a government was in bankruptcy.
(Issued 12/09)
[Full Text] [Summary] [Status]

Statement No. 57
OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans
Effective date: The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011.
(Issued 12/09)
[Full Text] [Summary] [Status]

Statement No. 56

Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards
Effective date: Effective upon issuance
(Issued 03/09)
[Full Text] [Summary] [Status]

Statement No. 55
The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments
Effective date: Effective upon issuance
(Issued 03/09)
[Full Text] [Summary] [Status]

Statement No. 54
Fund Balance Reporting and Governmental Fund Type Definitions
Effective date: For periods beginning after June 15, 2010
(Issued 02/09)
[Full Text] [Summary] [Status]

Statement No. 53
Accounting and Financial Reporting for Derivative Instruments
Effective date: For periods beginning after June 15, 2009
(Issued 06/08)
[Full Text] [Summary] [Status]

Statement No. 52
Land and Other Real Estate Held as Investments by Endowments
Effective date: For periods beginning after June 15, 2008
(Issued 11/07)
[Full Text] [Summary] [Status]

Statement No. 51
Accounting and Financial Reporting for Intangible Assets
Effective Date: For periods beginning after June 15, 2009
(Issued 06/07)
[Full Text] [Summary] [Status]

Statement No. 49
Accounting and Financial Reporting for Pollution Remediation Obligations
Effective date: For periods beginning after December 15, 2007
(Issued 11/06)
[Full Text] [Summary] [Status]

Statement No. 48
Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues
Effective date: For periods beginning after December 15, 2006
(Issued 09/06)
[Full Text] [Summary] [Status]

Statement No. 47
Accounting for Termination Benefits
Effective date: For periods beginning after June 15, 2005
(Issued 06/05)
[Full Text] [Summary] [Status]

Statement No. 46
Net Assets Restricted by Enabling Legislation—an amendment of GASB Statement No. 34
Effective date: For periods beginning after June 15, 2005. Earlier application is encouraged.
(Issued 12/04)
[Full Text] [Summary] [Status]

Statement No. 44
Economic Condition Reporting: The Statistical Section—an amendment of NCGA Statement 1
Effective date: Statistical sections prepared for periods beginning after June 15, 2005
(Issued 5/04)
[Full Text] [Summary] [Status]

Statement No. 42
Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries
Effective date: For periods beginning after December 15, 2004
(Issued 11/03)
[Full Text] [Summary] [Status]

Statement No. 41
Budgetary Comparison Schedules—Perspective Differences—an amendment of GASB Statement No. 34
Effective date: This Statement should be implemented simultaneously with Statement 34. For governments that have implemented Statement 34 prior to the issuance of this Statement, the requirements of this Statement are effective for financial statements for periods beginning after June 15, 2002
(Issued 5/03)
[Full Text] [Summary] [Status]

Statement No. 40
Deposit and Investment Risk Disclosures—an amendment of GASB Statement No. 3
Effective Date: For periods beginning after June 15, 2004
(Issued 3/03)
[Full Text] [Summary] [Status]

Statement No. 39
Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14
Effective Date: For periods beginning after June 15, 2003
(Issued 5/02)
[Full Text] [Summary] [Status]
Important Notice—Error Correction for Statement No. 39

Statement No. 38
Certain Financial Statement Note Disclosures
Effective Date: Coincides with the effective date of GASB Statement 34 for the reporting government. That is, the requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1 governments—with total annual revenues of $100 million or more—should implement paragraphs 6 through 11 for fiscal periods beginning after June 15, 2001. These governments should implement paragraphs 12 through 15 for fiscal periods beginning after June 15, 2002.
- Phase 2 governments—with total annual revenues of $10 million or more but less than $100

million—should apply this Statement for fiscal periods beginning after June 15, 2002.

- Phase 3 governments—with total annual revenues of less than $10 million—should apply this Statement for fiscal periods beginning after June 15, 2003.

Earlier application is encouraged. However, paragraphs 6, 14, and 15 should be implemented only if Statement 34 has also been implemented.

(Issued 6/01)
[Full Text] [Summary] [Status]

Statement No. 37
Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34
Effective Date: Coincides with the effective date of GASB Statement 34 for the reporting government. That is, the requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1 governments—with total annual revenues of $100 million or more—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2001.

- Phase 2 governments—with total annual revenues of $10 million or more but less than $100 million—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2002.

- Phase 3 governments—with total annual revenues of less than $10 million—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2003.

This Statement should be simultaneously implemented with Statement 34. Earlier application is encouraged, if done in conjunction with early adoption of Statement 34.

(Issued 6/01)
[Full Text] [Summary] [Status]

Statement No. 36
Recipient Reporting for Certain Shared Nonexchange Revenues—an amendment of GASB Statement No. 33
Effective date: Simultaneously with Statement 33, for periods beginning after June 15, 2000
(Issued 4/00)
[Full Text] [Summary] [Status]

Statement No. 35
Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities—an amendment of GASB Statement No. 34
Effective Date: In three phases based on a public institution's total annual revenues, beginning with periods beginning after June 15, 2001 and continuing through periods beginning after June 15, 2003. Public institutions that are component units of a primary government should implement this standard at the same time as that primary government.
(Issued 11/99)
[Full Text] [Summary] [Status]

Statement No. 34
Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments

Effective dates:

- Phase 1—Financial statements for periods beginning after June 15, 2001, for governments with total annual revenues of $100 million or more in the first fiscal year ending after June 15, 1999. Different provisions apply for reporting general infrastructure assets at transition.
- Phase 2—Financial statements for periods beginning after June 15, 2002, for governments with total annual revenues of $10 million or more but less than $100 million in the first fiscal year ending after June 15, 1999. Different provisions apply for reporting general infrastructure assets at transition.
- Phase 3—Financial statements for periods beginning after June 15, 2003, for governments with total annual revenues of less than $10 million in the first fiscal year ending after June 15, 1999. Different provisions apply for reporting general infrastructure assets at transition.

(Issued 6/99)
[Full Text] [Preface & Summary] [Status]

Statement No. 33
Accounting and Financial Reporting for Nonexchange Transactions
Effective date beginning after: June 15, 2000
(Issued 12/98)
[Full Text] [Summary] [Status]

Statement No. 32
Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans—a rescission of GASB Statement No. 2 and an amendment of GASB Statement No. 31
Effective date beginning after: December 31, 1998 or when plan assets are held in trust under the requirements of IRC Section 457, subsection (g), if sooner.
(Issued 10/97)
[Full Text] [Summary] [Status]

Statement No. 31
Accounting and Financial Reporting for Certain Investments and for External Investment Pools
Effective date beginning after: June 15, 1997
(Issued 3/97)
[Full Text] [Summary] [Status]

Statement No. 30
Risk Financing Omnibus—an amendment of GASB Statement No. 10
Effective date beginning after: June 15, 1996
(Issued 2/96)
[Full Text] [Summary] [Status]

Statement No. 29
The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities
Effective date beginning after: Dec. 15, 1993 (with exceptions)
(Issued 8/95)
[Full Text] [Summary] [Status]

Statement No. 28
Accounting and Financial Reporting for Securities Lending Transactions
Effective date beginning after: Dec. 15, 1997
(Issued 5/95)
[Full Text] [Summary] [Status]

Statement No. 24
Accounting and Financial Reporting for Certain Grants and Other Financial Assistance
Effective date beginning after: June 15, 1995
(Issued 6/94)
[Full Text] [Summary] [Status]

Statement No. 23
Accounting and Financial Reporting for Refunding of Debt Reported by Proprietary Activities
Effective date beginning after: June 15, 1994
(Issued 12/93)
[Full Text] [Summary] [Status]

Statement No. 21
Accounting for Escheat Property
Effective date beginning after: June 15, 1994
(Issued 10/93)
[Full Text] [Summary] [Status]

Statement No. 18
Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs
Effective date beginning after: June 15, 1993
(Issued 8/93)
[Full Text] [Summary] [Status]

Statement No. 17
Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements: Amendment of the Effective Dates of GASB Statement No. 11 and Related Statements—an amendment of GASB Statements No. 10, 11, and 13
Effective date on issuance: June 1993
(Issued 6/93)
[Full Text] [Summary] [Status]

Statement No. 16
Accounting for Compensated Absences
Effective date beginning after: June 15, 1993
(Issued 11/92)
[Full Text] [Summary] [Status]

Statement No. 14
The Financial Reporting Entity
Effective date beginning after: Dec. 15, 1992
(Issued 6/91)
[Full Text] [Summary] [Status]

Statement No. 13
Accounting for Operating Leases with Scheduled Rent Increases

Effective date beginning after: Various
(Issued 5/90)
[Full Text] [Summary] [Status]

Statement No. 10
Accounting and Financial Reporting for Risk Financing and Related Insurance Issues
Effective date ending after: Various
(Issued 11/89)
[Full Text] [Summary] [Status]

Statement No. 9
Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting
Effective date beginning after: Dec. 15, 1989
(Issued 9/89)
[Full Text] [Summary] [Status]

Statement No. 7
Advance Refunding Resulting in Defeasance of Debt
Effective date beginning after: Dec. 15, 1986
(Issued 3/87)
[Full Text] [Summary] [Status]

Statement No. 6
Accounting and Financial Reporting for Special Assessments
Effective date beginning after: June 15, 1987
(Issued 1/87)
[Full Text] [Summary] [Status]

Statement No. 3
Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements
Effective date ending after: Dec. 15, 1986
(Issued 4/86)
[Full Text] [Summary] [Status]

Statement No. 1
Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide
Effective date on issuance: July 1984
(Issued 7/84)
[Full Text] [Summary] [Status]

Annex 6: ISSAI #200: Fundamental Principles of Financial Auditing

1 Introduction

ISSAI #200 constitutes the basis for financial auditing standards in accordance with INTOSAI standards.

The main purpose of the ISSAI on financial audit is to provide INTOSAI members with a comprehensive set of principles, standards and guidelines for the audit of financial statements of public-sector entities.

Financial audit focuses on determining whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework. The scope of financial audits in the public sector may be defined by the SAI's mandate as a range of audit objectives in addition to the objectives of an audit of financial statements prepared in accordance with a financial reporting framework.

2 Purpose and Authority of the Fundamental Principles of Financial Auditing

ISSAI #200 provides the fundamental principles for an audit of financial statements prepared in accordance with a financial reporting framework.

Reference to ISSAI #200 in reports should only be made if auditing standards have been developed or adopted that fully comply with all relevant principles of ISSAI 200. A principle is considered relevant when it deals with the type of audit or combinations of audit types and the circumstances or procedures are applicable.

3 Framework for Financial Auditing

The Objective of Financial Auditing

The purpose of an audit of financial statements is to enhance the degree of confidence of intended users in the financial statements. This is achieved through the expression of an opinion by the auditor as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, or – in the case of financial statements prepared in accordance with a fair presentation financial reporting framework – whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

4 Elements of Financial Auditing

Introduction

Audits of financial statements are defined as assurance engagements, which involve at least **three separate parties: an auditor, a responsible party and intended users**. The elements of public-sector auditing are described in ISSAI 100. ISSAI 200 covers additional aspects of the elements relevant to an audit of financial statements.

Suitable Criteria

Criteria are the benchmarks used to evaluate or measure the subject matter, including, where relevant, benchmarks for presentation and disclosure. The criteria used in the preparation of financial statements are normally formal and may be IPSAS, IFRS or other national financial reporting frameworks for use in the public sector.

Subject matter information

The financial position, financial performance, cash flows and notes presented in the financial statements (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure (criteria) to a public-sector entity's financial data (subject matter). The term "subject matter information" refers to the outcome of the evaluation or measurement of the subject matter. It is on the subject matter information (e.g. the entity's financial statements) that the auditor gathers sufficient appropriate audit evidence to provide a reasonable basis for expressing an opinion in the auditor's report.

Reasonable Assurance Engagement

Audits of financial statements conducted in accordance with the ISSAI are reasonable assurance engagements. Reasonable assurance is high, but not absolute, given the inherent limitations of an audit, the result of which is that most of the audit evidence obtained by the auditor will be persuasive rather than conclusive. In general, reasonable assurance audits are designed to result in a conclusion expressed in a positive form, such as "in our opinion the financial statements present fairly, in all material respects (or give a true and fair view of) the financial position of … and its financial performance and cash flows …" or, in the case of a compliance framework, "in our opinion the financial statements are prepared, in all material respects, in accordance with ...".

5. Principles of Financial Auditing

5.1 Ethics and Independence

The auditor should comply with the relevant ethical requirements, including those pertaining to independence, when carrying out audits of financial statements.

Auditors conducting audits in accordance with the ISSAIs are subject to *ISSAI #130 – Code of Ethics* as applied in the national context. Auditors at SAI that have adopted the level 4 ISSAI as their authoritative standards, or that apply the ISA, are required either to comply with the Code of Ethics for Professional Accountants issued by the International Ethics Standards or to adopt national requirements that are at least as demanding.

5.2 Quality Control

Auditors should take responsibility for the overall quality of the audit.

The auditor is responsible for the performance of the audit and should implement quality control procedures throughout the audit process. Such procedures should be aimed at ensuring that the audit complies with the applicable standards and that the audit report, conclusion or opinion is appropriate given the circumstances.

5.3 Engagement Team Management and Skills

Auditors should have access to the necessary skills.

The individuals in the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being undertaken, familiarity with the applicable standards and authorities, an understanding of the audited entity's operations and the ability and experience to exercise professional judgement. Common to all audits is the need to recruit personnel with suitable qualifications, offer staff development and training, prepare manuals and other written guidance and instructions concerning the conduct of audits, and assign sufficient audit resources. Auditors should maintain their professional competence through ongoing professional development.

Audits may require specialised techniques, methods or skills from disciplines not available within the SAI. External experts may be used in different ways, e.g. to provide knowledge or conduct specific work. Auditors should evaluate whether experts have the necessary competence, capabilities and objectivity and determine whether their work is adequate for the purposes of the audit.

5.4 Principles related to Basic Audit Concepts

ISSAI #2000 - #2899 give best practice for the application of the Fundamental Principles of Financial Auditing. However, if an SAI chooses to develop standards based on the fundamental principles, or adopt national standards that are consistent with the principles, the matters covered by this and the following sections should be addressed.

GUID #2900 - #2999 provide Supplementary Financial Audit Guidance.

5.5 Audit Risk

Auditors should consider audit risk throughout the audit process.

Audits should be conducted in such a way as to manage or reduce the audit risk to an acceptable level. The audit risk is the risk that the audit report – or more specifically the auditor's conclusion or opinion -will be inappropriate in the circumstances of the audit.

Consideration of audit risk is relevant in both attestation and direct engagements. The auditor should consider three different dimensions of audit risk – inherent risk, control risk and detection risk – in relation to the subject matter and the reporting format, i.e. whether the subject matter is quantitative or qualitative and whether the audit report is to include an opinion or a conclusion. The relative significance of these dimensions of audit risk depends on the nature of the subject matter, whether the audit is to provide reasonable or limited assurance and whether it is a direct reporting or an attestation engagement.

5.6 Professional Judgement and Professional Scepticism

Auditors should plan and conduct the audit with professional scepticism and exercise professional judgement throughout the audit process.

The terms “professional scepticism” and “professional judgement” are relevant when formulating requirements regarding the auditor's decisions about the appropriate course of action. They express the attitude of the auditor, which must include a questioning mind.

The auditor must apply professional judgement at all stages of the audit process. The concept refers to the application of relevant training, knowledge and experience, within the context provided by auditing standards, so that informed decisions can be made about the courses of action that are appropriate given the circumstances of the audit.

The concept of professional scepticism is fundamental to all audits. The auditor should plan and conduct the audit with an attitude of professional scepticism, recognising that certain circumstances may cause the subject matter to diverge from the criteria. An attitude of professional scepticism means the auditor making a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit.

5.7 Materiality

Auditors should consider materiality throughout the audit process.

Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. This judgement may relate to an individual item or to a group of items taken together. Materiality is often considered in terms of value, but it also has other quantitative as well as qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs.

5.8 Communication

Auditors should maintain effective communication throughout the audit process.

Communication takes place at all audit stages; before the audit starts, during initial planning, during the audit proper, and at the reporting phase. Any significant difficulties encountered during the audit, as well as instances of material non-compliance, should be communicated to the appropriate level of management or those charged with governance. The auditor should also inform the responsible party of the audit criteria.

5.9 Documentation

Auditors should prepare sufficient audit documentation.

Documentation should be prepared at the appropriate time and should provide a clear understanding of the criteria used, the scope of the audit, the judgments made, the evidence obtained and the conclusions reached. Documentation should be sufficiently detailed to enable an experienced auditor, with no prior knowledge of the audit, to understand the following: the relationship between the subject matter, the criteria, the audit scope, the risk assessment, the audit strategy and audit plan and the nature, timing, extent and results of the procedures performed; the evidence obtained in support of the auditor's conclusion or opinion; the reasoning behind all significant matters that required the exercise of professional judgement; and the related conclusions. The auditor should prepare relevant audit documentation before the audit report is issued, and the documentation should be retained for an appropriate period of time.

6. Principles Related to the Audit Process

6.1 Agreeing the Terms of the Engagement

The auditor should agree or, if the terms of the engagement are clearly mandated, establish a common understanding of the terms of the audit engagement with management or those charged with governance.

6.2 Planning

The auditor should develop an overall audit strategy that includes the scope, timing and direction of the audit, as well as an audit plan.

6.3 Risk Assessment

Auditors should consider audit risk throughout the audit process.

Audits should be conducted in such a way as to manage, or reduce the audit risk to an acceptable level. The audit risk is the risk that the audit report – or more specifically the auditor's conclusion or opinion -will be inappropriate in the circumstances of the audit.

6.4 Risk of Fraud

Auditors should consider the risk of fraud.

The auditor should identify and assess the risks of material misstatement in the financial statements due to fraud, should obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud and should respond appropriately to fraud or suspected fraud identified during the audit.

The primary responsibility for the prevention and detection of fraud rests with the entity's management and those charged with governance. It is important that management, under the oversight of those charged with governance, strongly emphasise fraud prevention (limiting opportunities for fraud to take place) and fraud deterrence (dissuading individuals from committing fraud because of the likelihood of detection). The auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

6.5 Going-concern Considerations

The auditor should consider whether there are events or conditions that may cast significant doubt on the audited entity's ability to continue as a going concern.

6.6 Audit evidence

Auditors should gather sufficient appropriate audit evidence to cover the audit scope.

The auditor should gather sufficient and appropriate audit evidence to provide the basis for the conclusion or opinion. **Sufficiency** is a measure of the quantity of evidence, while **appropriateness** relates to the quality of evidence – its relevance, validity and reliability. The quantity of evidence required depends on the audit risk (the greater the risk, the more evidence is likely to be required) and on the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated.

However, merely obtaining more evidence does not compensate for its poor quality. The reliability of evidence is influenced by its source and nature and is dependent on the specific circumstances in which it was obtained. The auditor should consider both the relevance and the reliability of the information to be used as audit evidence and must respect the confidentiality of all audit evidence and information received.

6.7 Consideration of Subsequent Events

The auditor 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.

The auditor 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.

6.8 Evaluating Misstatements

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 course of the audit.

6.9 Forming an Opinion and Reporting on the Financial Statements

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

7. Considerations relevant to audits of group financial statements (including whole-of-government financial statements)

Auditors engaged to audit group financial statements should obtain sufficient appropriate audit evidence regarding the financial information of all components and the consolidation process to express an opinion as to whether the whole-of-government financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Annex 7: ISSAI #2000 – 2899: Financial Audit Standards

Introduction

Here we will examine them by mean of a brief overview of the objective of each standard. However, there is no substitute for reading them – and the relevant examples – in full.

ISSAI #2000: General Introduction to Guidelines

The main purpose of the INTOSAI Financial Audit Guidelines is to provide INTOSAI members with a comprehensive set of guidelines for the audit of financial statements of public sector entities.

The INTOSAI Fundamental Principles provide the overriding principles for the performance of and reporting on audits carried out by Supreme Audit Institutions. However, by utilizing the detail of the International Standard on Auditing (ISA) insofar as it is relevant to financial audits conducted by Supreme Audit Institutions, and by developing Practice Notes (PN) that deal with special considerations for financial audits of public sector entities, INTOSAI provides a comprehensive set of Financial Audit Guidelines that can be drawn upon by all Supreme Audit Institutions in all institutional settings and audit environments.

The objective of the INTOSAI Financial Audit Guidelines is to provide guidance for audits of financial statements in the public sector, including general guidance on additional auditing and reporting objectives related to the public sector audit of financial statements.

ISSAI #2003: Glossary

This ISSAI contains a glossary of terms.

ISSAI #2200: Overall Objectives; Audit in Accordance with Standards

In conducting an audit of financial statements, the overall objectives of the auditor are:

- To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- To report on the financial statements, and communicate as required by the ISA, in accordance with the auditor's findings.

In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISA require that the auditor disclaim an opinion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation.

ISSAI #2210: Agreeing Terms of Audit Engagements

The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- Establishing whether the preconditions for an audit are present; and
- Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

ISSA1 #2220: Quality Control for Audit of AFS

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- The audit complies with professional standards and applicable legal and regulatory requirements; and
- The auditor's report issued is appropriate in the circumstances.

ISSAI #2230: Audit Documentation

The objective of the auditor is to prepare documentation that provides:

- A sufficient and appropriate record of the basis for the auditor's report; and
- Evidence that the audit was planned and performed in accordance with ISA and applicable legal and regulatory requirements.

ISSAI #2240: Fraud

The objectives of the auditor 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, through designing and implementing appropriate responses; and
- To respond appropriately to fraud or suspected fraud identified during the audit.

ISSAI #2250: Laws and Regulations

The objectives of the auditor are:

- To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements;
- To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
- To respond appropriately to non-compliance or suspected noncompliance with laws and regulations identified during the audit.

ISSAI #2260: Communication

The objectives of the auditor are:

- To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- To obtain from those charged with governance information relevant to the audit;
- To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
- To promote effective two-way communication between the auditor and those charged with governance.

ISSAI #2265: Communicating Deficiencies in Internal Control

The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

ISSAI #2300: Planning an Audit of AFS

The objective of the auditor is to plan the audit so that it will be performed in an effective manner.

ISSAI #2315: Identifying Material Misstatements

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

ISSAI #2320: Materiality

The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit.

ISSAI #2330: Assessed Risks

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

ISSAI #2402: Using a Service Organisation

The objectives of the user auditor, when the user entity uses the services of a service organisation, are:

- To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and
- To design and perform audit procedures responsive to those risks.

ISSAI #2450: Evaluation of Misstatements

The objective of the auditor is to evaluate:

- The effect of identified misstatements on the audit; and
- The effect of uncorrected misstatements, if any, on the financial statements.

ISSAI #2500: Audit Evidence

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

ISSAI #2501: Audit Evidence (Specific Considerations)

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

- Existence and condition of inventory;
- Completeness of litigation and claims involving the entity; and
- Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

ISSAI #2505: External Confirmations

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

ISSAI #2510: Initial Engagement – Opening Balances

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- Opening balances contain misstatements that materially affect the current period's financial statements; and
- Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

ISSAI #2520: Analytical Procedures

The objectives of the auditor are:

- To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

ISSAI #2530: Audit Sampling

The objective of the auditor, when using audit sampling, is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

ISSAI #2540: Auditing Estimates

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether:

- accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable; and
- related disclosures in the financial statements are adequate, in the context of the applicable financial reporting framework.

ISSAI #2550: Related Parties

The objectives of the auditor are:

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

- To recognise fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and
- To conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:
  - Achieve fair presentation (for fair presentation frameworks); or
  - Are not misleading (for compliance frameworks); and
  - In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.

ISSAI #2560: Subsequent Events

The objectives of the auditor are:

- To obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework; and
- To respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

ISSAI #2570: Going Concern

The objectives of the auditor are:

- To obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements;
- To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
- To determine the implications for the auditor's report.

ISSAI #2580: Written Representations

The objectives of the auditor are:

- To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other ISAs; and

To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

ISSAI #2600: Group Financial Statements

The objectives of the auditor are:

- To determine whether to act as the auditor of the group financial statements; and
- If acting as the auditor of the group financial statements:
  - To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings; and
  - To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

ISSAI #2610: Using the Work of Internal Auditors

The objectives of the external auditor, where the entity has an internal audit function that the external auditor has determined is likely to be relevant to the audit, are:

- To determine whether, and to what extent, to use specific work of the internal auditors; and
- If using the specific work of the internal auditors, to determine whether that work is adequate for the purposes of the audit.

ISSAI #2620: Using the Work of Audit Experts

The objectives of the auditor are:

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

ISSAI #2700: Forming an Opinion on AFS

See Case Study for details.

ISSAI #2701: Communicating Key Audit Matters in the Independent Auditor's Report

See Case Study for details.

ISSAI #2705: Modifying Audit Opinion

See Case Study for details.

ISSAI #2706: Emphasis of Matter

See Case Study for details.

ISSAI #2710: Comparative Information

See Case Study for details.

ISSAI #2720: Other Information in AFS

See Case Study for details.

ISSAI #2800: Special Framework Audits

The objective of the auditor, when applying ISA in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to:

- The acceptance of the engagement;
- The planning and performance of that engagement; and
- Forming an opinion and reporting on the financial statements.

ISSAI #2805: Single Financial Statements

The objective of the auditor, when applying ISA in an audit of a single financial statement or of a specific element, account or item of a financial statement, is to address appropriately the special considerations that are relevant to:

The acceptance of the engagement;

The planning and performance of that engagement; and

Forming an opinion and reporting on the single financial statement or on the specific element, account or item of a financial statement.

ISSAI #2810: Summary Financial Statements

The objectives of the auditor are:

- To determine whether it is appropriate to accept the engagement to report on summary financial statements; and
- If engaged to report on summary financial statements:
  - To form an opinion on the summary financial statements based on an evaluation of the conclusions drawn from the evidence obtained; and
  - To express clearly that opinion through a written report that also describes the basis for that opinion.

Annex 8: Example of An Annual Audit Plan

This is a draft example from the Office of the Auditor-General of the Solomon Islands (December 2019). This is the OAG summary; each of the four branches have identical format spread sheets (see tabs) which automatically sum to provide the total. The spread sheet also provides for a basic summary of the time taken in each area each month to aid overall control of the annual audit. More sophisticated methods will be developed in Solomon Islands over the upcoming years but this provides an example of the minimum data we would expect to see in an SAI Annual Audit Plan.

	Staff	Total Planned Days	Total Actual Days	January Planned	January Actual	February Planned	February Actual	March Planned	March Actual	April Planned	April Actual	May Planned	May Actual	June Planned	June Actual	July Planned	July Actual	August Planned	August Actual	September Planned	September Actual	October Planned	October Actual	November Planned	November Actual	December Planned
Audit																										
Work Area																										
Planning	Manager	96	0	27	0	14	0	12	0	2	0	0	0	13	0	0	0	14	0	0	0	14	0	0	0	0
	Principal	35	0	9	0	8	0	6	0	1	0	0	0	1	0	0	0	8	0	0	0	2	0	0	0	0
	Senior	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	Intern	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Administration	Manager	86	0	7	0	18	0	13	0	8	0	5	0	7	0	3	0	10	0	5	0	5	0	5	0	0
	Principal	30	0	4	0	4	0	6	0	4	0	2	0	3	0	1	0	1	0	2	0	1	0	2	0	0
	Senior	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	Intern	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Operational Audit	Manager	193	0	0	0	14	0	19	0	26	0	26	0	26	0	18	0	14	0	26	0	13	0	11	0	0
	Principal	331	0	5	0	35	0	21	0	33	0	33	0	33	0	18	0	80	0	29	0	36	0	8	0	0
	Senior	1064	0	8	0	128	0	73	0	120	0	120	0	120	0	104	0	108	0	122	0	106	0	55	0	0
	Intern	10	0	0	0	0	0	0	0	0	0	0	0	0	0	10	0	0	0	0	0	0	0	0	0	0
Reporting	Manager	121	0	0	0	16	0	16	0	20	0	10	0	9	0	0	0	12	0	6	0	22	0	10	0	0
	Principal	50	0	0	0	10	0	8	0	6	0	0	0	5	0	0	0	9	0	0	0	6	0	6	0	0
	Senior	6	0	0	0	0	0	0	0	0	0	0	0	2	0	0	0	0	0	0	0	0	0	4	0	0
	Intern	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Reserve	Manager	46.5																								
	Principal	54																								
	Senior	128																								
	Intern	0																								
Total	Manager	542.5	0																							
	Principal	560	0																							
	Senior	1198	0																							
	Intern	10	0																							
	Total	**2310.5**	**0**																							

OAG Summary | GFAB | PGAB | CGFAB | PAB

Annex 9: Examples of Sources to be used to Gain an Understanding of the Audited Entity and Identifying Suitable Criteria

Examples of source material include:

- Laws and regulations, including documented intentions and the premises for establishing such legislation;
- Budget legislation / approved budget or appropriations;
- Legislative documents related to budget laws and resolutions, and to the premises or particular provisions for use of the approved appropriations, or for financial transactions, funds and balances;
- Legislative and ministerial directives;
- Information from regulatory authorities;
- Official records from meetings of the legislature, the Public Accounts Committee or similar legislative committees, or other public bodies;
- Principles of law;
- Legal precedent;
- Codes of practice and codes of conduct;
- Internal descriptions of policies, strategic and operational plans and procedures;
- Manuals and written guidelines;
- Formal agreements such as contracts;
- Loan and grant agreements;
- Industry standards;
- Well-established theory (e.g. theory for which there is general consensus; such theory may be obtained, for example, from published information: technical literature, methods, professional journals, etc., or through inquiry of knowledgeable sources like experts in a particular field);
- Generally accepted standards for a particular area (such standards are normally clearly identifiable standards that have their source in some form of legislation and that are a result of established practice and legal precedent, for example 'generally accepted accounting principles' in a particular country);
- For audits of propriety: principles for sound public sector financial management and conduct of public sector officials. Principles of conduct may stem from the legislature's or the public's expectations regarding the behaviour of public sector officials. In some cases, these principles may be documented in only fragmented ways. They may, in some cases, only be defined as a result of their breach.

Additional sources which public sector auditors may use to obtain an understanding about the audited entity, its environment and relevant programme areas may include:

1. The entity's annual report;
2. Legislative proposals and speeches;
3. Websites;
4. Published reports, articles in newspapers or journals, other media sources, etc.;
5. Knowledge obtained from previous audits;

6. Information gathered through meetings and other communications;
7. Minutes of Board meetings or other management meetings;
8. Internal audit reports;
9. Official statistics.

Annex 10: Documenting Controls – Different Approaches

There are different methods that auditors can use to gain an understanding of the control environment during the planning phase:

- Narratives;
- Flowcharts;
- Internal Control Questionnaires (ICQ); and
- Walk-throughs.

Narrative

This is a written description of an audited body's internal controls that generally provides:

- Information on the origin of every document and record in the system;
- A description of all the data processing that takes place;
- The position of every document and record in the system; and
- An indication of the controls relevant to the assessment of control risk, typically including the separation of duties, authorisations and approvals, and internal verifications.

As previously noted, major financial control systems, such as those relating to procurement, payment and payroll, will already be documented in the relevant regulations.

Flowchart

Flowcharts are diagrammatic representations of the audited body's documents and their sequential flow within the organisation. They can be a valuable component of the working paper file. They include the same four characteristics identified above for narratives.

The advantages of flowcharts are that they:

- Provide a concise overview of the audited body's systems;
- Help to identify inadequacies by showing how the system operates;
- Clearly illustrate the separation of duties, allowing auditors to judge whether they are adequate; and
- Are often easier to follow than a written description.

This is however a time-consuming exercise that is generally only used when the associated effort is justified, such as when there is some uncertainty about the processes, or where the complexity and importance of the procedures suggest a need for a clear representation.

Internal Control Questionnaire

An ICQ contains a series of questions about the controls in each audit area. There is usually a pre-developed ICQ that may be tailored to the specific area under examination. It is designed to require "yes" or "no" answers, with "no" answers indicating potential internal control deficiencies.

The advantage of using an ICQ is it allows for thorough cover of each audit area, reasonably quickly at the beginning of the audit. ICQs can also cover aspects of the control environment beyond procedural issues, such as management attitudes, staff awareness and so on.

The disadvantages are:

- The individual parts of the audited body's systems are examined without providing an overall view of them;
- A standardised questionnaire may not be applicable to all audit entities; and
- There is a danger of taking a mechanical approach rather than thinking through the control needs of the particular operations under examination.

Walk-Through (Cradle to Grave Test)

Walk-throughs are conducted to confirm that the system and controls are operating in accordance with the auditor's understandings. They are used to verify that the identified controls have been put into practice.

To conduct a walk-through test, the auditor should select a few (typically 3 to 6) transactions pertaining to each significant transaction cycle, then trace them through the cycle beginning with initiation of the transaction, through processing until it is ultimately summarised and included in a financial ledger or management report.

The auditor should document the transactions selected for walk-through, identify the controls that were observed and describe any enquiries made of the audited entity's personnel.

Annex 11: Examples of Testing Controls

Internal controls can be divided into two categories – preventive controls and detective controls. Preventive controls are designed to stop the occurrence of errors or irregularities in the accounting records in the first place. Detective controls are designed to find and correct errors or irregularities in the accounting records, if they have occurred already. Examples of issues to consider and ways of evaluating the controls are given in the table below.

MANAGEMENT CONTROLS	
The questions/actions which the auditor should consider when testing control procedures.	The audit techniques which help auditor to test if the control procedures operated effectively
1. Do you have a review the work of junior staff? If so, please show us if this review is recorded.	Inquiry of documentation which provide evidence for review. (e.g. signature)
2. Do management encourage and act on independent assessments of the control environment and internal controls?	Inquiry of documentation in order to provide if management letters are reviewed and responded to at board level and if internal audit reports on controls are encouraged by senior management and responded to at board level.
3. Does management respond robustly to breaches of codes of conduct and law? Is there communication throughout the organisation of disciplinary action taken as a result of breaches?	Verify if the reviewing of documents is made in addition to another controls.
4. Do senior management give appropriate consideration to the process and results of external audit? Does management follow if the recommendations of audit body was in fact implemented? What is the frequency of this ?	Inquiry of the way in which this follow up is documented.

ORGANISATIONAL CONTROLS	
The questions/actions which the auditor should consider when testing control procedures.	The audit techniques which help auditor to test if the control procedures operated effectively
1. Are in the accounting policies and Manual of procedure, the specific requirements regarding the segregations of duties?	Inquiry of staff for assessing if the segregation of duties is completed.
2. Which are the criteria for segregation of duties for each member of staff? Do you have any written paper for supporting these(e.g. job descriptions)	Observation on Manual of procedures in respect of identifying if segregation of duty are documented.
3. Are new employees made aware of their responsibilities and management's expectations of them, preferably via a detailed written job description, which is kept up to date over the course of their employment?	
4. Is the internal audit department independent of the accounting and operating function?	

AUTHORISATION CONTROLS	
The questions/actions which the auditor should consider when testing control procedures.	The audit techniques which help auditor to test if the control procedures operated effectively
1. Who is the person in charge with authorising transactions or accessing to assets and accounting records? Is this a handling or computer assisted process? Show us an example.(e.g signature, minute of the board)	Inspection of supporting document in view of endorsement and practical testing of system.
2. Which are the steps that have to be followed in respect of decide if the authorising could be made at an appropriate level? Are this steps observed? Does any transaction received the authorising?	
3. Does any possibility exist to avoid the authorising, even the system is manual or computerised? How internal control system detect this situation? Does this situation exist in our audited financial year?	
4. Do delegated authorities appear to be appropriate?	

OPERATIONAL CONTROLS	
The questions/actions which the auditor should consider when testing control procedures.	The audit techniques which help auditor to test if the control procedures operated effectively
1. How often do you perform reconciliations?	Inspection of reconciliation taken into consideration the following: - are these cleared (compared) with audited records? - do these meet the deadline?
2. Are reconciliations carrying out manual or are processed automatically by IT system, or is a combination of both?	Testing of system.
3. How do you ensure that all the information are included in a reconciliations process?	Observation on Manual of procedures.
4. Are all the reconciliation procedures included in Manual of procedures and accounting policies? Show us the Manual.	
5. Does the management review all the reconciliation made?	

PHYSICAL CONTROLS	
The questions/actions which the auditor should consider when testing control procedures.	The audit techniques which help auditor to test if the control procedures operated effectively
1. Have many changes been recorded in accessing to IT system during the audited year?	Following till to solve, any changing which have taken place during the audited year.
2. Are there regular physical checks of assets, premises and locations encouraged?	Checking if persons make the periodic physical counts independent of the accounting and asset records under appropriate supervision and if these counts being reconciled with stock records any adjustments write-offs being actioned.
3. Is there a specific officer responsible for physical security of the premises and assets?	

Annex 12: Examples of Subject Matters, Subject Matter Information and Criteria

	Subject Matter	Subject Matter Information	Criteria
1	Financial performance and use of appropriated funds: budget execution, including verifications that funds have been used as per with the purposes and intentions as decided by the legislature. Can be part of a regularity audit, including an audit of financial statements.	Financial information such as financial statements.	Relevant budget legislation such as an appropriations act. Approved budget.
2	Financial performance, for example revenue in the form of: project funds from donor agencies, funds from the central government, other similar types of funds and how they have been used.	Project financial information / project accounts.	Relevant legislation relating to the use of central government funds; Mandated activities of the audited entity; Funding agreement terms.
3	Financial performance, such as revenue in the form of grants, and how the revenue has been used.	Financial information related to use of the grant	Mandated activities of the audited entity. Grant agreement terms.
4	Financial performance, e.g. revenue and expenditures under a contract or loan agreement, and how those funds have been used.	Financial information related to the contract or loan agreement.	Terms of the contract or loan agreement.
5	Procurement	Financial information.	Relevant procurement legislation and regulations (national and international). Terms of a contract with a supplier.
6	Expenditures	Financial information. Statement of compliance.	Relevant budget legislation such as an appropriations act. Other relevant legislation. Relevant ministerial directives, government policy requirements and legislative resolutions. Contractual terms.

7	Programme activities	Activity indicators or reports.	Relevant agreed levels of performance such as those set out in laws and regulations, ministerial directives, goals agreed by the legislature, international treaties, protocols, conventions and agreements, a service level agreement, the terms of a contract, industry standards, and reasonable public expectations. For example: • number of kindergarten spots in relation to the number of eligible children; • number of qualified nurses and doctors per number of citizens; • number of miles of paved roads; • number of months required to process benefits payments or building permits frequency and quality of accounting information to be provided by service organisations; • number of building inspections to be performed within a particular time period; • measurements of results related to water quality, etc.
8	Service delivery	Statement of service delivery; Publicly reported information.	Relevant legislation or directives.
9	Probity of a public administrative decision	Citizen complaints register; Publicly reported information.	Relevant legislation or directives.
10	Behaviour / Propriety	A statement of compliance, for example a statement of independence (legal competence). In the public sector this statement may sometimes be implicit and related to the concepts of probity and propriety. (See criteria section above.)	- Relevant legislation or directives on the behaviour of public sector officials; - Code of ethics or internally developed code of conduct; - Stated values or leadership principles; - Internal policies, manuals and guidelines; - The organisation’s terms of reference, bylaws or similar texts; - Contractual terms (e.g. agreed confidentiality or quarantine arrangements subsequent to certain employment situations).

11	Membership obligations	Statement of compliance	Agreed terms of membership	
12	Health and safety processes	Statement of compliance Financial transactions	Relevant occupational health and safety legislation, e.g. in relation to access for persons with disabilities. Policies, processes, manuals, guidelines, etc.	
13	Environmental protection processes	Statement of compliance Financial transactions	• Relevant environmental legislation, such as relating to water quality, waste disposal or carbon emissions levels; • Terms of international environmental treaties, protocols, conventions and agreements • Policies, processes, manuals, guidelines, etc.	
14	Internal control processes	Statement of compliance. Financial transactions.	An internal control framework, for example COSO or similar, or internal control requirements set out in relevant legislation or generally accepted within a jurisdiction. Policies, processes, manuals, guidelines, etc.	
15	Processes specific to the entity's activities and operations, such as the payment of pensions and social benefits, the processing of passport and citizenship applications and the assessment of fines and other forms of penal sanctions	Statement of compliance. Financial transactions.	Relevant legislation and directives. Policies, processes, manuals, guidelines, etc.	
16	Physical characteristics	Specifications document or the physical object itself.	Building code (size, height, purpose, density measures for a particular zoned area, etc.). Terms of a construction contract or other type of contract.	
17	Tax revenue, taxpayer obligations and other obligations involving reporting to regulatory authorities	Individual and corporate tax returns. Other tax forms submitted to regulatory authorities (such as VAT forms, reporting forms for agencies operating within regulated industries such as banking and finance, pharmaceuticals, etc.)	Relevant legislation and industry-specific codes. Tax code, revenue code or similar.	

Annex 13: Concepts of Materiality

	Steps in determining what amount is considered Material in the context of a Specific Audit:
1	Identify the expected users of the financial statements (Members of Parliament, financial markets, Ministry of Finance, the public, NGOs multilateral agencies like the IMF, etc.).
2	Identify the information in the financial statements that will be most important to these users (e.g. total expenditures, total assets or the annual surplus or deficit).
3	Estimate the highest percentage(s) by which the important amount(s) in the financial statements could be misstated without significantly affecting their users' decisions.
4	Multiply the percentage(s) from step 3 by the base amount(s) from step 2.
5	Select the lowest amount from step 4. This is the materiality amount, meaning that an error or errors equal to or exceeding this value are considered to be material.
6	In general, select the lowest amount from each possible materiality value. This amount will be used for the financial statements audit as a whole. This is used because errors often affect more than one component. For example, an error in cash may also represent an error in expenditures. As a result, no higher materiality amount should be used to audit cash than the one used to audit expenditures. Some examples of how to calculate materiality are provided below.
	Percentage of Total Expenditure
	Applied to *not-for-profit* public sector entities. The percentages used generally range from 2% for "small" entities to 0.5% for "large" entities.
	Percentage of Normalised Pre-tax Income
	Applied to *profit-oriented* public sector entities (e.g. publicly-owned enterprises with a mandate to earn a return on their investments). The percentages used generally range from 5% for entities with "large" pre-tax incomes to 10% for entities with "small" pre-tax incomes.
	Percentage of Total Revenue
	The range utilised is between 0.5% and 2% for expenditures.
	Percentage of Equity
	Only for entities applying 1% accrual accounting to the equity.
	Percentage of Assets
	Usually 0.5%, which results in the same materiality amount as the amount under Percentage of Equity where the debt-to-equity ratio is 1 to 1.
	Professional Judgment for Defining Materiality
	In different circumstances, a different level of materiality might be required. Therefore the materiality assessment has to be documented in the working papers and be a part of the Planning File. In risk-based auditing, preserving a trace of how materiality was assessed is very important for the conclusions.
	Expected Aggregate Error
	By testing a sample, the Most Likely Error (MLE) in the population as a whole is established. Because it is only a sample from the population, there is a chance that the actual error in the population may be larger than the MLE. Therefore, the auditor needs to obtain sufficient assurance that the maximum possible error amongst the whole population, including errors which are not evident from the sample, is less than the materiality amount.
	This is done by reducing the materiality amount used to evaluate results, when planning and performing many analytical procedures and substantive tests on details. In these cases, the "expected aggregate error" has to be used, especially for financial statements as a whole.

	Calculating Expected Aggregate Error
	Option 1: If information about the financial errors found in previous audits is available, an average of the actual errors discovered during the previous three audits is calculated. The resulting estimate of expected aggregate error can be adjusted by using professional judgement where there have been any changes to the audited body's business or internal control structure that would likely increase or decrease the occurrence of errors.
	Option 2: The expected aggregate error can be estimated based on the level of materiality established in the preceding step, simply by estimating that the error is 10% of materiality if the auditor expects a low level of error, or 20% of materiality if the auditor expects a higher level of error.
	Planned Precision
	Planned precision is simply calculated as a percentage of the difference between materiality and the expected aggregate error. The percentage to be used will depend on the auditor's judgment regarding the nature of the errors in the sample. In general, "precision" is estimated as being between 80% and 100% of the difference between materiality and expected aggregate error. A higher percentage within this range should be chosen if errors vary little from year to year. Conversely, a lower percentage within this range should be applied if the amount of error is unpredictable. The basis for estimates of expected aggregate error and precision must be recorded in the working papers.
	Example
	A materiality level of O$100,000 has been established for the audited body. A review of the internal control system indicates that it appears to be reasonably adequate and a low level of error is expected, so the estimated error in the financial statements will be O$10,000 (10 % of the materiality amount). Based on previous audits, errors vary little from year to year, so precision is calculated as 90% of the difference between O$100,000 (materiality level) and O$10,000 (estimated error). O$100,000 x 0.9 yields planned precision of O$81,000.

Annex 14: Examples of Risk Factors Related to a Particular Subject Matter

Procurement is a typical subject matter for compliance audits. The following table gives some examples of risk factors relating to a compliance audit of procurement processes. This list is not exhaustive. The relevant risks and risk factors will vary depending on the subject matter and the circumstances of the particular audit.

	Examples of Risk Factors Related to Procurement Audits
	Inherent Risk
1	Lack of relevant procurement legislation
2	Recent changes to procurement legislation (e.g. to conform to international legislation)
3	Complex or unclear legislation, or legislation open to interpretation
4	Significant monetary amounts are involved, such as for defence procurement
5	Audit findings from the prior year revealed compliance deviations in regard to procurement legislation and directives
6	Previous suspicions or proven instances of fraud and corruption involving management and/or key staff
7	Inspections by regulatory authorities (e.g. competition authorities)
8	Complaints received from potential suppliers about unfair practices related to tender selection
9	Potential conflicts of interest
	Control Risk
1	Lack of good internal guidelines, including lack of clear and objective criteria
2	Recent changes in systems or application controls related to computerised procurement systems
3	Poor quality control or weak monitoring activities related to suppliers
4	Weak or non-existent controls regarding suppliers' compliance with ethical guidelines
5	Non-existent or poor-quality monitoring activities related to compliance with relevant legislation
	Detection Risk
1	Ineffectively designed audit procedures (e.g. procedures that only involve checking transactions that have been recorded, not checking for completeness; or making enquiries only of staff in the procurement department and not of others such as administrative and facilities management staff, suppliers, or agencies that register complaints)
2	Incentives that may lead management to intentionally withhold or conceal evidence (for example, suppliers may make bribes or give kickbacks)
3	Possible management collusion or override of controls

Annex 15: Inherent Risk and Control Risk

Inherent risk and control risk should be assessed in order to determine the mix of tests needed to address the errors and irregularity conditions identified for each component. Therefore, inherent risk and control risk may differ from one component to the next, and the auditors may have a number of different inherent and control risk assessments to handle.

Inherent Risk

Inherent risk is the assessment of the likelihood that a material misstatement or irregularity might occur in the first place, before considering the effectiveness of internal controls. A "material error" may refer to one error or to the sum of multiple smaller errors that, combined, exceed the materiality amount.

Inherent risk is evaluated at this stage to determine how much testing of internal controls and substantive testing needs to be done to achieve the desired level of assurance. In general, the greater the inherent risk, the more audit work will be required.

The factors to consider include the following.

- ***Nature of the component:*** Components such as cash are more vulnerable to manipulation or loss than, for example, fixed assets.
- ***Extent to which the items making up the component are similar in size and composition:*** If the population is composed of relatively homogeneous items, it will be easier for management (and for the auditors) to detect anomalous transactions and amounts.
- ***Volume of activity***: If a lot of transactions are being processed, the chances of an error occurring may be higher than if only a few transactions are being processed.
- ***Non-routine transactions:*** Errors are more likely in unusual transactions because of the audited body's lack of experience. Some examples include major property acquisitions, losses due to fire, rent agreements, etc. Knowledge of the audited body's activities and meeting minute reviews are useful in learning about the extent of non-routine transactions.
- ***Judgment items:*** Many account balances such as obsolete inventory and uncollectible accounts receivable are estimates that require management's judgment. The more judgment is required, the greater the risk of misstatement.
- ***Competency of the staff processing the transactions:*** If the staff are experienced and take their jobs seriously, there is probably a lower inherent risk than if they are inexperienced or careless.
- ***Number of locations:*** Entities operating out of a single location with a centralised accounts system may have a lower inherent risk than those operating out of many locations, each with its own accounts system.
- ***Accounting policies being used:*** Many components have a lower risk of error when the cash method of accounting is used than when the accrual method of accounting is used.
- ***Factors that could affect the risk of fraud:*** Errors can be intentional. Auditors should maintain a questioning mind and be alert to evidence that contradicts or brings into question the reliability of documents or of management's representations.

It can be seen from the above that assessments of inherent risk are primarily based on the auditor's knowledge of the audited body and its environment. This knowledge will primarily have been acquired during the planning process, as part of **"understanding the audited body's business"**.

The assessment of inherent risk is subjective and requires the use of professional judgment. It is therefore appropriate to have the most experienced and knowledgeable individuals on the audit team make the assessment of inherent risk. These should be the individuals with the greatest knowledge of the entity being audited.

Although inherent risk is often the same across the entire audit scope, it can also differ by audit objective and by component. For example, the risk of cash being improperly valued is low, but the risk of cash not being complete may be quite high.

While guidelines should not replace the use of professional judgment, the following may be useful when assessing inherent risk:

Level of Inherent Risk	Risk	Resulting Assurance
High inherent risk	60%	40%
Moderate inherent risk	50%	50%
Low inherent risk	40%	60%

It is recommended to work with an inherent risk factor of at least 40% unless there is convincing evidence such as prior compliance work that detected a high level of compliance or few monetary errors.

Control Risk

Control risk refers to the likelihood that the audited body's internal controls will not prevent or detect material errors and reflects the effectiveness of the internal control structure. The planner will evaluate control risk to determine the amount of assurance that can be obtained from tests of internal controls.

An overall assessment of control risk will have been performed as part of updating the auditor's understanding of the audited body's internal control structure. That assessment will establish the audited body's overall level of control risk. However, control risk may vary by component and by audit objective. For example, the audited body's management may have devised very good controls over the payment component, to ensure the validity and measurement of expenditures, but may have paid less attention to the completeness of those expenditures.

Control risk is also affected by the same factors that might affect the risk of fraud – particularly management fraud. This is because management can often override the internal controls that have been put in place. As discussed above, the auditor needs to use a questioning mind and be alert to evidence that contradicts or brings into question the reliability of documents or of management's representations.

Control risk should be re-assessed during the fieldwork phase of the audit, when the results of tests of controls will determine whether they are working as intended. For example, if control risk is assessed as "low" at the general planning phase but numerous internal control deviations (improperly approved supplier invoices, for example) are found during the fieldwork phase, then the assessment of control risk may need to be revised and additional substantive tests of detail may need to be conducted to achieve the required level of assurance.

While guidelines should not replace the use of professional judgment, the following may be useful when assessing control risk:

Level of Control Risk	Risk	Resulting Assurance
High (poor internal controls)	80%	Up to 20%
Moderate (moderate internal controls)	50%	Up to 50%
Low (strong internal controls)	20%	Up to 80%

The auditors should not rely on internal controls unless tests in the execution phase have demonstrated that the controls do, in fact, work.

Annex 16: Examples of Compliance Deviations

The following table provides some examples of compliance deviations and includes considerations related to materiality and the establishment of conclusions. The comments related to materiality and forming conclusions are not intended to be definitive assessments of whether the particular example constitutes a material compliance deviation or not, but rather to highlight relevant considerations. The determination of materiality will depend on the particular circumstances and the professional judgment of the public sector auditor.

	Example of Compliance Deviation	Considerations Related to Materiality and Forming Conclusions
1	During the year, a government agency received budget appropriations through the Ministry of Education for national educational purposes. The agency's grant expenditure for the year included O$ 10 million paid to overseas high tech manufacturers.	Based on the legislation governing the government agency, the agency did not have the power to make grants to overseas bodies. This non-compliance may be material because the grant expenditure was paid out to overseas bodies and was therefore not in compliance with the relevant authorisations, nor was it applied to the purposes intended by the legislature.
2	During the year, a government agency incurred expenditures of O$ 100 in excess of the total expenditure of O$ 5,000 authorised by the budget approved by the legislature.	In this case, actual expenditures were in excess of the amounts authorised under the approved budget. This non-compliance may be material because it was a clear violation of the clearly established authorisations. Depending on the circumstances, including the type of expenditures, it may also be very sensitive in nature.
3	A citizen is entitled to a monthly pension of O$ 1,000. The government agency has only been paying out O$ 900 per month. The payments were also made after the dates stipulated by legislation.	Although the monetary amounts involved may not be material to the financial statements of the government agency, the consequences of non- compliance are likely to be very significant to the individual pensioner living on a fixed income. If the non-compliance was due to a weakness in the system, the non-compliance may also affect many other citizens. This non-compliance may therefore be material in terms of the impact on the citizens and on society in general.
4	Child benefits for a 19 year-old child.	Non-compliance was due to a weakness in the system, the non-compliance may also affect many other citizens. This non-compliance may therefore be material in terms of the impact on the citizens and on society in general.
	Example of Compliance Deviation	**Considerations Related to Materiality and Forming Conclusions**
5	The terms of a building code require annual inspections to be performed. The government agency has not performed inspections for the past five years.	The non-compliance may be significant due to qualitative aspects such as safety implications. Although no particular monetary amounts are involved, the non-compliance may be material as a result of the potential consequences it may have on the safety of the building's occupants. In the event of a disaster, there is also a risk that the non- compliance may result in significant liability claims which could have material financial implications for the government agency as well.
6	The terms of a funding agreement state that the recipient of the funds must prepare financial statements and send them to the donor organisation by a certain date. The financial statements were not prepared and sent by this date.	The non-compliance may or may not be material depending on whether or not the financial statements were subsequently prepared and sent, the length of the delay, the reasons for the delay, any consequences that may arise as a result of non-compliance, etc.
7	Significant system weaknesses were identified in relation to revenue collected pursuant to a tax code. The weaknesses were caused by an incorrect interpretation of the tax code by the audited entity. Numerous instances were identified of taxpayers being assessed more than they	This type of compliance deviation relates to the due process rights of individual citizens. Certain citizens were being assessed too much tax, while others were not being assessed at all. Depending on the circumstances, and because it involves a system weakness, the deviation may be material.

Annex 17: Analytical Approaches that may be used during Audit Testing

There are several different types of analytical procedures that may be used during the planning phase and, potentially, in subsequent fieldwork, as explained below.

General Reviews for Reasonableness

These analytical procedures involve a high-level comparison of current information against previous periods, budgets or statistics from the audited body. No pre-determined threshold amount is specified for identifying significant fluctuations. The process is sometimes referred to as “eyeballing” the financial statements – looking for accounts that appear to be unusual in terms of their amounts, volume of activity, etc. The objective of this type of analysis is generally to decide where to focus attention during the audit.

Comparative Analysis

This involves comparing the current year’s reported amounts (or ratios) with those of prior years. Comparative analysis assumes that the prior year’s amounts provide a sufficiently accurate estimate of the current year’s amounts and, therefore, can be used to identify any significant fluctuations from the current year’s posted amounts. A pre-determined threshold amount is specified for identifying significant fluctuations.

Predictive Analysis

Predictive analysis compares the current year’s reported amounts (or ratios) to a prediction of what the current year’s amounts (or ratio) should be, based upon the trend in prior years’ amounts (or ratios). The data from prior years used in making this prediction are adjusted for all known changes in the factors affecting the data. This usually results in a more accurate estimate than the comparative analysis. A pre-determined threshold amount is specified for identifying significant fluctuations.

Statistical Analysis

This category of analytical procedures involves analysing the known behaviour of variables and developing an equation (model) that explains the relationships between these variables. Although this category is similar to predictive analysis, statistical analysis differs from the latter in that it uses more rigorous methods, such as regression analysis, to provide more accurate predictions and that it objectively measures the confidence level and the achieved level of precision.

Overall Verification Procedures

This category of analytical procedures involves building up an estimate of an account balance from known and verified data. For example, the auditor could verify the number of rental units by type of unit, the average rent by type of unit, and the vacancy rate. The auditor could then compare the estimate to the revenue actually received from rent. Overall verification procedures usually result in an accurate estimate of the account. A pre-determined threshold amount is specified for identifying significant fluctuations for the auditor to investigate.

Care is required with this type of analysis. The auditor must not assume that the data are more accurate than the financial information. For example, the actual vacancy rate may be lower than the posted vacancy rate, with the difference being due to fraud. Thus, the analytical data might substantiate the financial data, while the income received is in fact less than the income owed. The auditor should therefore test whether the sources of information are independent or might be subject to the same potential for error.

The following table provides guidance as to the amount of assurance that each category of analytical procedure can provide. While guidelines should not replace the use of professional judgment in planning for analytical procedures, the following is typical:

Type of Analytical Procedure	Risk	Assurance
Overall reviews for reasonableness	100%	0%
Comparative analysis	70% or more	Up to 30%
Predictive analysis	50% or more	Up to 50%
Statistical analysis	30% or more	Up to 70%
Overall verification procedures	10% or more	Up to 90%

Annex 18: Determining Sample Size

Calculating Sample Size

Method 1:

For use when transactions are similar in nature (such as salary payments) and it is believed that the population does not contain material expected aggregate error.

Step 1: Establish a risk factor for the population to be tested using the following table:

INHERENT RISK	CONTROL RISK	RISK FACTOR
H	H	3.0
H	M	3.0
H	L	2.0
M	H	3.0
M	M	2.0
L	H	2.0
L	M	2.0
L	L	0.7

Step 2: Calculate a theoretical sample size, using the following formula:

Population value / precision x Risk factor = Sample Size

Step 3: Where the theoretical sample size is more than 100 and the sample is to be selected manually (as opposed to using CAATS to select a sample from a computer database), the auditor can limit the sample to 100 items, to be selected at random from amongst the population.

Example:

At a certain audited body, the value of the salaries component is O$ 4 million, and ***precision*** is O$ 45,000.

The auditor has assessed ***inherent risk*** as ***high***, and ***control risk*** as ***medium****.* Consequently, the ***risk factor*** is *3.0.*

Population value / Precision x Risk factor = Sample Size

4,000,000 / 45,000 x 3 = 267

This yields a theoretical sample size of 267 units. Since the sample is to be taken from a population of manually-prepared pay slips, the auditor should limit the sample to 100 items drawn randomly from the population.

Method 2:

For use when the population is either very large or very small, and where transactions are not similar in nature (such as purchase orders).

Step 1: Calculate the sample size as in Method 1:

Population value / Precision x Risk factor = Sample Size

Step 2: Add 20%.

Step 3: Where the theoretical sample size is more than 100 and the sample is to be selected manually, the auditor can limit the sample to 100 items, to be selected at random from amongst the population.

Annex 19: Use of Monetary Unit Sampling Workbook

Steps in use of MUS

1. Determine correct population value for selected items (the sample size determined should be sufficient and each sampling unit in the population should have equal chances of being selected).
2. Consider performance materiality for the selected population or items for testing.
3. Select the multiple of population to performance materiality.
4. Consider assessed risks (risk/significant risk).
5. Consider results of control testing (effective or not effective).
6. Determine number of samples to be tested using the following table.

Population size-multiples of performance materiality*	Risk (not significant) & reliance on controls—low extent of testing	Risk (not significant) & reliance on controls—normal extent of testing	Significant risk & reliance on controls, or risk (not significant) & no reliance on controls	Significant risks & no reliance on controls
1x	1	1	2	3
2x	1	2	3	6
3x	1	3	5	9
4x	1	3	6	12
5x	1	4	8	15
6x	2	5	9	18
7x	2	5	11	21
8x	2	6	12	24
9x	2	7	14	27
10x	2	7	15	30
15x	3	11	23	45
20x	4	14	30	60
25x	5	18	38	75
30x	6	21	45	75(*)
40x	8	28	60	75(*)
50x	10	35	75	75(*)
100x	20	70	75(*)	75(*)
200x(or greater)	40(*)	75(*)	75(*)	75(*)

Note: *Suppose the multiple of population to performance materiality is 8, assessed risk is not a significant risk, and extent of reliance on control is normal, the sample size should be 6.*

7. Use MUS worksheet (fill up population size and sample size determined using above table).
8. Add rows depending on the number of items in the population as shown below.

**The numbers indicate the situations that are impacted by the existence of a maximum sample size (i.e., if we didn't have a maximum sample size, the required number selected would be greater in these situations).*

- *The sample sizes represent minimum sample sizes. The audit team may determine that, in some circumstances, it is appropriate to increase the sample sizes over those in the table.*
- *For a population that contains a significant risk, we are required to perform substantive procedures that are specifically responsive to that risk. These specifically responsive substantive procedures frequently involve non-representative selection.*

Monetary Unit Sampling Worksheet

Financial Statement Account	Purchase of Power
Population	435,747,415
Sample Size	14
Sampling Interval	31,124,815
Random Start	10,000,000

Add Rows

Item #	ID#	Description	Amount	Sub-Total	Number of Selections	Sampling Interval	Selection Remainder
	Insert population data in white cells below						(10,000,000)
1	5000000015	1/10/12	13,158,479.75	3,158,480	1	31,124,815	(27,966,336)
2	5000000306	1/31/12	5,293,473.28	(22,672,862)	0	31,124,815	(22,672,862)
3	5000000321	1/31/12	17,420,774.46	(5,252,088)	0	31,124,815	(5,252,088)
4	5000000361	1/31/12	13,740,795.12	8,488,707	1	31,124,815	(22,636,108)
5	5000001020	3/7/12	4,650,608.14	(17,985,500)	0	31,124,815	(17,985,500)
6	5000001062	3/7/12	12,931,211.93	(5,054,288)	0	31,124,815	(5,054,288)
7	5000001138	2/29/12	15,436,314.61	10,382,027	1	31,124,815	(20,742,789)
8	5000002021	4/5/12	13,705,066.05	(7,037,723)	0	31,124,815	(7,037,723)
9	5000002024	3/31/12	4,795,012.43	(2,242,710)	0	31,124,815	(2,242,710)
10	5000002186	3/31/12	18,882,067.07	16,639,357	1	31,124,815	(14,485,459)
11	5000002987	4/30/12	11,867,247.08	(2,618,211)	0	31,124,815	(2,618,211)
12	5000003001	4/30/12	4,131,736.23	1,513,525	1	31,124,815	(29,611,291)
13	5000003064	4/30/12	16,713,514.71	(12,897,776)	0	31,124,815	(12,897,776)
14	5000004106	5/31/12	17,222,699.45	4,324,924	1	31,124,815	(26,799,892)
15	5000004113	6/3/12	12,656,124.65	(14,143,767)	0	31,124,815	(14,143,767)
16	5000004192	6/11/12	3,611,245.52	(10,532,522)	0	31,124,815	(10,532,522)
17	5000004850	6/30/12	11,820,309.02	1,287,787	1	31,124,815	(29,837,028)
18	5000004895	6/30/12	3,759,930.53	(26,077,097)	0	31,124,815	(26,077,097)
19	5000004919	6/30/12	16,067,537.64	(10,009,560)	0	31,124,815	(10,009,560)
20	5000006002	8/6/12	4,036,880.38	(5,972,679)	0	31,124,815	(5,972,679)
21	5000006053	8/7/12	15,958,364.61	9,985,685	1	31,124,815	(21,139,130)
22	5000006055	8/7/12	12,077,352.30	(9,061,778)	0	31,124,815	(9,061,778)
23	5000007139	9/4/12	16,800,205.50	7,738,428	1	31,124,815	(23,386,388)
24	5000007142	9/13/12	4,089,418.29	(19,296,969)	0	31,124,815	(19,296,969)
25	5000007159	9/13/12	12,241,074.69	(7,055,895)	0	31,124,815	(7,055,895)
26	5000007995	10/9/12	4,140,548.39	(2,915,346)	0	31,124,815	(2,915,346)
27	5000008000	10/9/12	12,825,042.62	9,909,696	1	31,124,815	(21,215,119)
28	5000008013	10/9/12	16,880,647.27	(4,334,472)	0	31,124,815	(4,334,472)
29	5000009140	11/9/12	4,782,095.60	447,624	1	31,124,815	(30,677,192)
30	5000009141	11/9/12	14,219,044.19	(16,458,147)	0	31,124,815	(16,458,147)
31	5000009147	11/9/12	16,344,373.21	(113,774)	0	31,124,815	(113,774)
32	5000010342	12/5/12	13,515,854.95	13,402,081	1	31,124,815	(17,722,735)
33	5000010516	12/6/12	5,273,103.15	(12,449,631)	0	31,124,815	(12,449,631)
34	5000010597	12/7/12	18,489,622.17	6,039,991	1	31,124,815	(25,084,825)
35	5000012297	12/28/12	3,364,039.00	(21,720,786)	0	31,124,815	(21,720,786)
36	5000012514	12/31/12	22,870,504.49	1,149,719	1	31,124,815	(29,975,096)
37	5000012515	12/31/12	14,269,958.56	(15,705,138)	0	31,124,815	(15,705,138)
38	5000012516	12/31/12	5,705,137.84	(10,000,000)	0	31,124,815	(10,000,000)

9. Generate sample; the final result should be as follows:

Monetary Unit Sampling Worksheet

# of Selections: **#DIV/0!**

Item #	ID#	Description	Amount	Number of Selections
1	5000000015	1/10/12	13,158,479.75	1
4	5000000361	1/31/12	13,740,795.12	1
7	5000001138	2/29/12	15,436,314.61	1
10	5000002186	3/31/12	18,882,067.07	1
12	5000003001	4/30/12	4,131,736.23	1
14	5000004106	5/31/12	17,222,699.45	1
17	5000004850	6/30/12	11,820,309.02	1
21	5000006053	8/7/12	15,958,364.61	1
23	5000007139	9/4/12	16,800,205.50	1
27	5000008000	10/9/12	12,825,042.62	1
29	5000009140	11/9/12	4,782,095.60	1
32	5000010342	12/5/12	13,515,854.95	1
34	5000010597	12/7/12	18,489,622.17	1
36	5000012514	12/31/12	22,870,504.49	1

Notes:

1. The data provided above is fictitious. The entity used is an energy company owned by the government, where the audit is carried out by the SAI of country X.
2. This sampling tool is provided in Microsoft Excel Sheet as a separate file for use by SAIs.

Annex 20: Contents of the Current File

	Working Paper Folders	Contents that should be in the Working Paper Folder
A	**Audit Plan**	Audit Planning Memorandum which should cover: • Background • Materiality • Risk Assessment • Audit objectives • Audit approach for each account area • Resources and timing • Key contacts at the entity • Understanding the entity - consider and document: • External Environment; and • Legislation to which the entity is subject. • Materiality Calculation • Calculation of Estimated Error and Precision • Review of Information systems (if applicable) – consider and document: • Physical controls (location of computer, back-up, etc; • and application controls. • Risk Assessment – consider and document: • Inherent Risk for each account area • Control environment questionnaire and overall assessment • Control procedures questionnaire (if applicable) • Control Risk Assessment for each account area • Specific Risks for the entity • Specific Risks in respect of each account area • Assessment of key controls on each of the account areas. • Audit Approach for each account area: Including calculation of sample sizes required, and where applicable any use to be made of analytical procedures or tests of control. • Approval of Audit Planning Memorandum
B	**Draft Account**	Transaction listings Trial Balance; Draft Account and amendments; Cross reference from Draft Account to individual WPFs.

C	**Profit and Loss Account Areas.** **For each account area, for example income, salaries, operating expenditure, etc.**	Issues from last year; Audit planning document from the audit plan; Audit Programme; Samples tested; Errors found and evaluation of errors Overall lead schedule to show the amount audited for each account area; Summary of matters for attention; Issues to carry forward into next year.
D	**Balance Sheet Areas** **For each account area, for example fixed assets, cash, debtors, creditors etc.**	Issues from last year; Audit planning document from the audit plan; Audit Programme; Samples tested; Errors found and evaluation of errors Overall lead schedule to show the amount audited for each account area; Summary of matters for attention; Issues to carry forward into next year.
E	**Losses**	Details of losses; Summary of matters for attention.
F	**Internal Audit**	Evaluation of Internal Audit; Summary of matters for attention.
G	**Liaison**	Copies of correspondence with entities; Summary of matters for attention.