**AUDITING STANDARDS**

**DEFINITIONS:**

**Standard:**

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| |  | | --- | | Standard refers to a level of quality accepted as norm:a level of quality or excellence that is accepted as the norm or by which actual attainments are judged (**Microsoft® Encarta® 2009).** We have standards everywhere: Take the following scenario:   * What standards would you expect of a Bachelor of Commerce Degree? * In writing your research project, what standards is your supervisor setting? * Think of other scenario where you thought something was done that you thought was not standard, or was up to standard. | |

**Auditing Standards (Importance of Auditing Standards):**

Auditing Standardsdefine mandatory requirements for audit and assurance. They inform:

* The Audit and assurance professionals of the minimum level of acceptable performance required to meet the professional responsibilities set out in the relevant code of Professional Ethics.
* Management and other interested parties of the profession’s expectations concerning the work of practitioners of auditing.
* Holders of the relevant auditing professional qualification/ certification of requirements. Failure to comply with these standards may result in an investigation into the conduct by the relevant professional body, and ultimately, in disciplinary action.

**Who Sets Standards?**

Some standard setting bodies include:

* The International Organization for Standardization (ISO) sets general standards.
* The Information Systems Audit and Control Association (ISACA) sets IT audit Standards
* Standards as applied to financial auditing (Auditing Standards) are usually set by the International Audit and Assurance Standards Board (IAASB). Our interest in this course is on these standards set by IAASB.

**What is IAASB?**

The **International Auditing and Assurance Standards Board** (IAASB) is the independent standard setting body which issue [auditing](http://en.wikipedia.org/wiki/Auditing), review, other assurance related services and [quality control](http://en.wikipedia.org/wiki/Quality_control) standards to be applied by the global auditing profession. It is a body initiated by the [International Federation of Accountants](http://en.wikipedia.org/wiki/International_Federation_of_Accountants) (IFAC). The [Public Interest Oversight Board](http://en.wikipedia.org/wiki/Public_Interest_Oversight_Board) provides oversight of the IAASB, ensuring that the standards are in the public interest.

The [International Auditing and Assurance Standards Board (IAASB)](http://www.ifac.org/IAASB/About.php) serves the public interest by:

* Setting, independently and under its own authority, high-quality [International Standards on Auditing](http://web.ifac.org/clarity-center/the-clarified-standards) (ISAs) and assurance standards, and
* Facilitating the convergence of national and international auditing and assurance standards.

This contributes to enhanced quality and uniformity of practice in these areas throughout the world, and strengthened public confidence in financial reporting.

The IAASB’s [International Standards on Auditing (ISAs)](http://web.ifac.org/clarity-center/the-clarified-standards) are now effective and auditors worldwide are adopting and implementing these standards. The IAASB recognizes that the implementation of its standards is as important as their development and has committed to a number of activities to facilitate effective implementation. ([www.ifac.org/](http://www.ifac.org/) IAASB)

**The Due Process of Standards Setting**

The IAASB follows a rigorous [due process](http://web.ifac.org/download/PIAC-Due_Process_and_Working_Procedures.pdf) in developing its pronouncements. Input is obtained from the IAASB's [Consultative Advisory Group](http://www.ifac.org/IAASB/ConsultativeAdvisoryGroup.php), [national auditing standard setters](http://www.ifac.org/IAASB/NationalAuditingStandardSetters.php), IFAC member bodies and their members, and the general public. Exposure drafts of proposed pronouncements are placed on the website and widely distributed for public comment. For each final pronouncement, the IAASB issues a separate document explaining its [basis of conclusions](http://web.ifac.org/publications/international-auditing-and-assurance-standards-board/basis-for-conclusions) with respect to comments received on an exposure draft.

Please refer to IFAC website for more information on the due process of setting standards.

**The Steering Committee**

The Steering Committee is a standing committee of the IAASB that advises the IAASB on matters of strategic and operational importance, while also relieving the IAASB of the need to address certain administrative matters that do not necessarily require its deliberation. In addition, the Steering Committee acts as counsel and advisor to the IAASB Chair and Technical Director on matters and activities relating to achievement of the objectives of the IAASB. The Steering Committee reports to the IAASB.

**Examples of standards:**

## ISA 210, Agreeing the Terms of Audit Engagements

This ISA deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present. ISA 220- [**Quality Control for an Audit of Financial Statements**](http://web.ifac.org/clarity-center/isa-220) deals with those aspects of engagement acceptance that are within the control of the auditor.

This standard sets out the following as preconditions for accepting an audit engagement. The auditor should:

(a)Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the auditor with:

a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

b. Additional information that the auditor may request from management for the purpose of the audit; and

c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

## ISA 230, Audit Documentation

This ISA deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. Note that law or regulation may establish additional documentation requirements.

Audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “work papers” are also sometimes used).

Documentation primarily serves as:

(a) Evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor; and

(b) Evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.

Documentation is also useful in:

* Assisting the engagement team to plan and perform the audit.
  + Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with ISA 220.
  + Enabling the engagement team to be accountable for its work.
  + Retaining a record of matters of continuing significance to future audits.

*Form, Content and Extent of Audit Documentation*

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

(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;

(b) The results of the audit procedures performed, and the audit evidence obtained; and

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

## ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

This ISA deals with the auditor's responsibilities relating to fraud in an audit of financial statements.

The standard covers the following areas:

*Characteristics of Fraud*

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

*Responsibility for the Prevention and Detection of Fraud*

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity’s performance and profitability.

*Requirements*

*Professional Skepticism*

In accordance with ISA 200, the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance.

*Discussion among the Engagement Team*

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

*Risk Assessment Procedures and Related Activities*

When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity’s internal control, required by ISA 315, the auditor shall perform the procedures in paragraphs 17–24 to obtain information for use in identifying the risks of material misstatement due to fraud.

## ISA 300, Planning an Audit of Financial Statements

This ISA deals with the auditor's responsibility to plan an audit of financial statements. Here is what the standard has to say:

**The Role and Timing of Planning**

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

• Helping the auditor to devote appropriate attention to important areas of the audit.

• Helping the auditor identify and resolve potential problems on a timely basis.

• Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.

• Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

• Facilitating the direction and supervision of engagement team members and the review of their work.

• Assisting, where applicable, in coordination of work done by auditors of components and experts.

The auditor shall develop an audit plan that shall include a description of:

(a) The nature, timing and extent of planned risk assessment procedures, as determined under ISA 315- [**Identifying and Assessing the Risks of Material Misstatement through understanding the Entity and Its Environment**](http://web.ifac.org/clarity-center/isa-315).

(b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA 330- [**The Auditor's Responses to Assessed Risks**](http://web.ifac.org/clarity-center/isa-330).

(c ) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs.

(d) The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit.

(e) The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work

**Documentation**

The auditor shall include in the audit documentation (see ISA 230 above)

(a) The overall audit strategy;

(b) The audit plan; and

(c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

**ISA 320, Materiality in Planning and Performing an Audit**

This ISA deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. ISA 450 (see reference below where you can access this standard) explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

**Materiality in the Context of an Audit**

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

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

**Requirements**

**Determining Materiality and Performance Materiality When Planning the Audit**

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

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

**References for further reading.**

You can access these standards and others for free at**:** [**http://web.ifac.org/clarity-center/the-clarified-standards**](http://web.ifac.org/clarity-center/the-clarified-standards)

**NB: for this course concentrate on ISA 230, ISA 240, ISA 320, AND ISA 500)**