KPMG Audit Execution Guide - ISA (KAEG-I) INTL Version

2024

This KAEG PDF is as of 22 January 2024. Guidance on which version of KAEG is applicable to an engagement is available in the "Introduction to the KPMG Audit Execution Guide".

Please note the following:

- this PDF is supplemented by certain GAAM Alerts. Refer to the GAAM Alerts landing page on Alex for a list of Alerts that supplement KAEG.
- while this PDF provides a familiar and consistent experience to access and search KAEG, the contextual delivery of KAEG in the KPMG Clara workflow provides the relevant guidance for the task being performed in the workflow and, along with Alex, is the recommended source for KAEG.
- the following content is not available in this PDF, but links are provided to the content in the relevant bullets below:
  - Audits of special purpose financial statements: ISA 800
  - Audits of single financial statements and specific elements, accounts or items of a financial statement: ISA 805
  - KAEG 5: Multi-firm engagements involving entities registered for statutory purposes in a jurisdiction different than the location of their business activities

KAEG-I [INTL VERSION 2024]: ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

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KAEG-I [INTL VERSION]: ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing [ISA | KAEGISA200]

ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

View the Full Chapter for this Standard

ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

Introduction, Objectives, Definitions

International Standards on Auditing: ISA 200.01-13

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with ISAs. Specifically, it sets out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the ISAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the ISAs. The independent auditor is referred to as "the auditor" hereafter.

2. ISAs are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. ISAs do not address the responsibilities of the auditor that may exist in legislation, regulation or otherwise in connection with, for example, the offering of securities to the public. Such responsibilities may differ from those established in the ISAs. Accordingly, while the auditor may find aspects of the ISAs helpful in such circumstances, it is the responsibility of the auditor to ensure compliance with all relevant legal, regulatory or professional obligations.

An Audit of Financial Statements

3. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion. (Ref: Para. A1)

4. The financial statements subject to audit are those of the entity, prepared by management of the entity with oversight from those charged with governance. ISAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A2-A11)

5. As the basis for the auditor's opinion, ISAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. (Ref: Para. A31-A57)

6. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.[1] In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they 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 the light of surrounding circumstances, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The auditor's opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.

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1 ISA 320, *Materiality in Planning and Performing an Audit* and ISA 450, *Evaluation of Misstatements Identified during the Audit*

7. The ISAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control.

- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

8. The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation. (Ref: Para. A12-A13)

9. The auditor may also have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, in relation to matters arising from the audit. These may be established by the ISAs or by applicable law or regulation.[2]

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2 See, for example, ISA 260 (Revised), *Communication with Those Charged with Governance;* and ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements,* paragraph 44.

Effective Date

10. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Overall Objectives of the Auditor

11. In conducting an audit of financial statements, the overall objectives of the auditor are:

(a) 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

(b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

12. 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 ISAs require that the auditor disclaim an opinion or withdraw (or resign)[3] from the engagement, where withdrawal is possible under applicable law or regulation.

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3 In the ISAs, only the term "withdrawal" is used.

Definitions

13. For purposes of the ISAs, the following terms have the meanings attributed below:

(a) Applicable financial reporting framework - The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

(b) Audit evidence - Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. For purposes of the ISAs:

(i) Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

(ii) Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

(c) Audit risk - The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

(d) Auditor - The person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an ISA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.

(e) Detection risk - The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

(f) Financial statements - A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with a financial reporting framework. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement, or in the notes, or incorporated therein by cross-reference. (Ref: Para. A14-A15)

(g) Historical financial information - Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

(h) Management - The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.

(i) Misstatement - A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Where the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.

(j) Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted - That management and, where appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, 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 and, where appropriate, those charged with governance determine 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 and, where appropriate, those charged with governance are 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 and, where appropriate, those charged with governance 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.

In the case of a fair presentation framework, (i) above may be restated as "for the preparation and *fair* presentation of the financial statements in accordance with the financial reporting framework," or "for the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework."

The "premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted" may also be referred to as the "premise."

(k) Professional judgment - The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

(l) Professional skepticism - An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

(m) Reasonable assurance - In the context of an audit of financial statements, a high, but not absolute, level of assurance.

(n) Risk of material misstatement - The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level: (Ref: Para. A15a)

(i) Inherent risk - The susceptibility 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.

(ii) 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 controls.

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

ISA Application and Other Explanatory Material: ISA 200.A1-A16

Application and Other Explanatory Material

An Audit of Financial Statements

Scope of the Audit (Ref: Para. 3)

A1. The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the ISAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

Preparation of the Financial Statements (Ref: Para. 4)

A2. Law or regulation may establish the responsibilities of management and, where appropriate, those charged with governance in relation to financial reporting. However, the extent of these responsibilities, or the way in which they are described, may differ across jurisdictions. Despite these differences, an audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged and understand that they have responsibility:

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

(b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide the auditor with:

(i) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

(ii) Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and

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

A3. The preparation of the financial statements by management and, where appropriate, those charged with governance requires:

- The identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- The preparation of the financial statements in accordance with that framework.
- The inclusion of an adequate description of that framework in the financial statements.

The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

A4. The financial statements may be prepared in accordance with a financial reporting framework designed to meet:

- The common financial information needs of a wide range of users (that is, "general purpose financial statements"); or
- The financial information needs of specific users (that is, "special purpose financial statements").

A5. The applicable financial reporting framework often encompasses financial reporting standards established by an authorized or recognized standards setting organization, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial reporting standards established by an authorized or recognized standards setting organization and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources, or may even consist only of such sources. Such other sources may include:

- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations in relation to accounting matters;
- Published accounting interpretations of varying authority issued by standards setting, professional or regulatory organizations;
- Published views of varying authority on emerging accounting issues issued by standards setting, professional or regulatory organizations;
- General and industry practices widely recognized and prevalent; and
- Accounting literature.

Where conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained, or among the sources that encompass the financial reporting framework, the source with the highest authority prevails.

A6. The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.

A7. Some financial reporting frameworks are fair presentation frameworks, while others are compliance frameworks. Financial reporting frameworks that encompass primarily the financial reporting standards established by an organization that is authorized or recognized to promulgate standards to be used by entities for preparing general purpose financial statements are often designed to achieve fair presentation, for example, International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

A8. The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance and cash flows of an entity. For such frameworks, a complete set of financial statements would include a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements:

- For example, the International Public Sector Accounting Standard (IPSAS), *Financial Reporting under the Cash Basis of Accounting*, issued by the International Public Sector Accounting Standards Board states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares its financial statements in accordance with that IPSAS.
- Other examples of a single financial statement, each of which would include related notes, are:
  - Balance sheet.
  - Statement of income or statement of operations.
  - Statement of retained earnings.
  - Statement of cash flows.
  - Statement of assets and liabilities that does not include owner's equity.
  - Statement of changes in owners' equity.

- Statement of revenue and expenses.
- Statement of operations by product lines.

A9. ISA 210 establishes requirements and provides guidance on determining the acceptability of the applicable financial reporting framework.[5] ISA 800 (Revised) deals with special considerations when financial statements are prepared in accordance with a special purpose framework.[6]

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5 ISA 210, *Agreeing the Terms of Audit Engagements,* paragraph 6(a)

6 ISA 800 (Revised), *Special Considerations - Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks,* paragraph 8

A10. Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain the agreement of management and, where appropriate, those charged with governance that they acknowledge and understand that they have the responsibilities set out in paragraph A2 as a precondition for accepting the audit engagement.[7]

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7 ISA 210, paragraph 6(b)

Considerations Specific to Audits in the Public Sector

A11. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a public sector entity is conducted may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with law, regulation or other authority.[8]

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8 See paragraph A59.

Form of the Auditor's Opinion (Ref: Para. 8)

A12. The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor's opinion, however, will depend upon the applicable financial reporting framework and any applicable law or regulation. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, *preparation* of the financial statements in accordance with the applicable financial reporting framework includes *presentation*.

A13. Where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the ISAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework. Unless specifically stated otherwise, references in the ISAs to the auditor's opinion cover both forms of opinion.

Definitions

Financial Statements (Ref: Para. 13(f))

A14. Some financial reporting frameworks may refer to an entity's economic resources or obligations in other terms. For example, these may be referred to as the entity's assets and liabilities, and the residual difference between them may be referred to as equity or equity interests.

A15. Explanatory or descriptive information required to be included in the financial statements by the applicable financial reporting framework may be incorporated therein by cross-reference to information in another document, such as a management report or a risk report. "Incorporated therein by cross-reference" means cross-referenced from the financial statements to the other document, but not from the other document to the financial statements. Where the applicable financial reporting framework does not expressly prohibit the cross-referencing of where explanatory or descriptive information may be found, and the information has been appropriately cross-referenced, the information will form part of the financial statements.

Risk of Material Misstatement (Ref: Para. 13(n))

A16. For the purposes of the ISAs, a risk of material misstatement exists when there is a reasonable possibility of:

(a) A misstatement occurring (i.e., its likelihood); and

(b) Being material if it were to occur (i.e., its magnitude).

How do we comply with the Standards?

[ISA | KAEGHDWC]

1 Perform procedures to comply with the overall objectives [ISA | 4567]

What do we do?

Perform procedures to comply with the overall objectives in conducting an audit of the financial statements.

Why do we do this?

When we perform a financial statement audit our objective is to obtain reasonable assurance about whether the financial statements are free of material misstatement, so that we can express an opinion on the financial statements. This opinion is our ultimate deliverable, which the users of the financial statements rely upon when making decisions based on those financial statements.

We keep in mind the overall objective of our audit throughout the audit process.

Execute the Audit

How do we achieve the overall objectives of an audit of financial statements? [ISA | 4567.1300]

To achieve the overall objectives in performing an audit over financial statements, we:

- Comply with the appropriate rules and regulations regarding ethical and independence requirements
- Plan and perform work with due professional care
- Apply professional skepticism
- Exercise professional judgment
- Reduce audit risk to an acceptably low level
- Conduct the audit in accordance with auditing standards and KPMG audit methodology

Ethical Requirements Relating to an Audit of Financial Statements, Professional Skepticism

International Standards on Auditing: ISA 200.14-15

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

14. The auditor shall comply with relevant ethical requirements, including those related to independence, relating to financial statement audit engagements. (Ref: Para. A17-A20)

Professional Skepticism

15. The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A21-A25)

ISA Application and Other Explanatory Material: ISA 200.A17-A25

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 14)

A17. The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the provisions of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) related to an audit of financial statements, together with national requirements that are more restrictive.

A18. The IESBA Code establishes the fundamental principles of ethics, which are:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behaviour.

The fundamental principles of ethics establish the standard of behavior expected of a professional accountant.

The IESBA Code provides a conceptual framework that establishes the approach which a professional accountant is required to apply when identifying, evaluating and addressing threats to compliance with the fundamental principles. In the case of audits, reviews and other assurance engagements, the IESBA Code sets out *International Independence Standards*, established by the application of the conceptual framework to threats to independence in relation to those engagements.

A19. In the case of an audit engagement it is in the public interest and, therefore, required by the IESBA Code, that the auditor be independent of the entity subject to the audit. The IESBA Code describes independence as comprising both independence of mind and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

A20. International Standard on Quality Management (ISQM) 1,[11] or national requirements that are at least as demanding,[12] deal with the firm's responsibilities to design, implement and operate a system of quality management that provides the firm with reasonable assurance that the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements. As part of its system of quality management, ISQM 1 requires the firm to establish quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence.[13] ISA 220 (Revised) sets out the engagement partner's responsibilities with respect to relevant ethical requirements, including those related to independence.[14]. ISA 220 (Revised) also describes when the engagement team may depend on the firm's policies or procedures in managing and achieving quality at the engagement level. [15]

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11 ISQM 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

12 ISA 220 (Revised), Quality Management for an Audit of Financial Statements, paragraph 3

13 ISQM 1, paragraphs 29

14 ISA 220 (Revised), paragraphs 16–21

15 ISA 220 (Revised), paragraph A10.

Professional Skepticism (Ref: Para. 15)

A21. 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 ISAs.

A22. Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

A23. Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example, in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

A24. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.[16] In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), the ISAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.[17]

16 ISA 500, *Audit Evidence,* paragraphs 7 - 9

17 ISA 240, paragraph 14; ISA 500, paragraph 11; ISA 505, *External Confirmations,* paragraphs 10 - 11, and 16

A25. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Remain ethical and independent during our audit engagements [ISA | 644]

What do we do?

Remain ethical and independent during our audit engagements.

Why do we do this?

We remain independent and ethical so that we issue our auditor's report objectively and to maintain public confidence. Compliance with ethical and independence requirements during our audits is a priority each and every day. Although there are rules that we follow, being ethical and independent is a continuous process that is at the forefront of how we carry out our daily activities.

Execute the Audit

IESBA PIE Independence Rules | How do we remain ethical and independent during the audit? [ISA | 644.9667]

To remain ethical and independent we:

- Determine the appropriate independence rules and regulations
- Perform certain independence procedures during planning
- Perform certain independence procedures prior to the audit completion
- Perform independence procedures in relation to new related entities
- Report and document identified breaches of independence and ethical requirements
- Communicate independence matters to those charged with governance
- Conclude on compliance with independence requirements
- Perform independence procedures as a component auditor
- Comply with fee-related public disclosure requirements

IESBA non-PIE Independence Rules | How do we remain ethical and independent during the audit? [ISA | 644.160087]

To remain ethical and independent we:

- Determine the appropriate independence rules and regulations
- Perform certain independence procedures during planning
- Perform certain independence procedures prior to the audit completion
- Perform independence procedures in relation to new related entities
- Report and document identified breaches of independence and ethical requirements
- Communicate independence matters to those charged with governance
- Conclude on compliance with independence requirements
- Perform independence procedures as a component auditor

For what period is our independence maintained? [ISA | 644.9674]

We maintain independence for the period covered by the firm's report as well as the engagement period. The engagement period begins at the earliest of:

- The date we sign the initial audit engagement letter; or
- The date the audit planning commences; or
- The date the audit services are first provided to the entity

We remain independent from the entity for the duration of the professional relationship, which means the period through audit report issuance. For recurring engagements, we remain independent until the later of the audit relationship being terminated or the final audit report being issued.

What independence policies do we follow for IESBA non-PIE audits? [ISA | 644.157484]

We follow the independence policies in the GQ&RMM https://www.gqrmm-prod.kworld.kpmg.com/G/0/.

Can SEC and PCAOB Independence Rules be applicable in an ISA audit? [ISA | 644.158374]

Yes. For example, the financial statements filed by Canadian registrants reporting through the Multijurisdictional Disclosure System (MJDS) are not required to follow PCAOB auditing standards, however, SEC and PCAOB independence rules apply.

What independence procedures do we perform for an ISA audit where SEC and PCAOB Independence rules are applicable? [ISA | 644.158375]

Where SEC and PCAOB Independence Rules apply, refer to KAEG-P, AS 1005.01-07 | Remain ethical and independent during our audit engagements [PCAOB | 644].

1.1 Determine the appropriate independence rules and regulations [ISA | 7909]

What do we do?

Determine the appropriate independence rules and regulations.

Why do we do this?

Following rules and regulations established by our regulators for compliance with ethical and independence allows us to build public confidence and perform a high quality audit. Ethics and independence requirements are a priority each and every day and it is a continuous process that is at the forefront of how we carry out our daily activities.

Execute the audit

What ethics and independence rules and regulations do we comply with? [ISA | 7909.9635]

We comply with the rules and requirements of Parts 1, 2, 3 and 4A of the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) https://www.ethicsboard.org/iesba-code (IESBA Code) related to an audit of financial statements together with country specific requirements that are more restrictive. These requirements are incorporated in the Global Quality and Risk Management Manual (GQ&RMM). We therefore comply with the GQ&RMM and any incremental requirements from local laws and regulations (e.g. European Union Audit Reform independence requirements). In some instances, requirements are specific to audit clients that are public interest entities (PIEs) or non-public interest entities (non-PIEs). Where this is the case, we follow the applicable requirements.

How do we determine the applicable independence procedures to complete for our engagement? [ISA | 7909.160089]

The KPMG Clara workflow is designed to deliver the appropriate independence procedures for each engagement, based on the engagement profile selections made by the engagement team. When the Engagement Profile within the KPMG Clara workflow is completed accurately (in accordance with the Engagement Profile functional guidance), it will generate the appropriate Independence module. The Engagement Profile functional guidance can be located in the relevant workflow by navigating to the Guidance pane in the Engagement Profile screen.

Are we permitted to perform an audit when there is a breach of the applicable independence rules? [ISA | 7909.9639]

If a breach or potential breach of an independence requirement is identified, we consult with the Ethics and Independence Partner to evaluate the significance of the breach. We do not perform an audit where a breach exists unless we can conclude that it does not impact our objectivity and ability to issue an audit report. We make appropriate communications and determine what actions are taken to address the consequences of the breach of independence.

1.1.1 Comply with independence and ethical requirements - Overview [ISA | 7910]

What do we do?

Follow appropriate rules and regulations to comply with independence and ethical requirements.

Why do we do this?

It is of utmost importance to the profession that the general public maintain confidence in the independence of not only individuals but in the firm as a whole. Public confidence is impaired by evidence that independence was lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence. Following rules and regulations established by professional standards and by regulation allows us to issue an independent auditor's report.

It is also important to stay alert for violations of ethical or independence requirements by engagement team members as these can create reputational damage to the firm, including termination of the client relationship and financial penalties and sanctions by our regulators.

Execute the audit

IESBA PIE Independence Rules | What is auditor independence? [ISA | 7910.9828]

Auditor independence refers to the independence of the external auditor from the audit client and its related entities and the results published in the financial statements of the entity. Independence requires integrity and an objective approach to the audit process including remaining independent of mind and in appearance.

IESBA PIE Independence Rules | What is meant by independence of mind? [ISA | 7910.9830]

Independence of mind is the state of mind that allows the expression of a conclusion without being affected by influences that compromise professional judgment. Without the effects of these influences, we can act with integrity and exercise objectivity and professional skepticism.

IESBA PIE Independence Rules | What is meant by independence in appearance? [ISA | 7910.9831]

Independence in appearance is the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an engagement team member's integrity, objectivity or professional skepticism has been compromised. When we are not free from any obligation to or interest in our client, we will not appear to be independent.

IESBA PIE Independence Rules | How can we be independent of mind and in appearance from our audit clients? [ISA | 7910.9835]

To be independent of mind and in appearance, we follow the firm's independence rules and requirements as well as the rules of our regulators. We comply with both the letter and the spirit of the independence rules and requirements, to act in the public interest.

Our Code of Conduct https://spo-global.kpmg.com/sites/go-oi-intranet/SitePages/Our-Code-of-Conduct.aspx sets out how we act as individuals and as leaders. It encourages us all to act as role models, promoting ethical behavior and ensuring that our own actions serve to reflect and reinforce our Values.

IESBA PIE Independence Rules | How do we comply with independence requirements? [ISA | 7910.98365]

The independence requirements are set out in Chapters 6, 11 and 12 of the Global Quality & Risk Management Manual https://www.gqrmm-prod.kworld.kpmg.com/G/0/ (GQ&RMM) and any local risk management manual, if applicable.

IESBA PIE Independence Rules | What is the GQ&RMM? [ISA | 7910.157608]

The GQ&RMM sets out policies, procedures, and guidance about a variety of topics, including independence and ethics. The GQ&RMM is designed to conform to or exceed the requirements of the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (including International Independence Standards).

Individual countries may have a local quality and risk management manual that includes additional requirements and provides specific procedures required by the GQ&RMM.

IESBA PIE Independence Rules | How do we comply with ethical requirements? [ISA | 7910.9841]

The ethical requirements are set out in Chapter 5 of the Global Quality & Risk Management Manual https://www.gqrmm-prod.kworld.kpmg.com/G/0/ (GQ&RMM) and any local risk management manual/policies, if applicable.

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | What tools and resources are available to help us comply with independence requirements? [ISA | 7910.9842]

KPMG has in place a number of systems and tools that help us monitor independence requirements that can be found on the Global Independence Group website https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SitePages/GIG/GIG.aspx.

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | What are the fundamental principles of professional ethics under the IESBA Code? [ISA | 7910.9846]

The fundamental principles of professional ethics include:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality; and
- Professional behavior

IESBA PIE Independence Rules | How does the engagement partner remain alert for breaches of ethical and independence requirements? [ISA | 7910.9854]

The engagement partner remains alert through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements, which includes independence requirements, by members of the engagement team.

Other members of the engagement team are also responsible for reporting any evidence of non-compliance with relevant ethical requirements that they become aware of in accordance with the GQ&RMM.

IESBA PIE Independence Rules | What are possible scenarios of breaches of ethical and independence requirements by engagement team members? [ISA | 7910.9857]

The list below includes possible scenarios of breaches of ethical and independence requirements but is not an exhaustive list. We refer to the [Global Quality and Risk Management Manual](https://www.gqrmm-prod.kworld.kpmg.com/G/0/) https://www.gqrmm-prod.kworld.kpmg.com/G/0/ (GQ&RMM) for specific policies on ethics and independence.

Scenarios of breaches of ethical requirements	Scenarios of breaches of independence requirements
• Engagement team member sharing confidential information with individuals outside of the engagement team • Engagement team member not performing audit work as documented (e.g., ghost ticking) • Engagement team member obtaining audit evidence or performing audit procedures after the audit report is signed • Engagement team member back dating audit workpapers • Engagement team member charging hours that do not reflect those actually worked • Engagement team member ordering work supplies and then taking them home for personal use • Engagement team member sexually harassing an employee	• Having a direct or material indirect investment in the audit client • Direct observation or information that comes to the attention of an engagement team member regarding an engagement team member having a close relationship with a director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements on which the firm will express an opinion - including, but not limited to, a romantic relationship, overhearing reference to an engagement team member being invited to or attending the client personnel's wedding, excessive entertainment with the client or vacationing with the client • Engagement team members submitting an application for employment at their audit client without first notifying the proper parties. • Impermissible business relationships between KPMG or members of the engagement team and the audit client • Immediate family member of an engagement team member serving as a director or officer of the audit client or an

	employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements on which the firm will express an opinion • Engagement team member having a loan with the entity that is not a financial institution or, in the case of a financial institution, is not made under normal lending procedures, terms and conditions.

IESBA PIE Independence Rules | Who reviews the documentation related to the performance of independence procedures? [ISA | 7910.9862]

The Lead Audit Engagement Partner (LAEP) and the Engagement Quality Control (EQC) reviewer review the documentation related to this assessment and confirmation.

1.2 Perform certain independence procedures during planning [ISA | 7911]

What do we do?

Perform certain independence procedures during planning.

Why do we do this?

We perform procedures during audit planning to determine that we are in compliance with relevant independence requirements.

Execute the audit

IESBA PIE Independence Rules | What independence procedures do we perform during audit planning? [ISA | 7911.9634]

We perform the following independence procedures during audit planning:

- Determine the entity is appropriately restricted
- Assess whether engagement personnel rotation requirements have been met and long association threats have been considered
- Assess completeness and accuracy of the Sentinel family tree

1.2.1 Determine the entity is appropriately restricted [ISA | 7912]

What do we do?

Determine the entity is appropriately restricted

Why do we do this?

We restrict audit clients in PHAC to prevent partners and covered persons from entering into restricted or prohibited financial relationships with the audit client.

We determine that the appropriate attributes are assigned in Sentinel to prevent the firm or member firms from entering into prohibited services or business relationships with audit clients and to enable identification of proposed services and business relationships that require review by the lead audit engagement partner (or delegate) or services that require pre-approval from those charged with governance.

Execute the audit

IESBA PIE Independence Rules | How do we confirm that the PHAC is up to date? [ISA | 7912.1322]

Determine that the entity, if publicly held, is properly listed on the PHAC. If it is not included visit the PHAC Resource Center https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SitePages/PHAC/PHAC-Resource-Center.aspx and follow the process to fill out the required information and provide it to the local Ethics & Independence Partner (or delegate).

IESBA PIE Independence Rules | What is the PHAC? [ISA | 7912.1323]

The International Publicly Held Audit Client (PHAC) list includes the names of listed entities as defined by the Global Quality & Risk Management Manual, Chapter 12.3.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231, for which KPMG, its partners and covered persons are required to maintain independence.

The PHAC is not a global list of all KPMG audit clients, as it generally does not include unlisted audit clients.

IESBA PIE Independence Rules | What do we do if the audit client is not listed in the PHAC? [ISA | 7912.1324]

If we conclude that the audit client should be included in the PHAC, we visit the PHAC Resource Center https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SitePages/PHAC/PHAC-Resource-Center.aspx and follow the process to fill out the required information and provide it to the local Ethics & Independence Partner (or delegate).

IESBA PIE Independence Rules | How do we assess whether KICS or any other locally implemented tools (e.g., Restricted Entity List (REL)) to support independence are up to date? [ISA | 7912.1325]

To assess whether KICS or any other locally implemented tools (e.g., Restricted Entity List) to support our independence are up to date, we visit the local Quality & Risk Management portal and consider the guidance there.

1.2.2 Assess whether engagement personnel rotation requirements have been met and long association threats have been considered [ISA | 7913]

What do we do?

Assess whether engagement personnel rotation requirements have been met and long association threats have been considered.

Why do we do this?

Rotation of audit engagement personnel provides a safeguard against the familiarity and self-interest threats to independence that may arise due to long association with an audit client.

Execute the audit

IESBA PIE Independence Rules | How do we assess rotation requirements? [ISA | 7913.9646]

To assess that all applicable engagement personnel rotation requirements have been met, we review GQ&RMM Policy 6.9.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=204-policy-661 and GQ&RMM Policy 12.19.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=257-policy-1246 and each member firm's Partner Rotation System/ tool, if any.

IESBA non-PIE Independence Rules | How do we assess rotation requirements? [ISA | 7913.160090]

To assess that all applicable engagement personnel rotation requirements have been met, we review GQ&RMM Policy 6.9.2 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=204-policy-23881 and GQ&RMM Policy 12.19.2 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=257-policy-23874 and each member firm's Partner Rotation System/ tool, if any.

IESBA PIE Independence Rules | What do we consider in evaluating rotation requirements? [ISA | 7913.9651]

We consider triggering events that may affect engagement personnel subject to rotation. Triggering events may include (but are not limited to):

- Mid-year or temporary changes in engagement partner, engagement quality control reviewer or any other key audit partner role including component engagement partners identified as key audit partners.
- New public reporting requirements for the audit client or related entities, such as new offerings that will include a KPMG audit report.
- Changes in audit scoping resulting in new significant subsidiaries, segments, divisions, or equity method investees.
- Identifying a component audit partner as a key audit partner for the group audit.
- Changes in and/or additions to other key partners.

IESBA non-PIE Independence Rules | What do we consider in evaluating rotation requirements? [ISA | 7913.160091]

We consider triggering events that may affect engagement personnel subject to rotation. Triggering events may include (but are not limited to):

- Mid-year or temporary changes in engagement partner, engagement quality control reviewer or any other key audit partner role.
- Changes in audit scoping resulting in new significant subsidiaries, segments, divisions, or equity method investees.
- Identifying a component audit partner as a key audit partner for the group audit.
- Changes in and/or additions to other key partners.

What do we consider in evaluating whether to rotate other personnel on the audit engagement even when not required to? [ISA | 7913.9652]

We consider the following both individually and in combination to determine if there is a threat to independence:

(1) Factors relating to the individual such as:
- The overall length of the individual's relationship with the client, including if such relationship existed while the individual was at a different firm.
- How long the individual has been a member of the audit engagement team, and the nature of the roles performed.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the audit, for example, by making key decisions or directing the work of other members of the engagement team.
- The closeness of the individual's personal relationship with senior management or those charged with governance.
- The nature, frequency and extent of the interaction between the individual and senior management or those charged with governance.

(2) Factors relating to the audit client such as:
- The nature or complexity of the client's accounting and financial reporting issues and whether they have changed.
- Whether there have been any recent changes in senior management or those charged with governance.
- Whether there have been any structural changes in the client's organization which impact the nature, frequency and extent of interactions the individual may have with senior management or those charged with governance.

The combination of two or more factors may increase or reduce the significance of the threats to independence. For example, self-interest and familiarity threats created over time by the increasingly close relationship between an individual and a member of the client's senior management would be reduced by the departure of that member of the client's senior management and the start of a new relationship.

How do we identify and then address self-interest and familiarity threats (such as from long association) that are not at an acceptable level? [ISA | 7913.9653]

Self-interest and familiarity threats might be created when an individual is involved in the audit engagement over a long period of time.

We identify the self-interest and familiarity threats by reviewing the Partner Rotation System or equivalent tracking tool to identify whether we are properly rotating partners on our audit engagements. We also consider whether there are any other self-interest or familiarity threats such as those from long association with an audit client for engagements or engagement team members not covered by formal rotation requirements.

When the self-interest or familiarity threats from long association are not at an acceptable level, we consider eliminating the threats by rotating the individual off the engagement. We may also consider implementing safeguards to reduce the threat to an acceptable level. Safeguards might include:

- Changing the individual's roles and/or responsibilities on the audit team.
- Having an appropriate reviewer who was not an audit team member review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.

Other self-interest or familiarity threats we may identify are gifts and entertaining that is not inconsequential or family or personnel relationships with an audit client. Refer to GQ&RMM 6.11 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=206, 12.19 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=257 and 12.23 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=261.

1.2.3 Assess completeness and accuracy of the Sentinel family tree [ISA | 7916]

What do we do?

Assess completeness and accuracy of the Sentinel family tree.

Why do we do this?

It is important that Sentinel family trees are complete and accurate to allow firm independence controls to properly function including the identification of all services requiring pre-approval from those charged with governance and the prevention of those services that are prohibited for audit clients.

IESBA PIE Independence Rules | Why do we include the parent or any other entity that controls (directly or indirectly) the public interest entity audit client on the Sentinel family tree, even when the audit client is not a listed entity? [ISA | 7916.157442]

A parent or any other entity that controls the public interest entity audit client will be included on the Sentinel family tree, even when it is not a related entity or not included in the audit client definition. Inclusion of the controlling entity is necessary due to the requirement for communication to and concurrence from those charged with governance before providing a non-assurance service to a public interest entity audit client. Since pre-approval is required for controlling entities, we add the controlling entity to the Sentinel family tree to ensure all Sentinel requests are routed properly for review.

What is a Sentinel family tree? [ISA | 7916.157440]

The Sentinel family tree is the structure used within the [Sentinel Entity Management Tool](https://ngsclient.ema.kpmg.com/?affiliatetool) https://ngsclient.ema.kpmg.com/?affiliatetool that displays the hierarchy between an entity and its related entities.

IESBA PIE Independence Rules | What is included on the Sentinel family tree? [ISA | 7916.157441]

The Sentinel Lead Partner or TreeMaster includes on the Sentinel family tree the audit client and its related entities including those resulting from acquisitions, investments, mergers, etc. Further, the Sentinel Lead Partner or TreeMaster includes on the Sentinel family tree any entity that has direct or indirect control over the audit client, even if the audit client is not a listed entity.

Where KPMG is the group auditor, the Sentinel Lead Partner or TreeMaster includes on the Sentinel family tree all related entities of the group audit client, as appropriate, any entity that has direct or indirect control over the group audit client, even if the group audit client is not a listed entity, and any other components at which audit work is performed for the purposes of the group audit.

We see activity 'Assess completeness and accuracy of the Sentinel family tree' for further procedures.

IESBA non-PIE Independence Rules | What is included on the Sentinel family tree? [ISA | 7916.160094]

In accordance with GQRMM Policy 16.2.7, non-public interest entity audit clients with downstream subsidiaries operating in foreign jurisdictions are onboarded into Sentinel.

Non-public interest entity audit clients are also onboarded into Sentinel where required by local firm policy. When a non-public interest entity audit client is onboarded, the Sentinel family tree includes the audit client and related entities over which the client has direct or indirect control.

In a group audit scenario where KPMG is the group auditor of a non-public interest entity group audit client and there are non-KPMG component auditors, we onboard into Sentinel the group audit client, its relevant related entities and any other components at which audit work is performed for purposes of the group audit. Likewise, where we are the component auditor of a non-public interest entity component audit client reporting to a non-KPMG group auditor, we onboard into Sentinel the entities from which we are required to be independent. See question "What is included on the Sentinel family tree when we are a component auditor reporting to a non-KPMG group auditor 7939.xxx."

1.3 Perform certain independence procedures prior to audit completion [ISA | 7919]

What do we do?

Perform certain independence procedures prior to audit completion.

Why do we do this?

Performing independence procedures prior to the audit completion shows how the engagement team has taken the appropriate steps in complying with both internal and external independence requirements including laws and regulations.

Execute the audit

IESBA PIE Independence Rules | What are the independence procedures we perform prior to audit completion? [ISA | 7919.9643]

We perform the following independence procedures prior to audit completion:

- Assess fee-related matters
- Assess familial and close relationships
- Assess services proposed for the entity
- Determine the entity is appropriately restricted
- Evaluate threats to independence
- Assess completeness and accuracy of the Sentinel family tree
- Consider independence matters reporting by components
- Confirm compliance with independence requirements

1.3.1 Assess fee-related matters [ISA | 7921]

What do we do?

Assess fee-related matters.

Why do we do this?

Fee-related matters can result in threats to our independence that we identify and evaluate.

Execute the audit

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | What threats to independence are created in relation to fees paid to the auditor? [ISA | 7921.157485]

When fees are negotiated with and paid by an audit client, this creates a self-interest threat and might create an intimidation threat to independence. We evaluate the level of such threats and determine whether the threats are at an acceptable level.

What is a self-interest threat? [ISA | 7921.9704]

A self-interest threat is a threat that a financial or other interest will inappropriately influence the KPMG professional's judgment or behavior.

There are a number of circumstances that might create a self-interest threat to independence.

With regard to fee-related matters, when fees for professional services are negotiated with and paid by an audit client, a self-interest threat is created despite this practice being generally recognized and accepted by intended users of financial statements.

What is an intimidation threat? [ISA | 7921.9705]

An intimidation threat is a threat that a KPMG professional will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the KPMG professional

Fees for the audit and other services negotiated with and paid by an audit client might create an intimidation threat.

What situations related to fees for the entity and its related entities can impact the level of the self-interest threat or create an intimidation threat? [ISA | 7921.157468]

The level of the self-interest threat might be impacted by, or an intimidation threat might be created when:

- The level of audit fees is influenced by the provision of services other than audit, (except that the firm may take into consideration the cost savings achieved as a result of experience derived from the provision of services other than audit to an audit client).
- A large proportion of fees charged to the audit client is generated by providing services other than audit to the audit client.
- The total fees generated from the entity and its related entities represent a large proportion of the total fees of the member firm or a large proportion of the revenue of an individual partner or an office of the member firm.

What is meant by a threat related to the level of audit fees? [ISA | 7921.157469]

A threat to independence related to the level of the audit fee exists when the audit fee is inappropriately influenced by another factor, such as the provision of services other than audit. The audit fee is to be a standalone fee. However, the firm is permitted to consider cost savings achieved as a result of experience derived from the provision of non-audit services to the client in determining the audit fee.

How do we evaluate a self-interest or intimidation threat relating to the level of audit fees? [ISA | 7921.157470]

For the self-interest threat or an intimidation threat identified relating to the level of the audit fee paid by the audit client, we evaluate the threat and document how we will address any threat that is not at an acceptable level by eliminating the circumstances creating the threat or applying safeguards to reduce the threat to an acceptable level.

Factors that are relevant in evaluating the level of self-interest and intimidation threats created by the level of the audit fee paid by the audit client include:

- The firm's commercial rationale for the audit fee; or
- Whether undue pressure has been, or is being, applied by the client to reduce the audit fee.

Actions that might be safeguards to address threats to relating to the level of the audit fee include:

- Having an appropriate reviewer who does not take part in the audit engagement assess the reasonableness of the fee proposed, having regard to the scope and complexity of the engagement.
- Having an appropriate reviewer who did not take part in the audit engagement review the work performed (such as an engagement quality control reviewer).

What is meant by a threat related to the proportion of fees for services other than audit to the audit fee? [ISA | 7921.157471]

The level of the self-interest threat might be impacted when a large proportion of fees charged by the firm or member firms to an audit client is generated by providing services other than audit to the client, due to concerns about the potential loss of either the audit engagement or other services. Such circumstances might also create an intimidation threat. A further consideration is a perception that the firm or network firm focuses on the non-audit relationship, which might create a threat to the auditor's independence.

How do we evaluate a self-interest or intimidation threat relating to the proportion of fees for services other than audit to the audit fee? [ISA | 7921.157472]

For the self-interest threat or an intimidation threat identified relating to the proportion of fees for services other than audit relative to the audit fee, we evaluate the threat and document how we will address any threat that is not at an acceptable level by eliminating the circumstances creating the threat or applying safeguards to reduce the threat to an acceptable level.

Factors that are relevant in evaluating the level of such threats include:

- The ratio of fees for services other than audit to the audit fee.
- The length of time during which a large proportion of fees for services other than audit to the audit fee has existed.
- The nature, scope and purposes of the services other than audit, including:
  - Whether they are recurring services.
  - Whether law or regulation mandates the services to be performed by the firm.

Actions that might be safeguards to address such self-interest or intimidation threats include:

- Having an appropriate reviewer who was not involved in the audit or the service other than audit review the relevant audit work (such as an engagement quality control reviewer).
- Reducing the extent of services other than audit provided to the audit client.

We also consider any local independence rules relating to fee caps for non-assurance services provided to an audit client, as applicable (e.g., European Union Audit Reform).

What is meant by a threat created by a fee dependency? [ISA | 7921.157473]

When the total fees generated from an audit client by the firm expressing the audit opinion represent a large proportion of the total fees of that firm, the dependence on, and concern about the potential loss of, fees from audit and other services from that client impact the level of the self-interest threat and create an intimidation threat.

In addition, a self-interest or intimidation threat is created when the fees generated by a firm from an audit client represent a large proportion of the revenue of one partner or one office of the firm.

How do we evaluate the self-interest and intimidation threats relating to a firm fee dependency? [ISA | 7921.157474]

We evaluate the self-interest and intimidation threats related to firm fee dependency. If the threats are not at an acceptable level, we address the threats by eliminating the circumstances creating the threats or applying safeguards to reduce the threats to an acceptable level and document such evaluation of the threats and any safeguards applied.

Factors that are relevant in evaluating the level of such self-interest and intimidation threats arising from a fee dependency include:

- The operating structure of the firm.
- Whether the firm is expected to diversify such that any dependence on the audit client is reduced.

Actions that might be safeguards to address such threats include:

- Having an appropriate reviewer who is not a member of the KPMG member firm review the audit work
- Reducing the extent of services other than audit provided to the audit client
- Increasing the client base of the firm to reduce dependence on the client
- Increasing the extent of services provided to other clients.

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | When is the engagement partner notified that a firm fee dependency exists? [ISA | 7921.157475]

For public interest entity audit clients, the engagement partner is notified when total fees from the entity and its related entities represents more than 10 percent of the total fees of the firm expressing the audit opinion.

We comply with requirements of GQ&RMM 12.20.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=258-policy-1250 when the fee dependency exceeds, or is likely to exceed, 10 percent.

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | Who notifies the engagement partner about a firm fee dependency? [ISA | 7921.157476]

Each member firm appoints an individual or group in the firm to monitor fee dependency for all audit clients on a timely basis and at least annually, in accordance with GQ&RMM 12.20.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=258-policy-1250.

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | What do we do if a fee dependency of more than 10% is likely to continue for two consecutive years or the fee dependency reaches 15%? [ISA | 7921.157477]

We consult with the Ethics & Independence Partner and follow the procedures in GQ&RMM Policy 12.20.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=258-policy-1250.

IESBA PIE Independence Rules or SEC PCAOB Independence Rules | What do we do when the fees generated from the entity and its related entities represent a large proportion of the revenue of an individual partner or an office of the member firm? [ISA | 7921.157478]

For the self-interest threat and any identified intimidation threat when the fees generated by the entity and its related entities represent a large proportion of the revenue of an individual partner or of an office of the member firm, we document our evaluation of the threat and how we will address any threat that is not at an acceptable level by eliminating the circumstances creating the threat or applying safeguards to reduce the threat to an acceptable level.

Factors that are relevant in evaluating the level of such threats include:

- The qualitative and quantitative significance of the audit client to the partner or office.
- The extent to which the compensation of the partner, or the partners in the office, is dependent upon the fees generated from the client.

Actions that might be safeguards to reduce the threat to an acceptable level when the fees generated by the entity and its related entities represent a large proportion of the total fees of a partner or an office of the member firm include:

- Having an appropriate reviewer who was not involved in the audit engagement review the audit work
- Determining that the compensation of the partner is not significantly influenced by the fees generated from the client.

- Reducing the extent of services other than audit provided by the partner or office to the audit client
- Increasing the client base of the partner or the office to reduce dependence on the client
- Increasing the extent of services provided by the partner or the office to other clients.

IESBA PIE Independence Rules | Where do we go for additional guidance on self-interest or intimidation threats? [ISA | 7921.157479]

For additional guidance on self-interest or intimidation threats, refer to IESBA Code R410.4-R411.4 and GQ&RMM 5.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/33?jm=729. For additional guidance on total level of fees, refer to GQ&RMM Sections 6.10 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=205, 12.20.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=258-policy-1250, 12.20.2 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=258-policy-1251, 12.20.5 and 12.20.6.

IESBA PIE Independence Rules | Why do we consider whether prior year fees due from the entity and its related entities have been paid? [ISA | 7921.9708]

Overdue fees from the client might create a self-interest threat. If fees due from an audit client remain unpaid for a long time, especially if a significant part is not paid before the audit report for the following year has been issued, we determine whether the overdue fees might be equivalent to a loan to the client. We further determine if it is appropriate to be re-appointed as the auditor or to continue the audit engagement.

Engagement teams should refer to GQ&RMM 12.20.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231 for the policy and guidance on overdue fees.

IESBA PIE Independence Rules | What do we do if prior year fees have not been paid at the time the current year audit commences? [ISA | 7921.9709]

If a past due fee situation exists at the time the current year audit engagement commences, we document our evaluation of the threat and how we have or will address any threat that is not at an acceptable level by eliminating the circumstance creating the threat or applying safeguards (for example, agreement of the schedule with the entity and its related entities for payment of outstanding fees).

Refer to GQ&RMM 12.20.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=258-policy-1252.

IESBA PIE Independence Rules | What is included in past due fees? [ISA | 7921.9710]

Past due fees include fees from any professional service including audit, advisory, and tax. Engagement teams refer to GQ&RMM 12.20.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231 for the policy and guidance on overdue fees.

1.3.2 Assess engagement team personal independence prior to completion [ISA | 7922]

What do we do?

Assess the independence of engagement team members prior to completion.

Why do we do this?

Certain types of personal or familial relationships may create self-interest, familiarity, or intimidation threats to our independence.

Execute the audit

How do we confirm that no audit team members have an immediate family member in an officer or director role, or in a role where they are in a position to exert significant influence over the preparation of the accounting records and/or the financial statements which we are auditing? [ISA | 7922.9773]

We confirm that no audit team members have an immediate family member in an officer or director role, or in a role where they are in a position to exert significant influence over the preparation of the accounting records and/or the financial statements which we are auditing by inquiring of the engagement team members.

How often do we confirm that no engagement team members have an immediate family member in an officer or director role or in a position to exert significant influence over the preparation of the accounting records and/or the financial statements which we are auditing? [ISA | 7922.9774]

On an annual basis, we confirm that no engagement team members (or other covered persons) have an immediate family member in an officer or director role or in a position to exert significant influence over the preparation of the accounting records and/or financial statements which we are auditing at the entity by performing inquiries of all members of the engagement team.

When do we consult with the Ethics and Independence Partner in relation to close relationships? [ISA | 7922.9775]

We consult with the Ethics and Independence Partner when:

- an audit team member has an immediate family member who is an employee of the audit client in a position to exert significant influence over the client's financial position or performance or cashflows
- an audit team member has a close family member who is an officer or director of the audit client, or an employee of the audit client in a position to exert significant influence over the preparation of the accounting records and/or the financial statements which we are auditing
- an audit team member has a close relationship with a person who is not an immediate or close family member, but who is a director or officer of the audit client, an employee of the audit client in a position to exert significant influence over the preparation of the account records and/or the financial statements which we are auditing, or an employee of the audit client who directly interacts with the audit team member and/or whose work is being audited by the audit team member
- we become aware of a partner or employee of any member firm who is not a member of the audit team who has a personal or family relationship with a director or officer of the audit client or an employee of the audit client in a position to exert significant influence over the preparation of the accounting records and/or the financial statements which we are auditing

Additional guidance can be found in GQ&RMM Section 6.5 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=200.

1.3.3 Assess services proposed for the entity [ISA | 7923]

What do we do?

Assess services proposed for the entity for permissibility under the applicable independence rules.

Why do we do this?

We assess services proposed for the entity or its related entities to prevent prohibited services and/or fee arrangements and to determine that appropriate safeguards are in place to reduce the threats to independence to an acceptable level.

Execute the audit

IESBA PIE Independence Rules | How do we assess that we have appropriately reviewed proposed non-assurance services to the audit client or its related entities? [ISA | 7923.157443]

We review proposed non-assurance services by reviewing all Sentinel requests. When there are threats to independence identified, we confirm that the evaluation of threats to independence in the provision of the non-assurance service and the resulting safeguards applied have been documented in accordance with GQ&RMM Policy 11.1.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/87?jm=88-policy-165.

SEC PCAOB Independence Rules or IESBA PIE Independence Rules | How do we confirm that we have evaluated the threats arising from the provision of non-assurance services? [ISA | 7923.9798]

To confirm we have evaluated any threats that arise from the provision of non-assurance services, we review all non-assurance services provided to the audit client by running the Services Review (Live) Report and reviewing the documentation of threats and safeguards included in each Sentinel request.

SEC PCAOB Independence Rules or IESBA PIE Independence Rules | How do we review the non-assurance services? [ISA | 7923.9799]

We review all non-assurance services from the Services Review (Live) Report individually and evaluate the documentation of threats and safeguards within Sentinel for each individual service. In reviewing each service, we:

- Consider the sufficiency of the documentation and whether additional documentation of identified threats and safeguards is necessary.
- Consider if, in aggregate, the services give rise to additional threats to independence (e.g., the totality of the non-assurance fees are high).

SEC PCAOB Independence Rules or IESBA PIE Independence Rules | What is a Services Review (Live) Report? [ISA | 7923.9800]

The Services Review (Live) Report provides a detail of all services requested and provided globally for the audit client and its related entities, including fee amounts charged during a selected period. This will include both audit and non-assurance services.

SEC PCAOB Independence Rules or IESBA PIE Independence Rules | How do we generate a Services Review (Live) Report? [ISA | 7923.9801]

We follow the Quick Reference Card instructions https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SRC/Forms/AllItems.aspx?id=%2Fsites%2Fgo%2Doi%2Dbus%2DGQRM%2FSRC%2FSentinel%2DQRC%2DReport%2D1%2DServices%2DReview%2DLive%2Epdf&parent=%2Fsites%2Fgo

%2Doi%2Dbus%2DGQRM%2FSRC on the Sentinel Lead Partners page under the Sentinel Resource Center to generate the report.

SEC PCAOB Independence Rules or IESBA PIE Independence Rules | What do we do if, when reviewing the Services Review (Live) Report, we identify additional or cumulative threats to independence that were not previously identified or evaluated? [ISA | 7923.9802]

When reviewing the Services Review (Live) Report, if we identify additional threats or cumulative threats that were not identified or evaluated when the service(s) was approved, we document the identified threat, our evaluation of the threat (i.e., is it at an acceptable level) and how we have addressed the threat by eliminating the circumstance creating the threat or by applying safeguards to respond to the threat.

IESBA PIE Independence Rules | What types of threats may we expect to have been identified, evaluated and addressed when the services were approved? [ISA | 7923.9803]

The types of threats we expect to have been identified, evaluated and addressed and that we remain alert for when reviewing the non-assurance services are:

- Self-interest threats
- Advocacy threats
- Other threats identified related to non-assurance services (intimidation or familiarity).

Self-review threats may also be identified. However, when there is a risk that a self-review threat might be created for a public interest entity audit client, there are no safeguards that can reduce the self-review threat to an acceptable level. Thus, the non-assurance service cannot be provided, unless the service is related to providing advice or recommendations for a matter that arose in the course of the audit, as discussed in GQ&RMM Policy 11.1.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/87?jm=88-policy-165.

IESBA PIE Independence Rules | What are self-interest threats? [ISA | 7923.9804]

A self-interest threat is a threat that a financial or other interest will inappropriately influence the KPMG professional's judgment or behavior. Refer to GQ&RMM Policy 12.20.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231 specifically in relation to contingent fees that can pose a self-interest threat.

IESBA PIE Independence Rules | What are self-review threats? [ISA | 7923.9805]

A self-review threat is a threat that a KPMG professional will not appropriately evaluate the results of a previous judgment made or service performed by the KPMG professional, or by another individual within the member's firm, on which the KPMG professional will rely when forming a judgment as part of providing a current service.

The IESBA Code prohibits providing a non-assurance service to a public interest entity audit client when the service might create a self-review threat. Refer to GQ&RMM Policy 11.1.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/87?jm=88-policy-165 for additional information on an exception to this prohibition related to providing advice and recommendations to a public interest entity audit client.

IESBA PIE Independence Rules | What are advocacy threats? [ISA | 7923.9806]

An advocacy threat is a threat that a KPMG professional will promote a client's position to the point that the KPMG professional's objectivity is compromised.

IESBA PIE Independence Rules | What are other threats? [ISA | 7923.9807]

Other threats are familiarity or intimidation threats. Refer to GQ&RMM Section 5.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/33 for additional guidance.

SEC PCAOB Independence Rules or IESBA PIE Independence Rules | When do we consult with the Ethics and Independence Partner for non-assurance services? [ISA | 7923.9808]

We consult with the Ethics and Independence Partner if we believe the threats to independence cannot be reduced to an acceptable level for an on-going service or relationship. We can also consult when we have questions regarding the permissibility of a service.

IESBA PIE Independence Rules | What do we do after determining a proposed service is not prohibited and any threats to independence are at an acceptable level? [ISA | 7923.157444]

We communicate to those charged with governance regarding the service and obtain their concurrence, as further described in ISA 260. Such communication may also be made for non-public interest entities, particularly if they are of significant public interest.

What do we do if we (or any KPMG member firm) propose to provide word processing, translation or any other financial statement preparation services in connection with an audit of financial statements? [ISA | 7923.160098]

To facilitate the evaluation of permissibility under the applicable independence rules, the engagement team proposing such services separately identifies these non-assurance services from any audit services in the Sentinel requests using the appropriate financial statement preparation and/or financial statement word processing/translation Sentinel taxonomy code(s), even if a fee is not charged for such services.

1.3.4 IESBA PIE Independence Rules | Determine the entity is appropriately restricted [ISA | 7926]

What do we do?

Determine the entity is appropriately restricted.

Why do we do this?

For listed entities, we restrict audit clients in PHAC to prevent partners and covered persons from entering into restricted or prohibited financial relationships with the audit client.

For all public interest entity audit clients, we determine that the appropriate attributes are assigned in Sentinel to prevent the firm or member firms from entering into prohibited services or business relationships with audit clients and to enable identification of proposed services and business relationships that require review by the lead audit engagement partner (or delegate) or services that require pre-approval by those charged with governance.

Execute the audit

IESBA PIE Independence Rules | How do we confirm that the PHAC is up-to-date? [ISA | 7926.9697]

Visit the PHAC Resource Center https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SitePages/PHAC/PHAC-Resource-Center.aspx and follow the information to fill out the required information and provide it to the local Ethics & Independence Partner (or delegate). We check that the entity is properly listed.

IESBA PIE Independence Rules | What is the PHAC? [ISA | 7926.9698]

The International Publicly Held Audit Client (PHAC) list includes the names of listed entities as defined by Global Quality and Risk Management Manual (GQ&RMM) Policy 12.3.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=241-policy-1138 for which KPMG, its partners and covered persons are required to maintain independence.

The PHAC is not a global list of all KPMG audit clients, as it generally does not include unlisted audit clients.

IESBA PIE Independence Rules | What do we do if the audit client is not listed in the PHAC? [ISA | 7926.9699]

If we conclude that the audit client should be included in the PHAC, we visit the PHAC Resource Center https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SitePages/PHAC/PHAC-Resource-Center.aspx and follow the process to fill out the required information and provide it to the local Ethics & Independence Partner (or delegate).

IESBA PIE Independence Rules | How do we assess whether KICS or any other locally implemented tools (e.g. Restricted Entity List (REL)) to support independence are up-to-date? [ISA | 7926.9700]

To assess whether KICS or any other locally implemented tools (e.g. Restricted Entity List) to support our independence are up-to-date, we visit the local Quality & Risk Management portal and consider the guidance there.

1.3.5 Evaluate threats to independence [ISA | 7929]

What do we do?

Evaluate threats to independence.

Why do we do this?

If threats to our independence are not reduced to an acceptable level, this can impact whether or not we can continue providing services to the audit client.

Execute the audit

How can the engagement partner be made aware of any issues creating threats to independence? [ISA | 7929.1307]

The engagement partner can be made aware of threats to independence by the Ethics and Independence Partner, Risk Management Partner, head of audit, engagement team confirmations, or inquiries made or received of engagement team members or others.

What are types of issues that can create independence threats? [ISA | 7929.1308]

The following are issues that can create independence threats:

- Family and personal relationships:

  - For further information, refer to GQ&RMM Section 6.5 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=200. In relation to SEC independence rules, refer to section 20.6 of the GQ&RMM

- Employee and director relationships
  - For further information, refer to GQ&RMM Sections 6.6 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=201 and 6.7 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=202. In relation to SEC independence rules, refer to section 20.8 of the GQ&RMM
- Former partners and employees of KPMG employed by the entity
  - For further information, refer to GQ&RMM Sections 6.6 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=201 and 12.6 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=244. In relation to SEC independence rules, refer to section 20.7 of the GQ&RMM
- Audit team member financial and business relationships
  - For further information, refer to GQ&RMM Sections 6.2 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=197 and 6.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=198. In relation to SEC independence rules, refer to sections 20.2, 20.3, 20.4 and 20.5 of the GQ&RMM
- Firm financial relationships (other than fees)
  - For further information, refer to GQ&RMM Sections 12.15 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=253 and 12.16 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=254. In relation to SEC independence rules, refer to sections 20.2 and 20.3 of the GQ&RMM
- Firm business relationships (including sponsorships, alliances, joint ventures, consortia or similar third party arrangements)
  - For further information, refer to GQ&RMM Section 12.7 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=245. In relation to SEC independence rules, refer to section 20.5 of the GQ&RMM
- Gifts and hospitality
  - For further information, refer to GQ&RMM Sections 6.11 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=206 and 12.23 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=261.
- Actual or threatened litigation
  - For further information, refer to GQ&RMM Sections 6.12 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=207 and 12.24 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=262. For SEC audit clients also see GQ&RMM Section 20.17.
- Third parties used by the firm (as subcontractors, third party resources or external consultants) who may have employment relationships with the entity and its related entities
  - For further information, refer to GQ&RMM Policies 12.7.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=245-policy-20701 and 12.17.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=255-policy-24344. For SEC audit clients also see GQ&RMM Section 20.5.

What do we do if the engagement partner is made aware of any issues creating threats to independence? [ISA | 7929.1309]

When threats to independence are identified, we evaluate the threats to determine if they are at an acceptable level. If the threats are not at an acceptable level, we address the threats by eliminating the circumstances creating the threats or applying safeguards to reduce the threats to an acceptable level. We document our evaluation of the threats, how we addressed them and our conclusion on the impact on our independence.

How do we identify self-interest and familiarity threats? [ISA | 7929.1310]

We identify self-interest and familiarity threats by reviewing the Partner Rotation System or equivalent tracking tool to identify whether we are properly rotating partners on our audit engagements. We also consider whether there are any other self-interest or familiarity threats such as those from long association with an audit client for engagements not covered by formal rotation requirements, gifts and entertaining that is not inconsequential or family or personnel relationships with an audit client. Refer to GQ&RMM Sections 6.11 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/35?jm=206, 12.19 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=257 and 12.23 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=261.

What is a familiarity threat? [ISA | 7929.1302]

The threat that because of a long or close relationship with an audit client, we become too sympathetic to the audit client's interests or we become too accepting of the audit client's work.

What are examples of familiarity threats? [ISA | 7929.1311]

Examples of familiarity threats include:

- A partner or partner equivalent of the firm who has provided the audit client with audit services for a prolonged period
- An engagement team member has a close friend in a key position at the entity

We also consider whether excessive entertainment or other recreational activities with audit client personnel lacking a valid business purpose could be evidence of an inappropriate close relationship with audit client personnel that could impair the firm's independence. Consider your firm's local gift and entertainment policies as well as the Global gift and entertainment policies at GQ&RMM 5.7.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/33?jm=192-policy-540.

What if we identify a familiarity threat? [ISA | 7929.1303]

When we identify a familiarity threat we evaluate the threat to determine if it is at an acceptable level and if it is not, we address the threat by eliminating the circumstances that created the threat or applying safeguards to reduce the threat to an acceptable level. We document our overall conclusion, including our evaluation of the threats and how we addressed them.

How do we assess whether any other threats to independence exist (e.g. intimidation, self-interest, self-review and advocacy)? [ISA | 7929.1312]

Throughout the audit we remain alert for aggressive or dominant client staff that cause us to not act objectively due to actual or perceived pressures.

What is an intimidation threat? [ISA | 7929.1305]

An intimidation threat is a threat that a KPMG professional will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the KPMG professional.

What if we identify an intimidation threat? [ISA | 7929.1313]

When we identify intimidation threats we document our evaluation of the threats and how we have or will address any threat that is not at an acceptable level by eliminating the circumstance creating the threat or applying safeguards to reduce the threat to an acceptable level.

What is a self-interest threat? [ISA | 7929.1314]

A self-interest threat is a threat that a financial or other interest will inappropriately influence the KPMG professional's judgment or behavior.

A self-interest threat might also be created where an individual is concerned about losing a long-standing client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance.

What are self-review threats? [ISA | 7929.1315]

A self-review threat is a threat that a KPMG professional will not appropriately evaluate the results of a previous judgment made or service performed by the KPMG professional, or by another individual within the member's firm on which the KPMG professional will rely when forming a judgment as part of providing a current service.

What are advocacy threats? [ISA | 7929.1316]

An advocacy threat is a threat that a KPMG professional will promote a client's position to the point that the KPMG professional's objectivity is compromised.

1.3.6 Assess completeness and accuracy of the Sentinel family tree [ISA | 7930]

What do we do?

Assess completeness and accuracy of the Sentinel family tree.

Why do we do this?

It is important that Sentinel family trees are complete and accurate to allow firm independence controls to properly function including the identification of services or business relationships that are prohibited for audit clients.

Execute the audit

How do we assess that the Sentinel family tree is up to date? [ISA | 7930.9670]

We go to the Sentinel Entity Management Tool https://ngsclient.ema.kpmg.com/?affiliatetool and perform a search to confirm the audit client and its related entities are properly included on the Sentinel family tree.

What is a Sentinel family tree? [ISA | 7930.9671]

The Sentinel family tree is the structure used within the Sentinel Entity Management Tool that displays the hierarchy between an entity and its related entities.

What is included on the Sentinel family tree? [ISA | 7930.9672]

The Sentinel family tree includes the audit client and its related entities resulting from acquisitions, investments, mergers, etc. Refer to question 'Which entities do I need to consider to be related entities of the audit client and which related entities do I need to be independent of?' to understand the related entities included in the audit client definition for independence purposes

For a public interest entity audit client, the Sentinel family tree contains any entity that has direct or indirect control over the audit client, even if the audit client is not a listed entity.

For a group audit client, when the group entity under audit is a listed entity, the Sentinel family tree always includes the group entity under audit and its related entities and any other components at which audit work is performed. When the group entity under audit is not a listed entity, the Sentinel family tree includes the group entity under audit and its related entities over which the group entity under audit has direct or indirect control and any other components at which audit work is performed.

IESBA PIE Independence Rules | Why do we include the parent or any other entity that controls (directly or indirectly) the public interest entity audit client on the Sentinel family tree, even when the audit client is not a listed entity? [ISA | 7930.157448]

A parent or any other entity that controls the public interest entity audit client will be included in Sentinel, even when it is not a related entity or not included in the audit client definition. Inclusion of the controlling entity is necessary due to the requirement for communication to and concurrence from those charged with governance before providing a non-assurance service to a public interest entity audit client. Since pre-approval is required for controlling entities, we add the controlling entity to the Sentinel tree to ensure all Sentinel requests are routed properly for review.

1.3.7 Consider independence matters reported by components [ISA | 7931]

What do we do?

Consider independence matters reported by components.

Why do we do this?

We consider any independence issues identified and reported to us by any component auditor to assess the impact it has at the group level and whether additional consultations are made.

Execute the audit

What do we do if component auditors report independence issues to the group auditor? [ISA | 7931.9677]

The group auditor documents any independence issues identified and reported by any component auditors and how these have been addressed to manage independence.

What do we do if the reported independence issue constitutes a breach that impacts the group audit? [ISA | 7931.9678]

When a component auditor concludes that a breach of independence has occurred, we receive written communication from the component auditor and we consult with our member firm's Ethics and Independence Partner.

Upon receipt of the communication from the component auditor, the group engagement partner, in consultation with the Ethics and Independence Partner:

- reviews the component auditor firm's assessment of the significance of the breach and its impact on the component auditor firm's objectivity, and any action that can be or has been taken to address the consequences of the breach;
- evaluates the group auditor firm's ability to use the work of the component auditor firm for the purposes of the group audit; and
- determines the need for any further action needed to satisfactorily address the breach in order to use the component auditor firm's work.

When conducting our evaluation, we consider whether a reasonable and informed third party would be likely to conclude that the component auditor's objectivity is compromised. When the component auditor reporting the breach is from a KPMG member firm, we also comply with the communication and documentation requirements included in activity 'Communicate breaches of independence requirements'.

If the group engagement partner determines that the consequences of the breach have been satisfactorily addressed by the component auditor firm and does not compromise the component auditor's objectivity, we may continue to use the work of the component auditor for the group audit.

If there has been a breach by a component auditor and the breach has not been satisfactorily addressed, then we cannot use the work of the component auditor. In those circumstances, we might find other means to obtain the necessary audit evidence on the component's financial information.

1.4 Perform independence procedures in relation to new related entities [ISA | 7934]

What do we do?

Perform independence procedures in relation to new related entities.

Why do we do this?

We perform procedures to determine that we are independent of new related entities that will become related entities of our audit clients through merger or acquisition transactions or changes in ownership to prevent breaches of the independence rules.

Execute the audit

Which entities do we consider to be related entities of the audit client and which related entities do we need to be independent of? [ISA | 7934.1301]

We consider all entities that meet the definition of "related entity" and are included in the "audit client" definition, as per the IESBA Code. The IESBA Code defines a related entity as:

"An entity that has any of the following relationships with the client:

(a) An entity that has direct or indirect control over the client if the client is material to such entity;

(b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;
(c) An entity over which the client has direct or indirect control;
(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and
(e) An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity."

The IESBA includes the following related entities in the audit client definition:

"When the client is a listed entity, audit client will always include its related entities. When the audit client is not a listed entity, audit client includes those related entities over which the client has direct or indirect control."

Therefore, if our public interest entity audit client is listed, we consider all of the related entities in points a-e above to be entities from which we must be independent. If our audit client is not a listed entity, we include the entities under point c above to be entities from which we must be independent. For unlisted audit clients, the IESBA Code (section R400.20) also requires that when we know or have reason to believe that a relationship or circumstance involving any other related entity of the client is relevant to our independence evaluation, we include that related entity when identifying, evaluating and addressing the threats to our independence.

How do we assess that the engagement team has evaluated the firm's independence with respect to new related entities? [ISA | 7934.1302]

We assess that we have evaluated the firm's independence with respect to new related entities by performing the following procedures. We also complete these procedures when an entity that is not a related entity becomes a component at which audit work is performed for purposes of the group audit because independence will be required in relation to that component:

- Using the guidance in GQ&RMM 8.3.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/77 and 9.3.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/81 in determining whether a major acquisition or change in ownership requires a client and/or engagement re-evaluation.
- Obtaining a list of new related entities from the entity's management and determining whether KPMG (including member firms) has provided or is providing services to the new related entities
- Evaluating the effect of past or on-going services, fee arrangements, or other relationships with the entity on the firm's independence
- For any identified ongoing potentially impermissible services, fee arrangements, or other relationships, communicating our evaluation of the threats created and the impact to our independence to those charged with governance.
- Where applicable, requesting the local Ethics & Independence Partner (or delegate) to update the PHAC and KICs, or a local REL, if appropriate.

When do we assess the firm's independence for new related entities? [ISA | 7934.1303]

We assess the firm's independence for new related entities before the closing of the transaction.

Group Audit | When do we assess the firm's independence for new 'other components at which audit work is performed'? [ISA | 7934.160099]

Most components over which audit work will be performed meet the definition of a related entity. However, if as part of our audit planning and scoping procedures, we identify components over which audit work will be performed for purposes of the group audit which do not meet the definition of a related entity (e.g., an entity that is an equity method investment of the audit client which is not material to the audit client and therefore does not meet the definition of a related entity), we are to be independent of such entities (the "other components at which audit work is performed").

We assess our independence in the same way we assess independence in relation to a new related entity by performing the procedures described in this activity, 'Perform independence procedures in relation to new related entities'. We perform such procedures at the time that we determine such entity is an "other component over which audit work is performed" for purposes of the group audit.

When an equity method investee that is not material, thus not meeting the definition of a related entity for independence purposes, is not identified as a component but we use the equity method investee auditor's report as evidence of reliability of the financial information of the equity method investee, we are not required to be independent of the equity method investee.

How do we determine if we perform a client or engagement re-evaluation? [ISA | 7934.1304]

We refer to GQ&RMM Policy 8.3.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/77?jm=80-policy-818 and Policy 9.3.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/81?jm=220-policy-878.

From whom do we obtain a listing of the new related entities? [ISA | 7934.1305]

We obtain a listing of new related entities from management of our audit client. We may also consider reviewing other publicly available sources such as public filings or news reports. It is important to consider all the trade names (current and past) when identifying potential new related entities.

IESBA PIE Independence Rules | How do we determine whether the firm has provided or is providing services to or has other relationships with the related entity? [ISA | 7934.1306]

To identify whether the firm has provided or is providing services to the related entity, we:

- Search for the related entity in the Sentinel Entity Management Tool https://ngsclient.ema.kpmg.com/?affiliatetool
- Generate the Services Review (Live) Report to identify and review services that KPMG may be providing to the related entity or other relationships with the entity
- Determine whether the firm has any other business or financial relationships with the entity
- Inquire of our audit client's management about the existence of any professional services, business, financial, employment, or other relationships the related entity may have with the firm

How do we search for the new related entities in Sentinel? [ISA | 7934.1307]

We search for the new related entities and their related entities using the Sentinel Entity Management Tool https://ngsclient.ema.kpmg.com/?affiliatetool.

What are the various results when searching for the new related entities in the Sentinel Entity Management Tool? [ISA | 7934.1308]

The various results from searching for new related entities in the Sentinel Entity Management Tool https://ngsclient.ema.kpmg.com/?affiliatetool are:

- The entity appears in the Sentinel database with a tree icon next to the name, which is indicative that there is a TreeMaster and Sentinel Lead Partner assigned to the entity.

- The entity appears in the Sentinel database and there is no tree icon next to the name, which is indicative that the firm may have provided services to the entity, but the entity is not onboarded onto a Sentinel family tree.
- The entity does not appear in the Sentinel database.

IESBA PIE Independence Rules | What do we do if the results of our search indicate that the entity appears in the Sentinel database and has a tree icon next to the entity? [ISA | 7934.1309]

We consider the confidentiality of the transaction and contact the Ethics and Independence Partner if the corporate transaction has not been made known to the prospective related entity (e.g., hostile takeover). Otherwise, the LAEP contacts the Sentinel Lead Partner (SLP)/TreeMaster of the prospective related entity before the transaction closes to obtain access to the prospective related entity's Sentinel family tree. If the SLP is GO-FM Sentinel, the LAEP contacts the Global Sentinel team at GO-FM Sentinel. The engagement team checks the completeness of the related entity's Sentinel family tree and checks for duplicates of the related entity in the Sentinel database. When there is a large acquisition or there appear to be a significant amount of changes to the family tree, the engagement team considers requesting a Family Tree Accuracy Process (FTAP) report from the Global Sentinel team in order to identify all related entities and potential duplicate entities in the Sentinel database.

In reviewing for duplicates, the engagement team considers entities with similar names even if they are connected to other Sentinel family trees as well as entities that are not connected to a Sentinel family tree. Upon concluding the review, the engagement team requests that the Global Sentinel team process the changes to the family tree. The engagement team does not add a family tree with an SLP to their own family tree without first obtaining consent from that SLP nor does the team create a duplicate entity in their own family tree.

The engagement team then generates the Services Review (Live) Report to identify and review services that KPMG may be providing to the entity or other relationships with the entity.

IESBA PIE Independence Rules | What do we do if the results of our search indicate that the entity appears in the Sentinel database and does not have a tree icon next to the entity? [ISA | 7934.1310]

The engagement team adds all pre-existing entities that appear to be matches of the entity to the Sentinel family tree so that all services and other relationships with the entity can be identified.

The engagement team also looks for duplicate entities with similar names even if they are connected to other Sentinel family trees in addition to those that are not connected to a Sentinel family tree. The engagement team requests the Global Sentinel team to merge the duplicate entities.

After adding pre-existing entities to the audit client's Sentinel family tree (following the instructions in the [Sentinel Entity Management Tool User Guide](https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SRC/Entity-Management-Tool-User-Guide.pdf?web=1) https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SRC/Entity-Management-Tool-User-Guide.pdf?web=1), the engagement team generates the Services Review (Live) Report to identify and review services and other relationships with the entity.

IESBA PIE Independence Rules | What do we do if the results of our search indicate that the entity does not appear in the Sentinel database? [ISA | 7934.1311]

The entity is created and added to the audit client Sentinel family tree. Because the entity did not previously exist in the Sentinel database, this indicates that we have not provided any services to the entity or have other relationships with the entity.

However, related entities of the entity may exist within Sentinel and these are added to the newly created tree if they are also related entities of the audit client. The engagement team also considers entities with similar names connected to other Sentinel family trees.

If the entity has related entities that are also related entities of the audit client, and any were found pre-existing in the Sentinel database, the engagement team generates the Services Review (Live) Report to identify and review services and other relationships with these related entities.

IESBA PIE Independence Rules | What do we do once we have run the entity through Sentinel and made appropriate updates to the Sentinel family tree? [ISA | 7934.1312]

Once we have updated the Sentinel family tree for the new entity, we generate the Services Review (Live) Report.

Why do we run the Services Review (Live) Report? [ISA | 7934.1313]

We run the Services Review (Live) Report to identify and review services that the firm may have provided or may be providing to the entity or other relationships with the entity.

How do we generate the Services Review (Live) Report? [ISA | 7934.1314]

The Report 1 - Services Review (Live) report is used to review services for new related entities that are onboarded to a Sentinel family tree. Follow the Quick Reference Card instructions https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/SRC/Forms/AllItems.aspx?id=%2Fsites%2Fgo%2Doi%2Dbus%2DGQRM%2FSRC%2FSentinel%2DQRC%2DReport%2D1%2DServices%2DReview%2DLive%2Epdf&parent=%2Fsites%2Fgo%2Doi%2Dbus%2DGQRM%2FSRC on the Sentinel Lead Partners page under the Sentinel Resource Center to generate the report.

The Services Review (Live) report cannot be run on an entity that is not onboarded to a Sentinel family tree.

How do we determine whether the firm has any business or financial relationships with the entity? [ISA | 7934.1315]

We determine whether the firm has any recorded business or financial relationships with the entity by reviewing the "SKC Relationships" attributes previously assigned to the entity in the Sentinel system (if the entity was pre-existing on a Sentinel family tree).

If there is a reasonable possibility that another member firm may have a business or financial relationship with the entity, we correspond with the relationship check contact https://spo-global.kpmg.com/sites/go-oi-bus-GQRM/_layouts/15/Doc.aspx?sourcedoc=%7BB81D1B9D-1A54-4EBC-B404-1034A64F26F2%7D&file=Country%20Relationship%20Check%20Contacts.xlsx&action=default&mobileredirect=true&DefaultItemOpen=1 at the member firm(s) in the country where the entity has operations.

How do we review the "SKC Relationships" attributes previously assigned to the entity in the Sentinel system (if the entity was pre-existing on a Sentinel family tree)? [ISA | 7934.1316]

To review the Sentinel Key Clients (SKC) attributes, we search for the entity using the Sentinel Entity Management Tool https://ngsclient.ema.kpmg.com/?affiliatetool. If the entity is pre-existing in Sentinel and has a Sentinel family tree, we click on the family tree icon to view the family tree. We review the SKC attributes by clicking on "Key Client (SKC) Relationships" on the right side of the screen and we determine whether there are any attributes assigned that indicate a financial or business relationship with the entity (e.g., Alliance, Firm Financial Relationship, Safe List).

If there are any such attributes assigned indicating a firm business or financial relationship, we consult with the Ethics and Independence Partner.

Who do we inquire of about the existence of any professional services, business, financial, employment, or other relationships the new related entities may have with the firm? [ISA | 7934.1317]

We inquire of audit client's management about the existence of any professional services, business, financial, employment, or other relationships the new related entities may have with the firm.

How do we evaluate the effect of past or on-going services, fee arrangements, or other relationships with the entity to be acquired on the firm's independence? [ISA | 7934.1318]

Once we have obtained the Services Review (Live) Report, we review each service or business relationship listed to make a determination whether those services or business relationships are permissible services that can be provided to our audit client or whether they are impermissible. Each service or business relationship on the Services Review (Live) Report will have a KPMG contact who is providing the service or has the business relationship, so having discussions with those individuals may be necessary to understand if the services or business relationship are still ongoing and to obtain an understanding of the nature of the activities and deliverables to determine whether the services or business relationships are permissible. If the individual has left the firm, contact that firm's Risk Management Partner to determine who can provide information about the service or business relationship.

What if we identify impermissible services, interests or relationships for the entity to be acquired? [ISA | 7934.1319]

If we identify any impermissible services, interests or relationships for the entity to be acquired, we take steps to end the services, interests or relationships by the effective date of the of the transaction.

Who do we consult with if we identify any potentially prohibited services, fee arrangements, or other relationships? [ISA | 7934.1320]

If we identify any potentially prohibited services, fee arrangements, or other relationships, we consult with the Ethics and Independence Partner.

What do we do if impermissible services, interests or relationships cannot reasonably be ended by the date the entity becomes a related entity of the audit client? [ISA | 7934.1321]

If impermissible services, interests or relationships cannot reasonably be ended by the effective date of the transaction, in accordance with GQ&RMM Policy 12.14.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231, we evaluate the threats to independence that are created by the service, interest or relationship. We discuss with those charged with governance why the identified impermissible services, interests or relationships cannot reasonably be ended by the effective date of the transaction and our evaluation of the threats to our independence.

If those charged with governance request that we continue as the auditor, we follow the procedures as outlined at GQ&RMM Policy 12.14.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231 to ensure 1) the service, interest or relationship is ended as soon as reasonably possible, 2) the engagement team is separate from those who perform the impermissible service or have the impermissible interest or relationship and 3) appropriate transition measures are applied.

How do we evaluate the level of the threat created by the ongoing impermissible service, interest or relationship? [ISA | 7934.1322]

We evaluate the threat by following the conceptual framework as described in GQ&RMM Policy 5.4.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/33?jm=729-policy-24569 and considering the relevant factors as described in the guidance section of GQ&RMM Policy 12.14.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=252-policy-1176.

What transitional measures do we consider applying if the impermissible service or relationship cannot reasonably be ended before the transaction closes and those charged with governance have asked us to continue as the auditor? [ISA | 7934.1323]

We consider applying transitional measures such as the examples provided in guidance at GQ&RMM Policy 12.14.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=252-policy-1176.

What do we do if breaches (i.e., impermissible services, interests or relationships exist past the date the entity becomes a related entity and appropriate transitional measures were not put in place or discussions with those charged with governance did not occur) are identified? [ISA | 7934.1324]

If breaches are identified as a result of performing the procedures, we report these findings to the Ethics and Independence Partner, participate in the evaluation of the significance of the breach, including its impact on our objectivity and impartiality, and communicate the breaches to those charged with governance, in accordance with GQ&RMM Policy 12.18.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231. When it is determined that actions can be taken to satisfactorily address the consequences of the breach, concurrence from those charged with governance is required.

What if the new related entities are not included on the PHAC and are not restricted in KICS? [ISA | 7934.1325]

Any new related entities of the audit client that are publicly traded themselves are also listed on the PHAC and restricted in KICS. If they are not, we contact the local Ethics & Independence Partner (or delegate) to update the PHAC and KICS.

IESBA PIE Independence Rules | How do we document the procedures performed for multiple related entities that are identified during the audit? [ISA | 7934.1326]

When we identify multiple related entities during the audit, we list procedures performed for each related entity in the related entities module of KCw. Text boxes can be added where needed to capture responses for each related entity.

1.5 Component Audit | Perform independence procedures as a component auditor [ISA | 7939]

What do we do?

Perform independence procedures as a component auditor.

Why do we do this?

We perform procedures as a component auditor to determine we are independent under the independence rules applicable to the group audit.

Execute the audit

Component Audit | How does the component auditor comply with the independence requirements for group audit reporting purposes and document the relevant procedures performed? [ISA | 7939.1303]

The component auditor complies with all independence requirements outlined by the group auditor in the Group Audit Instructions and confirms to the group auditor compliance with the relevant independence rules.

The component auditor populates the Entity Profile screen within the KPMG Clara workflow (KCw) in accordance with the Engagement Profile functional guidance to generate the appropriate Independence module. The Engagement Profile functional guidance can be located in workflow by navigating to the Guidance button in the Engagement profile screen.

The component auditor completes the Component independence screen within the KPMG Clara Workflow (KCw) Independence module, which is generated by selecting "Component reporting" in the Entity Profile screen and either "Reporting to another KPMG office or member firm" or "Reporting to a non-KPMG entity". The KCw screen prompts documentation of relevant procedures where a component auditor is expected to attach additional evidence to document completion of the independence compliance procedure. This includes items such as notifying component auditor individuals of the entities from which they must be independent and reporting breaches or suspected breaches of independence to the component engagement partner and the Ethics and Independence Partner.

This section of KAEG does not include all execution guidance associated with on-screen content. Refer to activities:

- Determine the entity is appropriately restricted to confirm engagement information in PHAC and KICS is up to date, if relevant
- Assess completeness and accuracy of the Sentinel family tree[to assess the entity and its related entities are appropriately restricted
- Perform independence procedures in relation to new related entities' to perform procedures in relation to new entities requiring independence by the component auditor as a member of the group audit team
- Assess whether engagement personnel rotation requirements have been met and long association threats have been considered' to perform procedures in relation to long association
- Evaluate threats to independence to consider the issues that can create independence threats

Component Audit | Who is the component audit client? [ISA | 7939.160113]

The component audit client is a component over which we perform audit work for purposes of a group audit. The component audit client includes the entity and any related entities it controls directly or indirectly. Where the component audit client is a business unit or activity, the component audit client will be the legal entity or entities that the business unit belongs to or in which the business activity is performed and will not include controlled related entities.

Component Audit | What is the difference between reporting to a KPMG group auditor and a non-KPMG group auditor? [ISA | 7939.160114]

When we are a component auditor reporting to a KPMG group auditor, our affiliation through the KPMG network provides some understanding of the group auditor's processes. We can leverage and rely upon global systems of quality management in carrying out our independence procedures, which results in fewer procedures required to be performed by the component auditor. For example, Sentinel is a mandatory, globally-deployed application that facilitates compliance with required professional standards, including independence standards applicable to our audit clients. Sentinel captures all proposed engagements from KPMG member firms to ensure that the business rules and workflows are consistently and accurately applied. For instance, when the group audit client is onboarded in Sentinel and the KPMG group engagement partner is the Sentinel Lead Partner (SLP), the SLP is responsible for maintaining the Sentinel tree with all entities that require independence, including our component audit client (including its controlled related entities), and is notified of any proposed service at an entity within the Sentinel family tree. It is not necessary for a component auditor to duplicate procedures performed by the group auditor within the KPMG network.

When we are a component auditor reporting to a non-KPMG group auditor, we cannot leverage common systems or procedures and, therefore, we perform all relevant procedures as though we are performing a standalone audit to ensure the independence of the firm. For example, a component auditor reporting outside the network performs all the procedures to validate the entities identified for independence, including checking against the relevant systems, because there is no other audit engagement team within the network with the responsibility to perform the same procedures.

Component Audit | What ethical and independence rules do we follow as the component auditor reporting to a KPMG group auditor? [ISA | 7939.160115]

As a component auditor reporting to a KPMG group auditor, our work to support the group audit is subject to the ethical and independence requirements that are applicable to the group audit client and may include requirements specific to the group auditor's jurisdiction, which may be different from or in addition to those requirements applicable in our jurisdiction. The group auditor describes in the Group Audit Instructions the ethical and independence requirements that are relevant to the group audit.

Component Audit | What independence rules do we follow as the component auditor reporting to a non-KPMG group auditor when our component audit client is a public interest entity and the group audit client is a non-public interest entity? [ISA | 7939.160116]

When reporting to a non-KPMG group auditor where our component audit client is a public interest entity and the group audit client is a non-public interest entity, we follow the independence requirements that are applicable to non-public interest entity audit clients for purposes of the group audit.

However, if we also perform a standalone audit for the public interest entity component audit client, we follow the independence requirements that are relevant to public interest entities for purposes of the standalone audit.

Component Audit | Do we apply PIE independence rules as the component auditor reporting to a non-KPMG group auditor when the group audit client is a public interest entity but the component audit client is a non-public interest entity? [ISA | 7939.160117]

When we are a component auditor reporting to a non-KPMG group auditor, and the group audit client is a public interest entity but our component audit client is a non-public interest entity, we apply requirements applicable to public interest entities as it relates to the provision of non-assurance services to the component audit client. However, the requirement to obtain concurrence from those charged with governance does not apply (i.e., the component auditor may provide a non-assurance service that is permissible under the public interest entity requirements in Chapter 11 of the GQ&RMM to a component audit client without communicating or obtaining concurrence for the provision of that service from those charged with governance of the group audit client).

We consider the self-review threat in relation to the financial information over which we perform audit procedures. We further refer to GQ&RMM Chapter 11 for policy and guidance to assess permissibility of services provided to the component audit client.

Component Audit | What entities do we need to be independent from as the component auditor when reporting to a KPMG group auditor? [ISA | 7939.160118]

As a component auditor reporting to a KPMG group auditor, we are part of the group engagement team and are independent of the group audit client, which includes its relevant related entities and any other components at which audit work is performed. The group auditor describes in the Group Audit Instructions the entities from which we are to be independent.

Component Audit | What entities do we need to be independent from as the component auditor when reporting to a non-KPMG group auditor? [ISA | 7939.160119]

When reporting to a non-KPMG group auditor, component auditor individuals are required to be personally independent of:

- the component audit client (including its controlled related entities),
- the non-KPMG group entity being audited, and
- any entity that is controlled by the group entity being audited and in the chain of control of the component audit client.

Component auditor individuals notify the component engagement partner when they know or have reason to believe that a relationship or circumstance with any other related entity or component of the group audit client might create a threat to their independence.

In addition, when a component auditor reports to a non-KPMG group auditor, the component auditor firm:

- is independent of the component audit client (including its controlled related entities)
- does not have a direct or material indirect financial interest in the group entity being audited (excluding its related entities), including a financial interest held as a trustee, and a financial interest received unintentionally (GQ&RMM Policies 12.15.1 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=253-policy-1178, 12.15.3 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=253-policy-1180 and 12.15.4 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=253-policy-1181)
- does not have impermissible loans and guarantees involving the group entity being audited (excluding its related entities) (GQ&RMM Section 12.16 https://www.gqrmm-prod.kworld.kpmg.com/G/0/Content/231?jm=254-policy-1223).

When the component auditor firm knows or has reason to believe that a relationship or circumstance involving other related entities or components of the group audit client or involving other member firms is relevant to its evaluation of independence, the component auditor firm includes the relationship or circumstance when identifying, evaluating and addressing threats.

Independence may be required of additional entities per any incremental independence requirements relevant to the group audit (e.g., UK audit regulations). We consult with the Ethics and Independence Partner when the non-KPMG group auditor requests our independence in relation to other entities or components beyond what is required per the independence requirements relevant to the group audit.

When the entities the component auditor is required to be independent of are listed, we add the entities to the PHAC and restrict the entities in KICS under a "covered person only" restriction to prevent the component auditor individuals (and the component auditor firm as it relates to the group entity being audited) from entering into prohibited financial relationships with the entities. The KICS restrictions can be limited to the component auditor individuals and the component auditor firm as discussed in GQ&RMM Chapters 6 and 12.

We refer to activity 'Determine the entity is appropriately restricted' to confirm engagement information in PHAC and KICS is up to date.

Component Audit | What do we do if a non-KPMG group auditor requests our independence in relation to entities or other components beyond what is required per the independence requirements relevant to the group audit? [ISA | 7939.160120]

We consult with the Ethics and Independence Partner when a non-KPMG group auditor requests our independence in relation to other entities or components beyond what is required per the independence requirements relevant to the group audit.

Component Audit | What is included on the Sentinel family tree when we are a component auditor reporting to a non-KPMG group auditor? [ISA | 7939.160121]

For the purposes of the work we perform as component auditor for the non-KPMG group auditor, we include the entities from which we are required to be independent on the Sentinel family tree. The entities we include on the Sentinel family tree are:

- the component audit client (including its direct/indirect controlled related entities if the component audit client is a legal entity. Where the component audit client is a business unit or activity, for instance, the component audit client will be the legal entity or entities that the business unit belongs to or in which the business activity is performed and will not include controlled related entities.)
- the non-KPMG group entity being audited, and
- any entity that is controlled by the group entity being audited and in the chain of control of the component audit client.

The group auditor communicates the entities we are to be independent of in the Group Audit Instructions.

We further refer to activity 'Assess completeness and accuracy of the Sentinel family tree' for further guidance.

Component Audit | What do we do when we find a new entity from which we need to be independent on the list provided by the non-KPMG group auditor? [ISA | 7939.160122]

We refer to activity 'Perform independence procedures in relation to new related entities' to perform procedures to determine that we are independent of the new entity.

Component Audit | What do we do if we provide word processing, translation or any other financial statement preparation services to the component audit client? [ISA | 7939.160127]

We are permitted to provide such non-assurance services to a component of a non-public interest entity group audit client, assuming the component is not a public interest entity audit client, we have evaluated the threats to our independence, and do not assume a management responsibility.

For a component of a public interest entity audit client, we are permitted to perform certain forms of word processing and translation of financial statements. Financial statement preparation of the component's local statutory financial statements (provided the component is not a public interest entity audit client) may be permitted if the following conditions are met:

- the audit report on the group financial statements of the public interest entity has been issued;
- we do not assume a management responsibility and apply the conceptual framework to identify, evaluate and address threats;
- we do not prepare the underlying accounting records for the statutory financial statements and those financial statements are based on client approved information; and
- the statutory financial statements of the component audit client will not form the basis of future group financial statements of the public interest entity group audit client.

If we perform such non-assurance services to a component of a public interest entity audit client, the KPMG engagement team for the PIE audit client obtains concurrence from those charged with governance (when we are also a component auditor reporting to a KPMG group auditor). To facilitate compliance with the independence rules, as for all audit engagements, we separately identify these non-assurance services from statutory audit services in our Sentinel requests using the appropriate financial statement preparation and financial statement word processing / translation Sentinel taxonomy codes, even if we do not charge a fee for them.

Component Audit | When does the component auditor consult with the Ethics and Independence Partner? [ISA | 7939.1305]

We are required to consult with the Ethics and Independence Partner when we identify any circumstance that threatened, or may have appeared to threaten, independence in relation to the group audit, as outlined in the Global Quality and Risk Management Manual. This may include issues related to the following matters:

- family and close relationships and employee and director relationships
- former partners and employees of KPMG employed by the entity
- audit team member financial and business relationships
- firm financial interests
- firm business relationships (including sponsorships, alliances, joint ventures, consortia or similar third party arrangements)
- past due fees
- gifts and hospitality
- actual or threatened litigation
- third parties used by the firm (as subcontractors, third party resources or external consultants) who may have employment relationships

When we are reporting to a non-KPMG group auditor, we are required to consult with the Ethics and Independence Partner when the group auditor requests our independence from entities or other components beyond what is required by the IESBA Code or local ethical requirements.

Component Audit | How do we assess rotation requirements? [ISA | 7939.160128]

We refer to activity 'Assess whether engagement personnel rotation requirements have been met and long association threats have been considered' to perform procedures in relation to long association.

Component Audit | How do we report an independence issue we identify at the component level? [ISA | 7939.1308]

If we have identified any circumstances that may have threatened, or may have appeared to threaten, the group engagement team's independence, we refer to 'Evaluate threats to independence.' We notify the group auditor along with our conclusion whether the threats to independence that would impact the group audit are at an acceptable level.

If we have identified a breach or suspected breach that would impact the group audit, we consult with the Ethics and Independence Partner. If we are reporting to a KPMG group auditor, we also promptly report the breach or suspected breach to the group engagement partner in writing. If we are reporting to a non-KPMG group auditor, we promptly report a breach of the requirements of the IESBA Code or other external independence requirements to the group engagement partner in writing.

Component Audit | As a component auditor, what do we do when a breach or suspected breach of ethical or independence requirements is identified? [ISA | 7939.1310]

When an ethical or independence breach or suspected breach is identified, we promptly notify the Ethics and Independence Partner who, in conjunction with the component engagement partner, will determine that we:

- end, suspend, or eliminate the interest or relationship that created the breach and address the consequences of the breach
- evaluate the significance of the breach and its impact on our objectivity and ability to perform audit work for the purposes of the group audit
- depending on the significance of the breach, determine whether it is possible to take action that satisfactorily addresses the consequences of the breach and whether such action can be taken and is appropriate in the circumstances
- document the breach including our evaluation of the significance of the breach and its impact on our objectivity and ability to perform audit work for the purposes of the group audit
- promptly provide written communication of our assessment of the breach to the group engagement partner when the breach impacts the group audit.

When the group auditor is within our firm or a member firm, we promptly report breaches or suspected breaches of KPMG policies regarding ethical requirements, including independence requirements, to the group engagement partner in writing.

When the group auditor is a non-KPMG firm, we promptly report breaches of the requirements of the IESBA Code or other external independence requirements (e.g., local independence rules), to the group engagement partner in writing.

The group engagement partner determines the need for any further action and whether the group auditor may continue to use the component auditor's work for purposes of the group audit.

Component Audit | In a multi-tiered audit where a sub-component auditor(s) is reporting to us as a sub-group auditor, do we include matters from the sub-component auditor(s) in reporting to the group auditor? [ISA | 7939.160132]

In a multi-tiered audit where we have a sub-component auditor(s) reporting to us, we include any matters reported by the sub-component auditor(s) when reporting to the group auditor.

1.6 IESBA PIE Independence Rules | Comply with fee-related public disclosure requirements [ISA | 8014]

What do we do?

Document compliance with the requirement to publicly disclose fee-related information.

Why do we do this?

The public disclosure of fees provides visibility about the professional relationships between the firm and the public interest entity audit client, as these relationships might be thought to be relevant to the evaluation of the firm's independence.

Execute the audit

IESBA PIE Independence Rules | How do we comply with the requirement to publicly disclose fee-related information? [ISA | 8014.157566]

We comply with this by determining that fee-related information is publicly disclosed by either the public interest entity audit client or by the firm. If local laws and regulations do not currently require the public interest entity audit client to disclose audit fees, fees for services other than audit paid or payable to all KPMG member firms, and information about fee dependency, we discuss the following with those charged with governance:

(1) The benefit to the client's stakeholders of the audit client making such disclosures in a manner deemed appropriate, taking into account the timing and accessibility of the information; and
(2) The information that might enhance the user's understanding of the fees paid or payable and their impact on the firm's independence.

If the public interest audit client does not make the relevant disclosure, we publicly disclose: A) fees for the audit of the financial statements, B) fees for other services, and C) fee dependency (if applicable), as laid out at GQ&RMM 12.20.8.

IESBA PIE Independence Rules | Where do we publicly disclose fee-related information when the audit client does not make the required disclosure? [ISA | 8014.157567]

We follow our firm's approach to making the public disclosure. See additional information in GQ&RMM 12.20.8.

Examples

2 Plan and perform work with due professional care [ISA | 3732]

What do we do?

Plan and perform work related to the audit and the preparation of the report with due professional care

Why do we do this?

As auditors, we are not infallible, but we may be held liable for negligence, bad faith or dishonesty. To minimize this risk, we evidence our acting with 'good faith and integrity'. Due professional care represents our responsibility to perform an audit in accordance with the standards, possess the degree of skill commonly possessed by other auditors, and exercise professional skepticism in order to obtain reasonable assurance about whether the financial statements are free of material misstatement. Due professional care also demands the auditor to exhibit independence in thought and action.

Execute the Audit

What is due professional care? [ISA | 3732.1300]

Due professional care is a manner of attitude and conduct, which includes possessing the degree of skill commonly possessed by other auditors, acting with integrity, and exercising professional skepticism. Due professional care is the foundation for how we conduct our audits.

How do we apply due professional care? [ISA | 3732.10407]

Due professional care demands that we act with competence, exercising reasonable care and diligence and, applying professional skepticism. The ability to exercise professional skepticism is enhanced when we are independent of mind and independent in appearance, which is also referred to as being independent in thought and action.

Independence means	Why do we do it?
Independence of mind Means being objective in the way we view the client and our role as auditors.	If we too closely identify with our client, then this impairs our ability to be objective in our assessment of risks and our evaluation of audit evidence. Viewing the client as our friend, or feeling like we are 'in it together' with the client is dangerous as it can impact our risk assessment or our evaluation of the sufficiency of our audit evidence by preventing us from objectively recognizing the risks that exist in the client and the engagement. We may rationalize our findings or not investigate questions, or we may not assess the situation critically enough to realize that there may be a risk, because we may subconsciously relate too much to the client.

Independence in appearance Means making our audit decisions, and performing the audit, in a way that demonstrates our independence from the client.	Selecting audit procedures, determining the extent of our testwork, and reaching conclusions are all affected by our independence and objectivity. If we are not independent in thought, then it is difficult for us to be independent in appearance. This concept is connected to the concept of professional skepticism.

Refer to activity 'Remain ethical and independent during our audit engagements' for more information on independence.

When we offer services as auditors, we are implying that we are capable of performing the work and that we possess the requisite skill and exercise it with reasonable care and diligence.

How do we exhibit that we have applied due professional care? [ISA | 3732.1400]

To exhibit that the work has been planned and performed with due professional care we demonstrate:

- that we possess the degree of skill commonly possessed by other auditors and that we exercise it with reasonable care and diligence (see activity 'Possess and exercise expected degree of skill');
- that members of the engagement team are assigned to tasks and supervised commensurate with their level of knowledge, skill and ability (see activity 'Assign tasks and supervise engagement teams');
- that we know the standards and are knowledgeable about the client (see activity 'Know the standards and be knowledgeable about the client'); and
- professional skepticism (see activity 'Apply professional skepticism').

Group Audit or Component Audit or Multiple Locations | Do we apply due professional care even if our member firm is not the member firm issuing the auditor's report? [ISA | 3732.159375]

Yes. All members of the engagement team who perform audit procedures on the engagement are responsible for performing their work with due professional care, even if the members of the engagement team are not part of the member firm issuing the auditor's report.

2.1 Possess and exercise expected degree of skill

[ISA | 3733]

What do we do?

Possess "the degree of skill commonly possessed by other auditors" and exercise it with "reasonable care and diligence" (that is, with due professional care)

Why do we do this?

To exhibit that we exercise due professional care in our work, each member of the engagement team possesses the appropriate level of skill. Possession of relevant skills is dependent upon appropriate training and education. This enables us to perform our audit to the applicable standards.

Execute the Audit

What is considered "degree of skill commonly possessed" by other auditors? [ISA | 3733.1300]

"Degree of skill commonly possessed" by other auditors means that we are expected to receive training and become proficient as accountants and auditors, but we are not expected to have the qualifications of someone trained for another profession, for example, an appraiser. However, we are responsible for understanding when to involve specialists and/or specific team members. See the chapter on using the work of specialists (ISA 620, AU-C 620, AS 1210) and specific team members (ISA 300, AU-C 300, AS 2101) for more information.

While the ultimate responsibility for the outcome of the engagement lies with the engagement partner, the engagement team members, by participating in the engagement, are implying that they are appropriately qualified.

How do we develop the 'degree of skill commonly possessed by other auditors'? [ISA | 3733.10454]

A cornerstone of the 'degree of skill commonly possessed by other auditors' is appropriate education and training. In addition to our formal training, we also get 'on the job training' (i.e. 'experience'). For example, a junior assistant or similar, just entering upon an auditing career, obtains his or her professional experience via proper direction, supervision and review of his or her work by a more experienced member of the engagement team (see activity 'Review the work of engagement team members' for more information).

We do not expect all members of the engagement team to be equally skilled. The engagement partner, for example, usually has many more years of relevant experience than an audit assistant.

How do we exercise the 'degree of skill commonly possessed by other auditors' with reasonable care and diligence? [ISA | 3733.1400]

By thoughtfully following the applicable manuals (i.e. audit, reports and quality control manuals), including exercising professional skepticism (see activity 'Apply professional skepticism'), we are performing the audit with reasonable care and diligence.

2.2 Assign tasks and supervise engagement teams [ISA | 3734]

What do we do?

Appoint an engagement partner with appropriate authority to assign to engagement team members those tasks which are commensurate with their knowledge, skill and ability and to subsequently supervise the performance of the activities.

Why do we do this?

We assign tasks to members of the engagement team commensurate with their level of knowledge, skill and ability because otherwise it would not be possible for them to appropriately evaluate the audit evidence they examine. As the engagement partner is responsible for the proper assignment and supervision of the work, the engagement partner possesses the appropriate authority to perform the role.

Execute the Audit

Who can serve as an engagement partner? [ISA | 3734.1300]

An engagement partner is a partner or other appropriate person in KPMG who is responsible for the audit engagement and its performance, and for the auditor's report(s) that the firm issues, and who has the appropriate authority from the KPMG member firm and from a professional, legal or regulatory body.

What are the engagement partner's responsibilities? [ISA | 3734.1400]

The engagement partner is, among other things, responsible for the engagement and its performance and thus is responsible for the assignment of tasks and the supervision of the members of the engagement team (see activity 'Take responsibility for the audit' for more information on the engagement partner's responsibility for the direction, supervision, and performance of the audit in compliance with applicable professional standards, legal and regulatory requirements and the firm's policies and procedures). The engagement partner assigns tasks to team members that adequately match the individuals' skill sets.

How does the engagement partner match audit tasks with the skill level of engagement team members?

In general, the more judgment is involved to fulfil a task the more experienced the individual assigned the task. The table below shows examples of audit tasks and the level of expertise to perform them:

Task	Level of expertise demanded to perform the task
Inventory count	This task involves comparing actual quantities with what is reported by the entity on its inventory count sheet, and completing a detailed, but standardized, working paper. Therefore, this generally does not call for a certain type of expertise or level of experience and a less experienced member of the engagement team (e.g. an audit assistant) may be best suited to carry out this task.
Selection of items for sending accounts receivables confirmations	The selection of the items can involve some judgment. For example, if we use a substantive sampling technique to select the sample items, such as KPMG Monetary Unit Sampling, we determine certain inputs to the tool, for example, the expected misstatement in the population. An inexperienced team member may not have the expertise to determine this. Also, determining the specific method of selection to be used (e.g., specific item or sampling) may involve applying some

	judgment and drawing on experience that a more junior team member may not have. Therefore, a member of the engagement team with some experience (e.g. an audit senior) may be best suited to carry out this task.
Evaluation of impairment analysis	The evaluation of an impairment analysis may be complex, particularly if the asset we are evaluating is not a readily traded marketable security. Valuation reports include judgments made by management and other assumptions that involve careful assessment and critical evaluation by the audit team. Therefore, a more experienced member of the engagement team (e.g. an audit manager) with appropriate training may be best suited to carry out this task.

2.3 Know the standards and be knowledgeable about the client [ISA | 3735]

What do we do?

IF acting as the engagement partner THEN know the relevant accounting and auditing standards and be knowledgeable about the client.

Why do we do this?

The engagement partner can appropriately fulfil his or her role and perform a robust, quality audit only if they know the relevant standards and are knowledgeable about the entity.

Execute the Audit

What can the engagement partner do to obtain knowledge of the relevant standards and of the entity to enable him or her to fulfil their role? [ISA | 3735.1300]

To obtain the knowledge of the relevant standards, the engagement partner may, for example:

- read the accounting and auditing standards to be applied;
- obtain knowledge about how to use our tools and methodology; and
- attend trainings.

What can the engagement partner do to become knowledgeable about the entity? [ISA | 3735.10473]

To become knowledgeable about the entity, the engagement partner may, for example:

- obtain a preliminary understanding of the entity, its environment and the entity's internal control over financial reporting through our client acceptance process,
- read prior period financial statements and other publicly available information about the entity,
- review past audit files,
- hold discussions with the preceding engagement partner and/or entity management,

- read significant agreements and other material matters that impact the entity and its accounting, and
- read industry collateral and leverage their experience in the industry.

3 Apply professional skepticism [ISA | 788]

What do we do?

Apply professional skepticism in gathering and evaluating audit evidence.

Why do we do this?

Professional skepticism plays a key role in the audit and is integral to our skill set. Our due professional care requires that we exercise professional skepticism throughout the audit. Exercising professional skepticism can be particularly relevant when considering our fraud risk assessment or response to identified fraud risks because fraud often involves sophisticated and carefully organized schemes designed to conceal it.

Execute the Audit

What is professional skepticism? [ISA | 788.1300]

Professional skepticism involves having a questioning mind that critically assesses audit evidence. It includes watching out for conditions or evidence that may indicate a possible misstatement due to error or fraud.

What are examples of instances where we may apply a heightened degree of professional skepticism? [ISA | 788.7958]

Examples of potential red flags relevant to our understanding of the entity and its environment

- A lack of clarity regarding the identity of the counterparties and the nature of their relationship to the reporting entity;
- Reliance on a small number of business partners for significant volumes of revenues or profits;
- Transactions or arrangements that lack a clear business purpose or economic substance;
- Significant operations or business activities conducted through, or assets held in, offshore jurisdictions or jurisdictions with limited regulation/transparency;
- Complex or high volumes of related party transactions;
- Financial relationships/key performance indicators (KPIs) that are inconsistent with the entity's peers or our expectations, such as: – A significant and persistent or unusual gap between profitability and operating cashflows;
- The entity holds more interest-bearing debt than appears to be necessary given its holdings of liquid financial asset; or
- The entity has significantly increased its debt to finance assets that may be challenging to obtain audit evidence with respect to the existence assertion, such as material goods in transit, loans receivable, prepayments or assets under construction
- Excessively complex contractual arrangements;
- Media coverage or analyst reports which raise concerns, such as questions about the appropriateness of the entity's business or accounting practices;

- Commentary in the entity's Other Information, e.g. MD&A, which may highlight concerns about an entity's performance and future plans; and
- The existence of significant short positions held in the entity's shares.

If any of the above are identified, we understand the facts and circumstances, including consideration of the source of the information and its reliability, in determining whether there is an impact on our identification and assessment of the RMMs.

Examples of potential red flags relevant to other aspects of the audit

- Are there unusual delays in providing requested information?
- Is documentation only available as copies or electronically transmitted documents when documents in original form are expected to exist?
- Is electronic evidence missing or unavailable, and is this inconsistent with the entity's record retention practices or policies or legal booking keeping requirements?
- Does management attempt to restrict access to records, facilities, certain employees, customers, suppliers or others from who audit evidence may be sought?
- Is there an unwillingness to provide key electronic files for testing using computer-assisted audit techniques?
- Is information frequently presented at the last minute leaving little time to appropriately verify its contents?
- Are there indications of deficient controls or less than robust governance for the size of the business?
- Do management's explanations evolve over time, which may indicate they are not being transparent or presenting the full picture?
- Are responses from management and employees arising from our inquiries or analytical procedures inconsistent, vague or implausible?
- Is management dominant and/or aggressive when dealing with external or internal auditors? Do they question why we need to perform certain procedures or push back when we seek to obtain additional corroborating audit evidence?
- Does management take an unusual interest in the selection of accounting policies, how estimates are made, or transactions are accounted for? Does management appear to be more focused on a desired outcome than on ensuring the accounting treatment is appropriate?
- Is there an unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable?
- Is management involved in making journal entries, particularly when they would not normally do so, or need to override controls in order to do so?

We do not only think about the indicators individually, but also in the aggregate. When more than one indicator is present, collectively they may indicate a pattern of collusion and concealment, which may cause us to evaluate the implications for our audit.

How do we apply professional skepticism? [ISA | 788.1400]

We apply professional skepticism by being alert to matters such as:

- audit evidence that contradicts other audit evidence we have obtained;
- information that brings into question the reliability of documents and responses to inquiries we plan to use as audit evidence; and

- conditions that may indicate possible fraud.

Professional skepticism also involves remaining alert to our biases and other circumstances that can cause us to gather, evaluate, rationalize, and recall information in a way that is consistent with client preferences rather than interests of external users throughout the audit.

We maintain professional skepticism by asking whether the information and audit evidence we gather suggests that a material misstatement due to fraud may exist.

Applying professional skepticism does not mean that we assume management is dishonest or not. Rather, we exercise professional skepticism with balance. We do not accept less persuasive evidence merely because we believe management to be honest.

What are examples of biases that may impede our ability to apply professional skepticism? [ISA | 788.1500]

Common biases that can undermine professional skepticism and ways to mitigate them include:

Bias/trap and potential impact:	Ways to mitigate:
Rush-to-solve trap The tendency due to time pressures to want to solve a problem by making a quick judgement. Potential impact Can lead to a limited understanding of a problem or alternative resulting in inappropriate conclusions.	• Awareness • Plan your audit to allow sufficient time for the performance and appropriate review of audit procedures • Document work performed routinely and in a timely manner to facilitate critical thinking and capture a more accurate and complete reflection of how the conclusions were reached • Start working on the key decisions early in the process
Availability bias The tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not. Potential impact Can lead to limited alternatives considered or evidence gathered related to those alternatives	• Awareness • Consider why something comes to mind • Vividness • Recent events • Make the opposing case • Seek advice from others • Obtain and consider objective data
Overconfidence bias The tendency to overestimate one's own ability to make accurate assessment of risks or other judgements or decisions.	• Awareness • Challenge management's estimates and: - Ask about potential causes of unexpected outcomes

Potential impact Can lead to underinvesting in understanding issues, insufficient challenging of management views or limited consideration of potential alternatives.	- Ask for estimate or likelihood of unexpected outcomes • Challenge extremely high or low estimates • Maintain professional skepticism
Confirmation bias The tendency to seek confirming information or to favor conclusions that are consistent with initial beliefs. Potential impact Can lead to only seeking evidence that is consistent with a client's explanation or a preferred outcome.	• Awareness • Consider alternatives provided by others or yourself • Seek disconfirming or more complete information • Explicitly acknowledge and consider your preferences or motives
Anchoring bias The tendency to make assessments in evaluating information by starting with an initial value and then adjusting sufficiently away from initial value in forming a final judgment. Potential impact Can lead to a lack of objectivity in assessing transactions, estimates and account balances.	• Awareness • Make an independent judgement or estimate void of an anchor • Solicit input from others, being careful not to provide anchor for their thinking • Take steps to make judgements or formulate expectations prior to seeing preliminary outcomes • Obtain benchmarking information
Groupthink The tendency to think or make decisions as a group that discourages creativity or individual responsibility. Potential impact Can lead to limited alternatives considered or evidence gathered related to those alternatives.	• Awareness • Communicate individual opinions and thoughts • Encourage others to communicate their opinions and thoughts
Automation bias	• Awareness

The tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions as to whether such output is reliable or fit for purpose. Potential impact Can lead to inappropriate reliance on information.	• Involve specific team members with expertise in IT

What are examples of additional impediments on exercising professional skepticism? [ISA | 788.157463]

Additional examples include but are not limited to:

Impediments	Potential impact
Budget constraints	Discourage the use of sufficiently experienced or technically qualified resources for the effective understanding, assessment of and responses to risks and informed questioning of management.
Tight deadlines	Negatively affect the behavior of those who perform the work as well as those who direct, supervise and review. For example, external time pressures may create restrictions to analyze complex information effectively.
Lack of cooperation or undue pressures imposed by management	Negatively affect the engagement team's ability to resolve complex or contentious issues.
Insufficient understanding of the entity and its environment, its system of internal control and the applicable financial reporting framework	Constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
Difficulties in obtaining access to records, facilities, certain employees, customers, vendors or others	Cause us to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.

Overreliance on automated tools and techniques	Result in the engagement team not critically assessing audit evidence.

What are possible actions that we can take to mitigate impediments in applying professional skepticism?

[ISA | 788.157464]

Possible actions to mitigate impediments may include:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement, and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement.
- Explicitly alerting the engagement team to instances or situations when vulnerability to unconscious or conscious auditor biases may be greater (e.g. areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures.
- Changing the composition of the engagement team, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise are assigned to the engagement.
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with.
- Involving specific team members or KPMG specialists to assist the engagement team with complex or subjective areas of the audit.
- Modifying the nature, timing and extent of direction, supervision or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis or more in-depth reviews of certain working papers for:
    - Complex or subjective areas of the audit;
    - Areas that pose risks to achieving quality on the audit engagement;
    - Areas with a fraud risk; and
    - Identified or suspected instance of non-compliance with laws or regulations, including illegal acts.
- Setting expectations for:
    - Less experienced members of the engagement team to seek advice frequently and in a timely manner from more experienced engagement team members or the engagement partner; and
    - More experienced members of the engagement team to be available to less experienced members of the engagement team throughout the audit engagement and to respond positively and in a timely manner to their insights, requests for advice or assistance.
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors or others from whom audit evidence may be sought.

What is contradictory, or disconfirming audit evidence? [ISA | 788.11474]

Contradictory, or disconfirming audit evidence is evidence obtained in the audit that seems to contradict the evidence on which we based our original risk assessments (and in some cases, the amount or disclosure being audited). We may come across contradictory audit evidence while performing procedures on a specific account balance, or in an unrelated manner.

> Example: Contradictory audit evidence may exist in the form of information that an entity is insolvent, and therefore it may not be able to repay the outstanding accounts receivables balance, and the client has not created an allowance for doubtful accounts related to this receivable. The evidence is "contradictory" because it contradicts the client's premise, i.e. that the amount is collectible and no allowance is necessary.

Who is responsible for applying professional skepticism? [ISA | 788.1600]

It is the responsibility of each individual involved in the engagement to appropriately apply professional skepticism throughout the audit, including when identifying and assessing risks of material misstatement (RMMs), including RMMs due to fraud - i.e., fraud risks, performing tests of controls and substantive procedures to respond to identified RMMs, and evaluating the results of the audit.

The engagement partner is responsible for setting an appropriate tone that promotes:

- emphasizing the importance of each engagement team member to exercise and maintain a questioning mind throughout the audit; and
- exercising professional skepticism in gathering and evaluating audit evidence.

When do we apply professional skepticism? [ISA | 788.1700]

We apply professional skepticism throughout the audit, including when we respond to RMMs, particularly fraud risks. We apply professional skepticism particularly when we:

- perform engagement acceptance or continuance, including evaluating the integrity of management;
- identify and assess RMMs;
- design and perform audit procedures to address RMMs, including the nature, timing and extent of our audit procedures;
- evaluate management judgments; and
- determine our overall conclusion on the audit evidence obtained.

Why do we apply professional skepticism when responding to fraud risks? [ISA | 788.1800]

Applying professional skepticism can be particularly relevant when responding to fraud risks as it enhances the effectiveness of our audit procedures. We also reduce the risk that we may:

- overlook unusual transactions or circumstances;
- misinterpret audit results and reach the wrong conclusion; and
- use inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results.

How do we apply professional skepticism when we review documents and records? [ISA | 788.1900]

When we review documents and records, we apply professional skepticism by considering their reliability, as fraud, including fraudulent financial reporting and misappropriation of assets, is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization. We may accept records and documents as genuine unless we have a reason to believe the contrary.

If we doubt the reliability of information or find indications of possible fraud - e.g. if conditions identified during the audit lead us to believe that a document is inauthentic or its terms have been falsified - we investigate further and determine whether to modify or add new audit procedures to resolve the matter.

> For example, when designing our response to an assessed RMM related to the risk of management override of controls, we inspect a selection of manual journal entries that have certain characteristics that could indicate a higher risk of fraud. If we examine the supporting documentation for those entries and find them vague or unclear, we apply professional skepticism by obtaining more persuasive audit evidence - e.g. from a third party - before we conclude whether fraud is indicated, rather than by obtaining other potentially less reliable internal evidence or inquiry alone.

To what extent do we rely on representations from management? [ISA | 788.11475]

As part of evaluating audit results, we conclude on whether sufficient appropriate audit evidence has been obtained to support the opinion on the financial statements. In order to accomplish this, we do not simply rely on explanations from management or those charged with governance. A common pitfall of auditors is to 'audit by conversation', which means to obtain evidence merely from discussions with the entity's representatives, without appropriate audit evidence; this does not display professional skepticism. Instead, we don't just accept the entity's explanation but seek to obtain appropriately persuasive audit evidence.

Representations from management or those charged with governance are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base our audit opinion(s).

What conditions may cause us to believe that a document may be inauthentic or has been modified? [ISA | 788.11476]

The following conditions may cause us to believe that a document may be inauthentic or has been modified:

- significant delays in management providing requested documents;
- evidence of alterations to documents;
- documents missing signatures or that are incomplete;
- discrepancies in accounting records and documents; or
- conflicting or missing documents.

How do we "investigate further", if we identify conditions that cause us to believe that a document may not be authentic or has been modified? [ISA | 788.11477]

When we identify conditions that cause us to believe that a document may not be authentic, that terms in a document have been modified but not disclosed to us, or that undisclosed side agreements may exist, we perform procedures to further investigate such as:

- confirming directly with the third party; and
- using the work of a KPMG specialist to assess the authenticity of a document

An audit rarely involves the authentication of documents, nor are we trained as, or expected to be, an expert in such authentication.

How do we demonstrate our professional skepticism? [ISA | 788.2000]

We demonstrate our professional skepticism by maintaining the proper mindset and evidencing our application of professional skepticism throughout the audit and our audit documentation.

For example, we can evidence our professional skepticism by documenting:

- our revisions to risk assessment as a result of identified disconfirming evidence;
- significant decisions reached by the engagement team;
- our additional questions in response to inquiries and other information obtained from management and those charged with governance;
- how we incorporate unpredictability in our audit plan;
- how we evaluate disconfirming evidence and the impact to the audit, including changes in our audit strategy; and
- how we evaluate the reasonableness of management assumptions and challenge those assumptions.

Examples

How do we respond to contradictory or disconfirming audit evidence? [ISA | 788.11488]

Fact pattern

ABC Company recorded accounts receivable from its customer, XYZ Company, in the amount of CU1 million. This balance has been confirmed with the customer. The balance is past due by over 90 days, and no allowance for doubtful accounts has been recorded. Unrelated to our audit procedures, the engagement team comes across an article in the news that indicates that XYZ Company may become insolvent.

Analysis

The engagement team does not ignore this information, but questions ABC Company as to why the allowance for doubtful accounts does not include a provision for this customer. If ABC Company provides a plausible explanation, then the engagement team does not rely on the explanation, but investigates further and seeks objective evidence. For example, if ABC Company says that they know XYZ Company well, and have a longstanding relationship with them, and know they are committed to paying the amount, the engagement team documents the conversation and then seeks objective evidence. The evidence the team finds may either confirm (support) the entity's position, such as appropriately sourced subsequent payments on account, or contradict the entity's position, such as no subsequent payments, downgraded credit ratings or other media coverage that are an indication that the customer may not be able to pay.

Professional Judgment

International Standards on Auditing: ISA 200.16

Professional Judgment

16. The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A26-A30)

ISA Application and Other Explanatory Material: ISA 200.A26-A30

Professional Judgment (Ref: Para. 16)

A26. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the ISAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- Materiality and audit risk.
- The nature, timing and extent of audit procedures used to meet the requirements of the ISAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the ISAs and thereby, the overall objectives of the auditor.
- The evaluation of management's judgments in applying the entity's applicable financial reporting framework.
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

A27. The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.

A28. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as that required by ISA 220 (Revised),[18] assist the auditor in making informed and reasonable judgments.

18 ISA 220, paragraph 35

A29. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report.

A30. Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the audit.[19]

Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

19 ISA 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement, paragraph 16

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Exercise professional judgment [ISA | 628]

What do we do?

Exercise professional judgment in planning and performing the audit.

Why do we do this?

Professional judgment is applied in planning and performing the audit. Applying this judgment helps us determine which auditing procedures to perform, and make appropriate decisions throughout the audit.

Execute the Audit

What is 'judgment'? [ISA | 628.1300]

Judgment is the process of reaching a decision or drawing a conclusion where there are a number of possible alternative solutions.

What is 'professional judgment'? [ISA | 628.1400]

Professional judgment is applying knowledge, skills and experience, in a way that is informed by professional standards, laws and ethical principles, to develop an opinion or decision.

Because professional judgment draws on a person's knowledge, skills and experience, being an informed and qualified professional enables us to exercise professional judgment.

How do we think about 'professional judgment' at KPMG? [ISA | 628.10685]

At KPMG we think about professional judgment by referring to the KPMG Professional Judgment Framework, which includes the 5 steps of our Critical Thinking Process.

What is the 'KPMG Professional Judgment Framework'? [ISA | 628.10686]

The KPMG Professional Judgment Framework is a framework developed and used by KPMG that includes a number of components, such as mindset, seeking advice, knowledge and professional standards, influences and biases, reflection, and coaching. The KPMG professional judgment framework is performed using the 5 steps "Critical Thinking Model" as below.

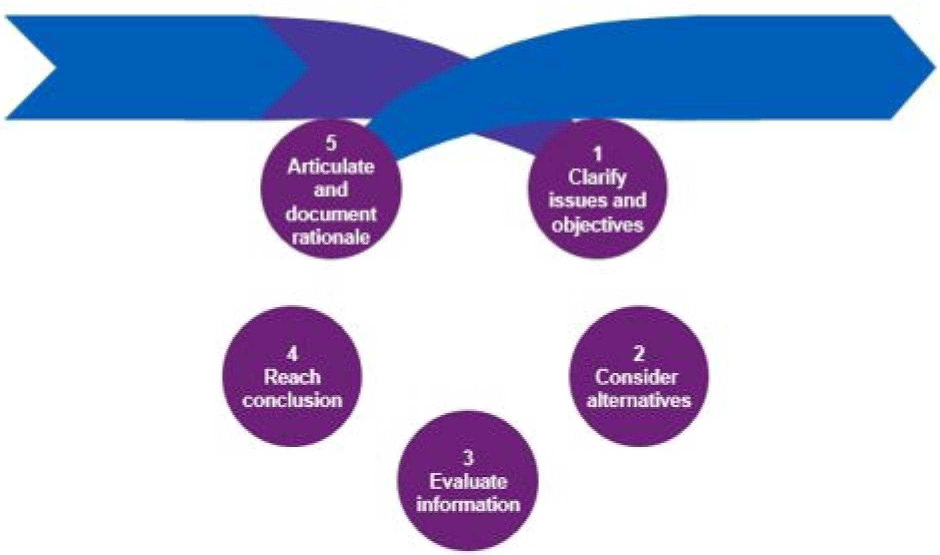
What are the benefits of using the KPMG Professional Judgment Framework? [ISA | 628.10687]

By using the framework, we:

- enhance our professional judgment and professional skepticism;
- make good judgments in a consistent manner;
- enhance audit documentation associated with exercising professional judgment and demonstrate skepticism; and
- effectively coach and mentor team members in how to apply professional judgment.

What is the 'Critical Thinking Model'? [ISA | 628.10688]

The Critical Thinking Model consists of the 5 steps to follow in making effective professional judgments as depicted below.



How can we apply the Critical Thinking Model? [ISA | 628.10691]

The following table includes some questions that we may ask ourselves in applying each of the 5 steps of the Critical Thinking Model and relevant examples for each step.

Steps	Questions	Example: measuring fair value of property
(1) Clarify issues and objectives	• What is the problem to be solved? • Is the issue stated clearly? • How does the issue relate to the overall audit?	Initially we recognize that our objective is to audit the valuation of property, however, we consider the RMMs that caused us to test management's property valuation and the financial reporting framework and determine that the first issue related to the model being used is "has management used the most appropriate valuation technique?"
(2) Consider alternatives	• What are the possible courses of action? • Is the decision influenced by external factors? • Has opposing information been considered for each point of view?	There are three techniques that are used to measure fair value • market approach • income approach • cost approach In considering the alternatives and which the best one to use is, we determine whether there are transactions with comparable properties that are valued differently or whether there is evidence that the property's highest and best use is different from its current use. We may inspect market data from real estate agents to compare with the entity's valuation and any other analysts reports within the similar industry and size of the entity.
(3) Gather and evaluate information	• What subjective assumptions are embedded in the information obtained? • Are inferences supported by objective facts or supportable based on other information obtained throughout the audit?	We would first obtain the entity's calculation and understand what model, data and assumptions were used, whether each of those assumptions were supported, and whether the support was sufficient. We apply the estimates topic to gain sufficient appropriate audit evidence.

	• Has attention been paid to both the negative and positive implications of the facts? • Has sufficient information been obtained?	
(4) Reach conclusion	• Does the conclusion make sense in the context of the audit and other audit evidence?	Before making the conclusion, we assess whether all the information we have gathered is consistent. For cash flow projections, we would review whether it is consistently used for fair value measurements for other assets, where applicable. If there was more than one technique used to measure the fair value of an asset, we consider whether all results were given the same weight and that management did not just use the one that indicated the highest value.
(5) Articulate and document rationale	• Is the reasoning sound? • Have all relevant factors that were considered been documented (positive and negative)? • Does the conclusion make sense after it was documented?	After concluding, we document the challenges we have made and decisions that were made when we or the entity had options to select from and whether the option selected was reasonable. For example, the rationale of choosing one of the values that was calculated using a technique when several techniques were used to measure the fair value. Also, when documenting our thought process and conclusion, we think of whether an experienced auditor is able to understand the rationale that was used to reach the conclusion by referring to the documentation without further discussion.

What does the 'Environment' in the Professional Judgment Framework represent? [ISA | 628.10692]

The Environment in the Professional Judgment Framework represents the internal and external factors which impact our professional judgment. The table below sets out examples of those factors mentioned previously.

External	Internal

• Time pressure • Limited resources • Client, regulatory, industry • KPMG culture • Engagement team	• Judgment traps and biases. See question 'What traps and biases may undermine our professional judgment and how can we mitigate against them?' for more information.

How do our KPMG culture and engagement team affect our ability to exercise our professional judgment? [ISA | 628.10693]

At KPMG, our culture fosters input and involvement from all team members, even the newest staff, to encourage openly sharing information and perspectives crucial to exercising good professional judgment. Our culture encourages seeking advice from others, including our engagement team members and others at KPMG.

Our engagement team, including partners, managers, and others on the team influence the environment in which audit judgments are made. A positive atmosphere can facilitate good judgment and open communication.

When may we 'seek advice' to assist us in exercising professional judgment? [ISA | 628.10695]

We may seek advice from others within KPMG on issues or matters requiring our professional judgment, as they arise. This includes when we encounter environmental factors that we feel will negatively affect our ability to exercise our professional judgment. Seeking advice can assist us in making informed and reasonable judgments during the audit by drawing on the knowledge and experience of others.

At KPMG, we believe that one way to boost our professional judgment is to seek advice or consult with others. These discussions are encouraged.

What is the difference between 'seeking advice' and a 'consultation'? [ISA | 628.10696]

The table below sets out the key differences between seeking advice and a consultation.

	Seeking advice	Consultation
When	When we encounter issues or matters requiring our professional judgment, for which discussions with others may assist us in making informed and reasonable judgments.	Technical accounting or auditing matters which could significantly impact our audit. This may include areas that are more complex, judgmental or relate to decisions that can have significant ramifications to the firm or the audit. In certain situations, we are required to consult with others. These situations are highlighted throughout the Audit Execution Guide.
Who	Others within our engagement team, such as employed KPMG specialists and specific team members	Others more knowledgeable in a certain subject matter. These individuals use appropriate research resources along with their collective

		experience and technical skills to assist us in reaching a conclusion.
How	Informal discussion that may not be directly evidenced in our engagement file (e.g. we may not document persons involved, date of discussions etc.)	Formal discussion evidenced in the KPMG Clara workflow in accordance with the question '[What do we document for a consultation?](#)'

What traps and biases may undermine our professional judgment and how can we mitigate against them? [ISA | 628.10697]

The following table shows common judgement traps and biases that can undermine our professional judgment and its possible mitigations**.**

Bias/Trap and Potential impact	Mitigation
Rush to solve trap The tendency due to time pressures wanting to solve a problem by making a quick judgment. **Potential impact** Can lead to a limited understanding of a problem or alternatives, resulting in inappropriate conclusions.	• Awareness • Plan your audit to allow sufficient time for the performance and appropriate review of audit procedures • Document work performed routinely and in a timely manner to facilitate critical thinking and capture a more accurate and complete reflection of how the conclusions were reached • Start working on the key decisions early in the process.
Availability bias The tendency to place more weight on events or experiences that immediately come to mind or are readily available than those that are not. **Potential impact** Can lead to limited alternatives considered or evidence gathered related to those alternatives	• Awareness • Consider why something comes to mind (a) Vividness (b) Recent events • Make the opposing case • Seek advice from others • Obtain and consider objective data
Overconfidence bias The tendency to overestimate one's own ability to make accurate assessment of risks or other judgements or decisions. **Potential impact**	• Awareness • Challenge management's estimates and: (a) Ask about potential causes of unexpected outcomes (b) Ask for estimate or likelihood of unexpected outcomes

Can lead to underinvesting in understanding issues, insufficient challenging of management views or limited consideration of potential alternatives.	• Challenge extremely high or low estimates • Maintain professional skepticism
Confirmation bias The tendency to seek confirming information or to favor conclusions that are consistent with initial beliefs. **Potential impact** Can lead to only seeking evidence that is consistent with a client's explanation or a preferred outcome.	• Awareness • Consider alternatives provided by others or yourself • Seek disconfirming or more complete information • Explicitly acknowledge and consider your preferences or motives
Anchoring bias The tendency to make assessments in evaluating information by starting with an initial value and then adjusting insufficiently away from that initial value in forming a final judgment. **Potential impact** Can lead to a lack of objectivity in assessing transactions, estimates and account balances.	• Awareness • Make an independent judgement or estimate before looking at the book value ('anchored value') • Solicit input from others, being careful not to provide anchor for their thinking • Take steps to make judgements or formulate expectations prior to seeing preliminary outcomes • Obtain benchmarking information
Groupthink The tendency to think or make decisions as a group that discourages creativity or individual responsibility. **Potential impact** Can lead to limited alternatives considered or evidence gathered related to those alternatives.	• Awareness • Communicate individual opinions and thoughts • Encourage others to communicate their opinions and thoughts
Automation bias The tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions as to whether such output is reliable or fit for purpose. **Potential impact**	• Awareness • Involve specific team members with expertise in IT

Can lead to inappropriate reliance on information.	

Which decisions involve professional judgment when planning and performing the audit? [ISA | 628.10699]

Professional judgment can be a part of any activity we do in planning and performing the audit, but comes into play in those places where there is increased risk, subjectivity or uncertainty.

Examples of decisions that may involve increased professional judgment when planning and performing the audit include decisions about:

- determining materiality and audit risk;
- determining the nature, timing, and extent of audit procedures;
- determining the significance of a matter;
- evaluating whether sufficient appropriate audit evidence has been obtained, and whether more is to be done to form our opinion;
- evaluating management's judgments, especially when auditing estimates; and
- drawing conclusions based on the audit evidence obtained.

How do we evidence our professional judgment? [ISA | 628.1700]

We evidence our professional judgment by preparing audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant findings or issues:

- arising during the audit;
- actions taken to address them (including additional audit evidence obtained);
- the basis for the conclusions reached; and
- significant professional judgments made in reaching those conclusions.

See question 'How do we determine the form, content, and extent of audit documentation?' for more information on the related audit documentation.

When documenting our professional judgment, we may think of including our consideration of each of the first 4 steps of the Critical Thinking Model in KPMG's Professional Judgment Framework (e.g. our consideration of alternatives) and consider the CLEAR framework https://intra.ema.kpmg.com/sites/AUDIT/Pages/AQ_Documentation.aspx. We also keep in mind that our audit documentation reflects that we have competently applied the auditing standards and accounting policies or principles and is consistent with the facts we know.

What is the difference between professional judgment and professional skepticism? [ISA | 628.1800]

Professional skepticism is a component in the process of professional judgement.

The terms professional judgement and professional skepticism often go together in discussions about obtaining audit evidence or evaluating support for management accounting estimates.

Professional skepticism is not synonymous with professional judgement, but rather, it is an objective attitude that includes having a questioning mind and involves critical assessment of audit evidence. However, it is a key part of the professional judgment process and at the center of the KPMG Professional Judgement Framework.

To understand better the difference, imagine that we are testing the goodwill in our audit, and consider the following.

We apply professional judgement in	We apply professional skepticism in
The overall determination of whether or not, in the auditor's view, goodwill has been impaired.	Seeking independent corroborating evidence to support management's assumptions. We do not simply assume management assumptions are appropriate.

Examples

What happens if we don't perform all the steps in the KPMG Professional Judgment Framework? [ISA | 628.1900]

Fact pattern

For each of the five previous years of a public entity's audit, the entity has accelerated their targeted deadline to publicly release their year-end earnings to a date closer to year-end.

In the current year, the CFO intends on meeting an even more accelerated reporting deadline and has consistently pushed the engagement team to reach its conclusions more quickly upon being provided with the company's analysis and conclusion.

A question arises relatively late in the engagement regarding the entity's accounting treatment for certain hedge transactions. The CFO feels very strongly and emphasizes to the engagement team that the entity's documented accounting position considers all applicable professional literature and is the correct accounting treatment. She indicates that all of the "legwork" has been completed and asks for the engagement team's concurrence with the position as soon as possible.

Analysis

We cannot omit any step in our KPMG Professional Judgement Framework.

In developing the KPMG Professional Judgment Framework and teaching the judgment process to our team members, we emphasize the importance of giving adequate attention to each of the components of the five-step judgment framework.

We don't allow unrealistic expectations to override all the steps.

Pressure placed on engagement teams in the form of aggressive timetables can be excessive especially during the height of the financial reporting season. It is therefore important for an engagement team to recognize the potential pitfalls of failing to give significant judgments the proper consideration, for example, by skipping the first couple of steps in the judgment process and proceeding directly to documenting reasons for why the entity's treatment is justified.

Taking the time to clarify the issues and objectives and independently consider other available alternatives is invaluable. Furthermore, sometimes another alternative is the correct answer.

When the engagement team fails to consider all of the steps, it is more likely to accept the entity's position without thinking through the issues and alternatives. Another way of saying this is that the team may fail to apply a sufficient degree of professional skepticism. It is clear that we are more prone to weak and incomplete reasoning or rationalization if we do not invest sufficient time in the initial steps of the judgment process.

What are the benefits of seeking advice of more experienced engagement team members when we exercise professional judgment in planning the audit? [ISA | 628.2000]

Fact pattern

An audit manager and a senior are determining the audit approach for auditing fixed assets and the related depreciation expense.

The audit manager (with eight years of audit experience) has not previously worked on this entity. The audit senior (with four years of audit experience) has worked on this audit engagement for the past three years. Because of the audit senior's prior experience with the entity, the manager defers to the senior for purposes of determining the best audit approach for auditing fixed assets.

The entity operates in the retail industry, selling maternity clothing and accessories throughout the country from more than 1,000 distinct store locations. The entity's fixed assets (net of accumulated depreciation) and related depreciation expense balances are material to the financial statements. The entity uses an off-the-shelf software product to calculate depreciation expense and to maintain its fixed asset subsidiary ledger, which consists of 30,000 individual fixed asset balances.

Consistent with prior year audits, the audit senior, with the concurrence of the audit manager, plans to audit management's calculation of current period depreciation expense by manually recalculating depreciation expense for a judgmental sample of 50 individual fixed assets. Since there were no errors identified in the prior year recalculations and because the entity's internal controls over the calculation and recording of depreciation expense are operating effectively, the audit manager and the senior do not believe that this is a high-risk audit area that calls for more extensive sampling or additional audit procedures.

Analysis

In this case, although the audit senior and manager properly identified the issue and objective (i.e., to plan the audit procedures to test depreciation expense), their failure to consider alternatives prevented them from identifying more effective and efficient audit techniques to address their objective.

While the audit senior's planned audit approach for testing depreciation expense may be acceptable, it may not be the most effective or efficient approach. Seeking advice from others during audit planning may have yielded alternative approaches that were more efficient and effective. For example, the audit senior and manager could have considered alternatives, including the following:

Alternative procedure	Explanation
Substantive analytical procedures	This procedure would entail grouping fixed assets by similar depreciable category (e.g., machinery, buildings, equipment, etc.) and applying various depreciation rates. This can be an effective approach to estimate depreciation expense over an entire population of individual fixed assets. **Benefits**

	• Efficient because it minimizes the number of recalculations performed by the auditor • Effective because it provides an overview of the reasonableness of the entire depreciation expense balance.
D&A procedures	This technique might enable the automated recalculation of the entire 30,000 individual fixed asset balances with a little programming and the push of a button **Benefits** • Providing a highly effective audit procedure (testing 100% of the transactions) with optimal efficiencies.

Sufficient Appropriate Audit Evidence and Audit Risk

International Standards on Auditing: ISA 200.17

Sufficient Appropriate Audit Evidence and Audit Risk

17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A31-A57)

ISA Application and Other Explanatory Material: ISA 200.A31-A57

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 5 and 17)

Sufficiency and Appropriateness of Audit Evidence

A31. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[20]) or through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

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20 ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement,* paragraph 16

A32. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

A33. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

A34. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. ISA 500 and other relevant ISAs establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence.

Audit Risk

A35. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

A36. For purposes of the ISAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Risks of Material Misstatement

A37. The risks of material misstatement may exist at two levels:

- The overall financial statement level; and
- The assertion level for classes of transactions, account balances, and disclosures.

A38. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

A39. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.

A40. The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.

A41. Inherent risk is influenced by inherent risk factors. Depending on the degree to which the inherent risk factors affect the susceptibility to misstatement of an assertion, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk. The auditor determines significant classes of transactions, account balances and disclosures, and their relevant assertions, as part of the process of identifying and assessing the risks of material misstatement. For example, accounts balances consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty may be identified as significant account balances, and the auditor's assessment of inherent risk for the related risks at the assertion level may be higher because of the high estimation uncertainty.

A42. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

A43. Control risk is a function of the effectiveness of the design, implementation and maintenance of controls by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of controls. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.[21]

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21 ISA 330, *The Auditor's Reponses to Assessed Risks,* paragraphs 7 - 17

A44. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. The ISAs typically refer to the "risks of material misstatement" rather than to inherent risk to be assessed separately from control risk separately. However, ISA 315 (Revised 2019)[22] requires a inherent risk to be assessed separately from control risk to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement at the assertion level, in accordance with ISA 330.

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22 ISA 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement

A45. ISA 315 (Revised) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

A46. Risks of material misstatement are assessed at the assertion level in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.[23]

23 ISA 330, paragraph 6

Detection Risk

A47. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

A48. Detection risk relates to the nature, timing and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

- adequate planning;
- proper assignment of personnel to the engagement team;
- the application of professional skepticism; and
- supervision and review of the audit work performed,

assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

A49. ISA 300[24] and ISA 330 establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

24 ISA 300, *Planning an Audit of Financial Statements*

Inherent Limitations of an Audit

A50. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; and
- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

The Nature of Financial Reporting

A51. The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates. Nevertheless, the ISAs require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.[25]

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25 ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures,* and ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements, paragraph 12

The Nature of Audit Procedures

A52. There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.
- Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

A53. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, the IASB's *Framework for the Preparation and Presentation of Financial Statements*). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognizing that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

A54. Consequently, it is necessary for the auditor to:

- Plan the audit so that it will be performed in an effective manner;

- Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- Use testing and other means of examining populations for misstatements.

A55. In light of the approaches described in paragraph A51, the ISAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;[26] and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.[27]

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26 ISA 315 (Revised 2019), paragraphs 17 - 22

27 ISA 330; ISA 500; ISA 520, *Analytical Procedures;* ISA 530, *Audit Sampling*

Other Matters that Affect the Inherent Limitations of an Audit

A56. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion. See ISA 240 for further discussion.
- The existence and completeness of related party relationships and transactions. See ISA 550[28] for further discussion.
- The occurrence of non-compliance with laws and regulations. See ISA 250 (Revised)[29] for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See ISA 570 (Revised)[30] for further discussion.

Relevant ISAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

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28 ISA 550, *Related Parties*

29 ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

30 ISA 570 (Revised), *Going Concern*

A57. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with ISAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Reduce audit risk to an acceptably low level [ISA | 352]

What do we do?

Obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level to obtain reasonable assurance

Why do we do this?

The goal of an audit is to provide reasonable assurance that the financial statements are free of material misstatement, whether due to error or fraud. We do this by obtaining sufficient appropriate audit evidence to reduce audit risk to an appropriately low level.

Execute the Audit

What is audit risk? [ISA | 352.1400]

Audit risk is the risk that we express an inappropriate audit opinion when the financial statements are materially misstated i.e., the financial statements are not presented fairly in conformity with the applicable financial reporting framework (see activity 'Evaluate whether the financial statements are presented fairly').

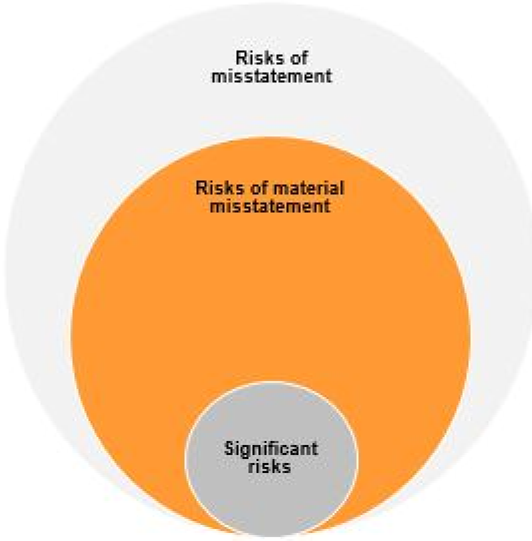
Audit risk is made up of two components:

- Risks of material misstatement (RMM), which we assess in accordance with the chapter on 'Identifying and assessing risks of material misstatement' (ISA 315, AU-C 315, AS 2110); and
- Detection risk.

What is a risk of material misstatement? [ISA | 352.1300]

A risk of material misstatement (RMM) is a risk that could result in a *material* misstatement to the financial statements.

In practice, RMMs represent a subset of the total population of risks of misstatement. They are more broadly defined as those risks with a 'reasonable possibility' of resulting in misstatements, individually or in combination with others, that are material to the financial statements. 'Reasonable possibility' means a more than remote possibility, and is therefore a low threshold. We assess both risks due to error and risks due to fraud.



What is detection risk? [ISA | 352.1800]

Detection risk is the risk that our substantive procedures will not detect a misstatement in the financial statements that could be material, individually or in combination with other misstatements.

Due to the inherent limitations of an audit, detection risk can be reduced but not eliminated.

How do we reduce detection risk? [ISA | 352.10543]

We reduce detection risk by gathering more persuasive audit evidence from our substantive procedures. As the detection risk we are willing to accept decreases, the more persuasive the audit evidence we obtain from our substantive procedures.

The persuasiveness of the evidence we obtain from our substantive procedures is affected by the nature, timing and extent of the audit procedures we perform (see activity 'Design and perform substantive procedures to respond to the level of CAR').

What procedures we perform is only a part of what affects detection risk. How we perform those procedures also affects it. Even if we perform the right procedures, we still perform them in the right way, which includes:

- proper planning;
- having the right people on the engagement team;
- using professional skepticism; and
- proper supervision and review of work performed.

If we do not perform our procedures with due professional care, we may fail to reduce detection risk to an appropriate level. This includes increasing the possibility that we might select an inappropriate audit procedure, misapply an appropriate audit procedure or misinterpret the audit results.

Why can't detection risk be eliminated? [ISA | 352.2200]

Detection risk can't be eliminated because all audits have inherent limitations and we may not detect all misstatements in the financial statements, even if we properly plan and perform our audit.

Why do inherent limitations exist in an audit? [ISA | 352.10544]

Inherent limitations of an audit arise from:

- management's judgements in applying the financial reporting framework to the entity;
- the judgements and inherent measurement uncertainty of financial statement accounts or disclosures - e.g. estimates;
- limitations of audit procedures - e.g. fraud or unintentionally being provided with incomplete information;
- users' expectation that we will form an opinion within a reasonable time period and cost - e.g. by using sampling techniques; and
- limitations of certain assertions and subject matters - e.g. the existence and completeness of related party relationships and transactions.

What does 'reasonable assurance' mean? [ISA | 352.1301]

Reasonable assurance is not an absolute level of assurance: an audit has inherent limitations.

> For example, we don't perform audit procedures over every transaction; and for those transactions on which we do perform audit procedures, our audit evidence is persuasive rather than conclusive. Therefore, it isn't practical to reduce audit risk to zero and we don't attempt to do so.

What does 'sufficient' mean? [ISA | 352.1600]

Sufficiency is the measure of the quantity of audit evidence.

The following table describes the two factors that affect the sufficiency of the audit evidence:

Factors	How the factors affect the sufficiency of audit evidence
CAR Risk associated with the control (RAWTC)	The higher the assessed risk, the amount of audit evidence we obtain also increases.
Quality of the audit evidence obtained (i.e. its appropriateness)	As the quality of the audit evidence increases, the less evidence (in quantity) we may obtain.

Obtaining more audit evidence, however, may not compensate for its poor quality.

What does 'appropriate' mean? [ISA | 352.1700]

Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

What is audit evidence? [ISA | 352.1302]

Audit evidence is the cumulative information that we obtain and use to draw reasonable conclusions on which to base the auditor's opinion. We obtain this information from the accounting records underlying the financial statements and our audit procedures, but it may also come from other sources (e.g. previous audits).

Audit evidence is information to which audit procedures have been applied and consists of information that supports or contradicts management's assertions regarding the financial statements (or internal control over financial reporting in an ICOFR audit). In certain instances, the absence of information is used by the auditor and therefore is also audit evidence. For example, when considering information related to the entity's recorded warranty provision, the absence of sales returns of the product in question may be audit evidence supporting management's assertion about the completeness of the warranty provision.

We apply audit procedures to evaluate the relevance and reliability of information used in the audit.

What information may be used as audit evidence? [ISA | 352.10552]

The following table describes examples of different sources of information, which may be used as audit evidence:

Source	Considerations	Examples
Internal - from within the entity (i.e. management)	Management may provide us with information obtained from the financial reporting process used to prepare the financial statements as well as information obtained from outside of the general and subsidiary ledgers. This information may be stored by the entity within its IT systems or in a remote server. Management may also use specialists who could provide information to be used as audit evidence.	• Accounting records • Reports prepared by the entity, either manual or system generated • Information from the entity's risk management system or sales functions • Information prepared using the work of management's specialists • Board minutes • Internal audit reports • Projections • The results of inquiries with individuals
External - from outside the entity (i.e. external information sources and other external parties)	Management or we may use information obtained from external information sources and other external parties.	• Inquiries of external parties to corroborate management's assertions • Information used as inputs to forecasts or models used to prepare accounting estimates or accumulated by us to analyze industry trends, such as: - Information from service providers - Industry statistics

		- Industry articles - Analyst reports - Competitors' information
Auditor	We may develop information to be used as audit evidence (e.g. accumulate and analyze industry trends to be used in the audits of entities in that industry). We may also employ or engage a specialist to assist us in developing audit evidence. We may also use CAATs to analyze information provided by management or external parties, resulting in audit evidence.	• Previous audits • Findings from KPMG's quality control procedures for client acceptance and continuance • Other engagements performed for the entity • Information obtained from 'complying with certain additional responsibilities under laws and regulations (e.g. regarding an entity's non-compliance with laws and regulations, including illegal acts)

How do we obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level?

[ISA | 352.10546]

We perform substantive procedures in accordance with 'Obtain sufficient appropriate audit evidence' to reduce audit risk to an acceptably low level.

How does obtaining sufficient appropriate audit evidence affect risk? [ISA | 352.1401]

Obtaining sufficient appropriate audit evidence reduces audit risk (see question 'What is audit risk?').

Audit risk consists of combined assessed risk (CAR) (see question 'What is combined assessed risk?'), the combination of inherent risk and control risk, and detection risk. We obtain more persuasive evidence as CAR increases.

What influences the persuasiveness of audit evidence? [ISA | 352.1500]

The following diagram illustrates the factors that influence the persuasiveness of audit evidence:

Conduct of an Audit in Accordance with ISAs

International Standards on Auditing: ISA 200.18-24

Conduct of an Audit in Accordance with ISAs

Complying with ISAs Relevant to the Audit

18. The auditor shall comply with all ISAs relevant to the audit. An ISA is relevant to the audit when the ISA is in effect and the circumstances addressed by the ISA exist. (Ref: Para. A58-A62)

19. The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A63-A73)

20. The auditor shall not represent compliance with ISAs in the auditor's report unless the auditor has complied with the requirements of this ISA and all other ISAs relevant to the audit.

Objectives Stated in Individual ISAs

21. To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant ISAs in planning and performing the audit, having regard to the interrelationships among the ISAs, to: (Ref: Para. A74-A76)

(a) Determine whether any audit procedures in addition to those required by the ISAs are necessary in pursuance of the objectives stated in the ISAs; and (Ref: Para. A77)

(b) Evaluate whether sufficient appropriate audit evidence has been obtained. (Ref: Para. A78)

Complying with Relevant Requirements

22. Subject to paragraph 23, the auditor shall comply with each requirement of an ISA unless, in the circumstances of the audit:

(a) The entire ISA is not relevant; or

(b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A79-A80)

23. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an ISA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Ref: Para. A81)

Failure to Achieve an Objective

24. If an objective in a relevant ISA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the ISAs, to modify the auditor's opinion or withdraw from the engagement (where withdrawal is possible under applicable law or regulation). Failure to achieve an objective represents a significant matter requiring documentation in accordance with ISA 230.[4] (Ref: Para. A82-A83)

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4 ISA 230, *Audit Documentation,* paragraph 8(c)

ISA Application and Other Explanatory Material: ISA 200.A58-A83

Conduct of an Audit in Accordance with ISAs

Nature of the ISAs (Ref: Para. 18)

A58. The ISAs, taken together, provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. The ISAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics.

A59. The scope, effective date and any specific limitation of the applicability of a specific ISA is made clear in the ISA. Unless otherwise stated in the ISA, the auditor is permitted to apply an ISA before the effective date specified therein.

A60. In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the ISAs. The ISAs do not override law or regulation that governs an audit of financial statements. In the event that such law or regulation differs from the ISAs, an audit conducted only in accordance with law or regulation will not automatically comply with ISAs.

A61. The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. In such cases, in addition to complying with each of the ISAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that jurisdiction or country.

Considerations Specific to Audits in the Public Sector

A62. The ISAs are relevant to engagements in the public sector. The public sector auditor's responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with the ISAs. These additional responsibilities are not dealt with in the ISAs. They may be dealt with in the pronouncements of the International Organization of Supreme Audit Institutions or national standard setters, or in guidance developed by government audit agencies.

Contents of the ISAs (Ref: Para. 19)

A63. In addition to objectives and requirements (requirements are expressed in the ISAs using "shall"), an ISA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the ISA, and definitions. The entire text of an ISA, therefore, is relevant to an understanding of the objectives stated in an ISA and the proper application of the requirements of an ISA.

A64. Where necessary, the application and other explanatory material provides further explanation of the requirements of an ISA and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover, including in some ISAs such as ISA 315 (Revised 2019), why a procedure is required.
- Include examples of procedures that may be appropriate in the circumstances. In some ISAs, such as ISA 315 (Revised 2019), examples are presented in boxes.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an ISA. The application and other explanatory material may also provide background information on matters addressed in an ISA.

A65. Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related ISAs or within the title and introduction of the appendix itself.

A66. Introductory material may include, as needed, such matters as explanation of:

- The purpose and scope of the ISA, including how the ISA relates to other ISAs.
- The subject matter of the ISA.
- The respective responsibilities of the auditor and others in relation to the subject matter of the ISA.
- The context in which the ISA is set.

A67. An ISA may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the ISAs. These are provided to assist in the consistent application and interpretation of the ISAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the ISAs. The Glossary of Terms relating to International Standards issued by the International Auditing and Assurance Standards Board in the *Handbook of International Quality Manangement, Auditing, Review, Other Assurance, and Related Services Pronouncements* published by IFAC contains a complete listing of terms defined in the ISAs. It also includes descriptions of other terms found in ISAs to assist in common and consistent interpretation and translation.

A68. When appropriate, additional considerations specific to audits of smaller entities and public sector entities are included within the application and other explanatory material of an ISA. These additional considerations assist in the application of the requirements of the ISA in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of the ISAs.

Scalability Considerations

A69 Scalability considerations have been included in some ISAs (e.g., ISA 315 (Revised 2019)), illustrating the application of the requirements to all entities regardless of whether their nature and circumstances are less complex or more complex. Less complex entities are entities for which the characteristics in paragraph A66 may apply.

A70. The "considerations specific to smaller entities" included in some ISAs have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities.

A71. For purposes of specifying additional considerations to audits of smaller entities, a "smaller entity" refers to an entity which typically possesses qualitative characteristics such as:

(a) Concentration of ownership and management in a small number of individuals (often a single individual - either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and

(b) One or more of the following:

(i) Straightforward or uncomplicated transactions;

(ii) Simple record-keeping;

(iii) Few lines of business and few products within business lines;

(iv) Simpler systems of internal controls;

(v) Few levels of management with responsibility for a broad range of controls; or

(vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

Considerations Specific to Automated Tools and Techniques

A72. The considerations specific to "automated tools and techniques" included in some ISAs (for example, ISA 315 (Revised 2019)) have been developed to explain how the auditor may apply certain requirements when using automated tools and techniques in performing audit procedures.

A73. The ISAs refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the "owner-manager."

Objectives Stated in Individual ISAs (Ref: Para. 21)

A74. Each ISA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual ISAs serve to focus the auditor on the desired outcome of the ISAs while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding whether more needs to be done to achieve them in the particular circumstances of the audit.

A75. Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this ISA. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

A76. In using the objectives, the auditor is required to have regard to the interrelationships among the ISAs. This is because, as indicated in paragraph A55, the ISAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each ISA. At a more detailed level, ISA 315 (Revised) and ISA 330 contain, among other things, objectives and requirements that deal with the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An ISA dealing with specific aspects of the audit (for example, ISA 540) may expand on how the objectives and requirements of such ISAs as ISA 315 (Revised) and ISA 330 are to be applied in relation to the subject of the ISA but does not repeat them. Thus, in achieving the objective stated in ISA 540, the auditor has regard to the objectives and requirements of other relevant ISAs.

Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

A77. The requirements of the ISAs are designed to enable the auditor to achieve the objectives specified in the ISAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the ISAs by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the ISAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the ISAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the ISAs to meet the objectives specified in the ISAs.

Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))

A78. The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 21(b):

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other ISAs;
- Extend the work performed in applying one or more requirements; or
- Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the ISAs to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

Complying with Relevant Requirements

Relevant Requirements (Ref: Para. 22)

A79. In some cases, an ISA (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in ISA 610 (Revised 2013)[31] is relevant.

31 ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, paragraph 2

A80. Within a relevant ISA, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

- The requirement to modify the auditor's opinion if there is a limitation of scope[32] represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies in internal control identified during the audit to those charged with governance,[33] which depends on the existence of such identified significant deficiencies; and the requirement to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the

applicable financial reporting framework,[34] which depends on that framework requiring or permitting such disclosure, represent implicit conditional requirements.

In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the auditor may be required to withdraw from the audit engagement, where withdrawal is possible under applicable law or regulation, or the auditor may be required to do something, unless prohibited by law or regulation. Depending on the jurisdiction, the legal or regulatory permission or prohibition may be explicit or implicit.

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32 ISA 705, *Modifications to the Opinion in the Independent Auditor's Report,* paragraph 13

33 ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management,* paragraph 9

34 ISA 501, *Audit Evidence - Specific Considerations for Selected Items,* paragraph 13

Departure from a Requirement (Ref: Para. 23)

A81. ISA 230 establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement.[35] The ISAs do not call for compliance with a requirement that is not relevant in the circumstances of the audit.

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35 ISA 230, paragraph 12

Failure to Achieve an Objective (Ref: Para. 24)

A82. Whether an objective has been achieved is a matter for the auditor's professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the ISAs, and the auditor's evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the ISAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an ISA.
- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example, due to a limitation in the available audit evidence.

A83. Audit documentation that meets the requirements of ISA 230 and the specific documentation requirements of other relevant ISAs provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor's evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Conduct the audit in accordance with auditing standards and KPMG audit methodology [ISA | 629]

What do we do?

Conduct the audit in accordance with the relevant auditing standards and relevant KPMG audit methodology

Why do we do this?

In order to enable a consistent high quality KPMG audit that is in accordance with the standards, we apply the relevant KPMG audit methodology which include the relevant auditing standards and KPMG policies and procedures used to comply with those standards.

Execute the Audit

What do we do to conduct the audit in accordance with the auditing standards and relevant KPMG audit methodology? [ISA | 629.1300]

To conduct the audit in accordance with the relevant auditing standards and to comply with the relevant KPMG audit methodology we:

- comply with auditing standards relevant to the audit; and
- conduct the audit in accordance with the relevant KPMG Audit Execution Guide

1.1 Comply with auditing standards relevant to the audit [ISA | 630]

What do we do?

Comply with all auditing standards relevant to the audit AND do not represent compliance with the auditing standards unless we have complied with all standards relevant to the audit.

Why do we do this?

Financial statement users expect that we will comply with all auditing standards relevant to the audit engagement. Compliance with the auditing standards helps those users know that audits are performed consistently and rely on those financial statements' value and credibility to make better decisions for each of their purposes.

Execute the Audit

What do we mean by 'auditing standards'? [ISA | 630.1300]

Auditing standards refers to a set of standards or individual standards.

What does standards 'relevant to the audit' mean? [ISA | 630.1500]

A set of standards are 'relevant to the audit' when we perform our audit in accordance with those standards because of laws, regulations or contracts.

An individual standard within a set of standards is 'relevant to the audit' when the standard is in effect and the circumstances addressed by the auditing standard exists.

Scenario	Jurisdiction	Standards relevant to the audit
UK entity listed in the UK and US (a 20-F filer)	INTL	PCAOB and ISA
US component of a UK listed entity	US	ISA and AICPA
UK PIE	INTL	ISA
German University that receives US Government funding	INTL	GAGAS and ISA and/or local auditing standards

What do we do to comply with the ISAs relevant to the audit? [ISA | 630.1800]

To comply with the ISAs relevant to the audit we:

- understand relevant standards;
- comply with each relevant requirement;
- perform alternative procedures when departing from a relevant auditing standards requirement or KPMG Audit Execution Guide; and
- use the standards' stated objectives.

We do not represent compliance with the auditing standards unless we have complied with all standards relevant to the audit.

How do we comply with the auditing standards at KPMG? [ISA | 630.1900]

At KPMG, in order to comply with the auditing standards we conduct the audit in accordance with the appropriate KPMG Audit Execution Guide, use the KPMG Clara workflow and perform all activities that are relevant to the audit.

What do we do if we are unable to represent compliance with the standards? [ISA | 630.10719]

If we cannot represent compliance with the standards, we respond in accordance with activity 'Accumulate, communicate, and evaluate misstatements' and activity 'Modify the audit opinion for specific circumstances' for further steps on how to address the non-compliance with the standards.

How may local laws and regulations affect an audit performed to comply with auditing standards relevant to the audit? [ISA | 630.2100]

Laws and regulations may define the auditing standards to be applied to an engagement. At a minimum, we consider either the ISA, the standards of the PCAOB or AICPA standards to be relevant to the audit at KPMG.

In performing an audit, in certain cases, we comply with legal or regulatory requirements in addition to the auditing standards. The auditing standards do not override laws or regulations.

1.1.1 Understand relevant standards [ISA | 633]

What do we do?

Understand the entire text of the relevant standards

Why do we do this?

The ISA standards consists of various texts. When complying with the ISA standards, we first understand the entire text of those standards to help us apply them properly.

Execute the Audit

What constitutes the 'entire text' of the ISA standards? [ISA | 633.1300]

The entire text of an ISA standard is relevant to our understanding of the objectives stated in each ISA standard and the proper application of the requirements of each standard. The below table shows what it is comprised of.

Texts*	Notes
Introductory material	Provides context relevant to a proper understanding of the standard and definitions. It includes: • the purpose and scope, including interrelated standards; • the subject matter and respective responsibilities of the professional; • the context in which the standard is set; and • the effective date. Unless otherwise stated in the standard, we are permitted to apply a standard before the effective date specified therein.
Requirements	Provides material of what we comply with. See activity 'Comply with each relevant requirement'
Objectives	Provides a link between the requirements and the overall objectives of the auditor. The objectives in individual standards serve to focus the auditor on the desired outcome of the standard
Definitions	Provides a description of the meanings attributed to certain terms

Application and other explanatory material	When necessary, provides further explanation of the requirements of a standard and guidance for complying with the requirements. It may: • explain more precisely what a requirement means or is intended to cover; • include examples of procedures that may be appropriate in the circumstances; and • include additional considerations specific to smaller, less complex entities and governmental entities. Appendices form part of this material as well.

* note: not all standards include all texts and therefore the entire text of each standard may vary

What do we do to understand the relevant ISA standards? [ISA | 633.1400]

The ISA standards are embedded in the KPMG Audit Execution Guide to help us understand the entire text of those standards in the context of the activities we perform throughout the audit.

What do we do to understand the relevant ISA standards when we perform an audit of a smaller entity or public sector entity?

We take into account the additional considerations specific for those types of audits that assist us in the application of the ISA standards' requirements in such entities. We can find them within the application and other explanatory material of an ISA standard.

The application and other explanatory material in regards to the specific types of audits explained above do not limit or reduce our responsibility to apply and comply with the requirements of the ISA standard.

Also, our responsibilities may be affected by law, regulation, or other authority (such as ministerial directives, governmental policy requirements, or resolutions of legislature), which may encompass a broader scope than an audit of financial statements in accordance with the ISA standards. However, these additional responsibilities are not addressed in the ISA standards, but they may be dealt with in the pronouncements of the International Organization of Supreme Audit Institutions or national standard setters, or in guidance developed by government audit agencies.

What is a 'smaller entity'?

It is an entity that typically possesses specific qualitative characteristics including when the ownership and management is concentrated in a small number of individuals. The below are a few other characteristics it may have:

- straightforward or uncomplicated transactions;
- simple record keeping;
- few lines of business and few products within business lines;
- few internal controls;
- few levels of management with responsibility for a broad range of controls; and
- few personnel, many having a wide range of duties.

The above characteristics are not exhaustive and they are not exclusive to smaller entities.

What is a 'public sector entity'?

The term "public sector" refers to national governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises). Hospitals, schools, and universities may be a public sector entity depending on jurisdictions.

1.1.2 Comply with each relevant requirement [ISA | 634]

What do we do?

IF an auditing standard is relevant to the audit THEN comply with each requirement of that standard UNLESS the requirement is not relevant to the circumstances of the audit

Why do we do this?

While we read and understand the entire text of the standards, some standards may not be relevant (e.g., standards related to internal audit and service organizations only apply when internal audit or a service organization exists) and we comply with standards when relevant. Similarly certain requirements in the standards are conditional and we apply those requirements when those conditions exist. We comply with all other requirements. Failing to understand and comply with the standards can put us at risk of performing the wrong or inappropriate activities as part of our audit.

Execute the Audit

When is a requirement not relevant to the circumstances of the audit? [ISA | 634.1300]

A requirement is not relevant when, in the circumstances of the audit,

(a) the entire standard is not relevant; or
(b) the requirement in a relevant standard is not relevant because it is conditional and the condition does not exist.

For example, there are standards that cover the use of the internal audit function that would not be relevant if an internal audit function does not exist. Additionally, there are requirements in the standards that apply only when we become aware of a matter that may require revision of the previously issued financial statements. Those requirements are only relevant to engagements where that condition exists, which is not necessarily every audit engagement.

How do we identify the requirements in the ISAs? [ISA | 634.1600]

Requirements are set out in the requirements section of the standard and are expressed using "shall". However within a relevant standard, there may be "conditional requirements", and the conditionality can either be explicit or implicit. See below for a few examples:

Type	Requirement	Why?

Explicit conditional requirement	"Modify the auditor's opinion if there is a limitation of scope".	The performance is directly required in the circumstance.
Implicit conditional requirement	"Communicate significant deficiencies in internal control identified during the audit to TCWG".	Depends on the existence of such identified significant deficiencies.

In some cases, a requirement may be expressed as being conditional dependent on applicable law or regulation. For example, we may be required to withdraw from the audit engagement, where withdrawal is possible under applicable law or regulation, or we may be required to do something, unless prohibited by law or regulation. Depending on the jurisdiction, the legal or regulatory permission or prohibition may be explicit or implicit.

In addition, application and other explanatory material includes present tense statements which are intended to demonstrate the application of an existing requirement in a standard and not create an additional requirement. The following is an example of a present tense statement:

The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team.

However at KPMG, we apply certain application and other explanatory material from a standard, which will be presented as present tense within the KPMG Audit Execution Guide.

Are procedures and actions described by terms "may," "might," and "could" considered requirements? [ISA | 634.158697]

No. These and other similar terms and phases describe procedures and actions that we understand and think about. How and whether we carry out such procedures or actions is based on our professional judgment in the circumstances.

Do we always comply with each relevant requirement in the auditing standards? [ISA | 634.1700]

No, we comply with each relevant requirement in the auditing standards, except in the exceptional circumstances when the engagement partner judges it necessary to depart from a relevant requirement. If we depart from a relevant requirement we perform alternative procedures to achieve the intent/aim of that requirement. See activity 'Perform alternative procedures when departing from a relevant auditing standards requirement or KPMG Audit Execution Guide'.

How do we comply with each relevant requirement at KPMG? [ISA | 634.1800]

In order to comply with each relevant requirement in the auditing standards we perform the audit in accordance with the applicable KPMG Audit Execution Guide and the KPMG Clara workflow.

Is the engagement team responsible for complying with all the relevant requirements included in the standards? [ISA | 634.1900]

Yes, as it relates to the auditing standards. However, there are some standards that may be relevant to the engagement which apply to others in the firm. This could include the firm and not to individual engagement teams or certain other groups within the firm (e.g. DPP, Risk Management personnel, etc.). In these instances, the responsible party is identified.

1.1.3 Perform alternative procedures when departing from a relevant auditing standards requirement or KPMG Audit Execution Guide [ISA | 635]

What do we do?

IF we depart from a relevant auditing standard requirement OR KPMG Audit Execution Guide, THEN perform alternative audit procedures, have the engagement partner review the departure and consult when there is a departure

Why do we do this?

We are responsible to comply with the relevant auditing standards when planning and performing the audit. However, as situations may differ for each audit engagement, there might be cases where it is not feasible to apply a specific auditing standard or requirement as worded. If in such case, we are still responsible to comply, we therefore perform alternative procedures to fulfill our responsibilities.

As there can be different views of when it is considered to be not feasible, we base our final decisions after having discussions with the engagement partner, and when applicable consulting with DPP, to consistently perform a high quality audit. Having these discussions helps us to be consistent in our procedures as a firm.

Execute the Audit

When may we depart from a relevant auditing standard requirement or the KPMG Audit Execution Guide - ISA? [ISA | 635.1300]

The engagement partner may determine that it is necessary to depart from a relevant auditing standard requirement or the KPMG Audit Execution Guide - ISA (see activity 'Comply with each relevant requirement' when:

- the requirement and/or the KPMG Audit Execution Guide are/is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement and/ or the KPMG Audit Execution Guide;
- we perform alternative audit procedures to achieve the aim of the requirement and/or KPMG Audit Execution Guide;
- in the engagement partner's professional judgment it is necessary to depart from the relevant requirement and/ or the KPMG Audit Execution Guide - ISA; and
- we consult when relevant.

What is considered to be a departure from a relevant auditing standard requirement or the KPMG Audit Execution Guide? [ISA | 635.1500]

Performing audit procedures in accordance with the KPMG Audit Execution Guide is a way we comply with the relevant auditing standard requirement. (See question 'How do we comply with each relevant requirement at KPMG?'). Departing from an activity or performing it in a way different from the KPMG Audit Execution Guide is considered a departure from a relevant auditing standard requirement in relation to the procedures we perform and the documentation in the audit file.

What does the engagement partner review include when we depart from a relevant auditing standard requirement or the KPMG Audit Execution Guide? [ISA | 635.1600]

The engagement partner review includes assessing whether:

- it is necessary to depart from the relevant auditing standard and/or the KPMG Audit Execution Guide and
- the alternative audit procedures achieve the aim/intent of the relevant requirement and/or the KPMG Audit Execution Guide.

What are 'significant findings or issues'? [ISA | 635.1700]

Significant findings or issues are also referred to as 'significant matters' in some auditing standards. They are substantive matters that are important to the procedures performed, evidence obtained or conclusions reached.

Examples of significant findings or issues include:

- matters involving the selection, application, and consistency of significant accounting practices, including related disclosures. Such matters include, but are not limited to (*a*) accounting for complex or unusual transactions or (*b*) accounting estimates and uncertainties and, if applicable, the related management assumptions;
- matters that give rise to significant risks (see question 'What are the different types of risks, and how are they interrelated?' for more details of the significant risks);
- results of audit procedures (including identification of corrected and uncorrected misstatements) indicating (*a*) that the financial statements could be materially misstated or (*b*) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks;
- circumstances that cause the auditor significant difficulty in applying necessary audit procedures; and
- findings that could result in a modification to the audit opinion or the inclusion of additional information in the auditor's report.

How do we assess whether findings or issues are significant? [ISA | 635.1800]

Judging the significance of findings or issues involves an objective analysis of the facts and circumstances. When assessing the significance, we keep in mind:

- significant matters are not determined just because of quantitative aspects using our materiality, but also involve our professional judgment;
- the circumstances surrounding the matter; and
- our evaluation of the impact in the context of the financial statements.

Who do we consult with when the engagement partner considers it appropriate to depart from a relevant requirement or a standard of the KPMG Audit Execution Guide, related to significant findings or issues? [ISA | 635.1900]

If the engagement partner considers it necessary to depart from a relevant requirement in the auditing standards and/ or a standard of the KPMG Audit Execution Guide, related to significant findings or issues, they consult with DPP.

Who does DPP consult with before responding to the engagement team in relation to a consultation related to a departure from an ISA requirement? [ISA | 635.2000]

When an engagement team consults with DPP in relation to a departure from an ISA requirement related to a significant matter DPP consults with ISG before completing the consultation with the engagement team.

1.1.4 Use the standards' stated objectives [ISA | 636]

What do we do?

Use the objectives stated in the relevant auditing standard in planning and performing the audit, considering interrelationships among the standards AND evaluate those instances when we cannot achieve a stated objective

Why do we do this?

Wherever we are planning and performing the audit, we remind ourselves the reason why we are performing the related procedures to accomplish an effective audit. The objectives stated in the standards help us in such process. Also, it helps us determine whether the audit evidence we obtained is sufficient and appropriate for such objectives or not. If the obtained audit evidence isn't sufficient, we are not able to accomplish an effective audit.

Execute the Audit

How do we use the standards' stated objectives in planning and performing the audit? [ISA | 636.1300]

Throughout the audit we ask ourselves "Why am I doing this" and "What am I trying to achieve?" The objectives of the standards answer those questions and help keep us focused on our goal in the audit, which is ultimately to gain sufficient appropriate audit evidence to support the audit opinion. When performing audit procedures, we also think of "How much is enough," "What do I need to test," and "What else do I need to understand?" These questions and objectives of the standards help us avoid performing inconsistent and unnecessary audit procedures as well.

Why do we consider interrelationships among the standards? [ISA | 636.1400]

We consider interrelationships among the standards to:

- determine whether any audit procedures in addition to those required by the standards are necessary in pursuance of the objectives stated in the standards; and
- evaluate whether sufficient appropriate audit evidence has been obtained.

This is because the standards can sometimes deal with general responsibilities and other times with the application of those responsibilities to specific topics. For example, when evaluating the engaged KPMG specialist's work, one of the procedures we perform is to evaluate the relevance and reasonableness of that individual's findings or conclusions. The same procedure is contained within the application and other explanatory material when evaluating the management's specialist's work in a different standard.

What do we evaluate when we cannot achieve a standard's stated objective? [ISA | 636.1500]

When we cannot achieve a standard's stated objective we evaluate whether this prevents us from achieving our overall objectives and therefore, whether it is necessary to modify our opinion or withdraw from the engagement (when withdrawal is possible under applicable law or regulation).

What does our inability to achieve a standard's stated objective represent? [ISA | 636.1600]

Failure to achieve a stated objective represents a significant finding or issue, which we include in our audit documentation. See activity 'Document significant findings or issues' for more details on the related audit documentation.

1.2 Conduct the audit in accordance with the appropriate KPMG Audit Execution Guide [ISA | 640]

What do we do?

Conduct the audit in accordance with the appropriate KPMG Audit Execution Guide, considering the engagement circumstances

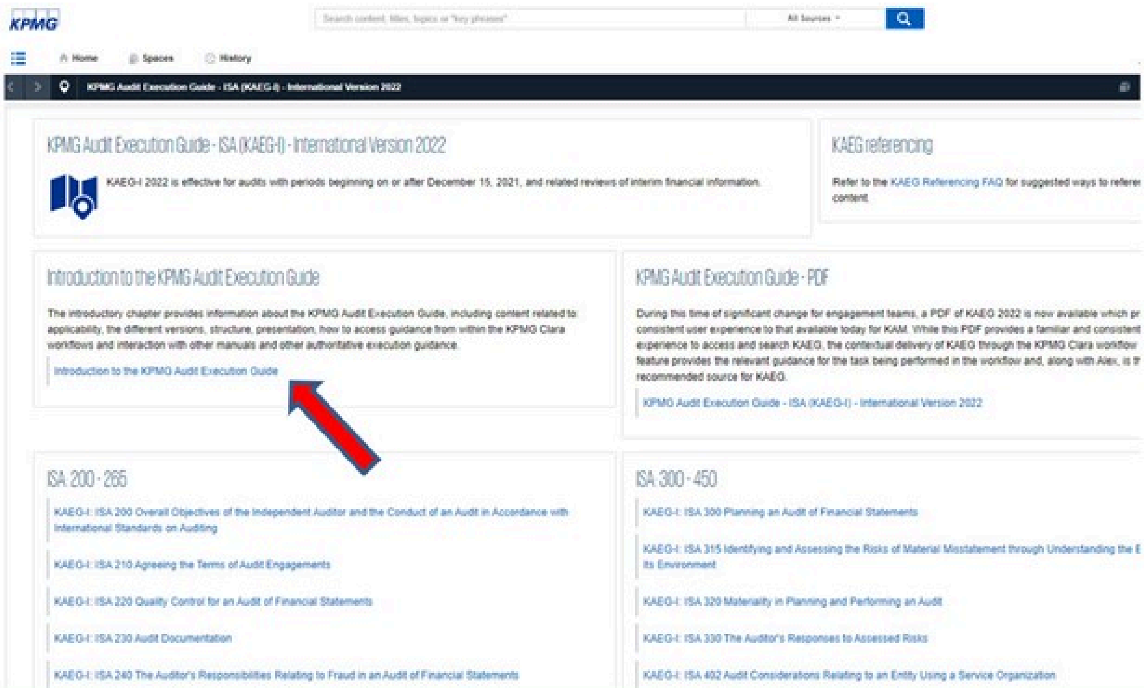
Why do we do this?

There are various auditing standards that we comply with depending on various circumstances of each engagement. Complying with these helps us accomplish effective audits and helps us deliver a reliable audit opinion to the users of the financial statements. At KPMG, we use the appropriate KPMG Audit Execution Guide to comply with the auditing standards to support the audit opinion that we issue.

Execute the Audit

Where do we find information regarding the appropriate version of the KPMG Audit Execution Guide and the KPMG Clara workflow to use? [ISA | 640.9411]

Refer to the relevant Introduction to the KPMG Audit Execution Guide (i.e., the introductory chapter) available on Alex on the relevant KAEG landing page (see below screen shot). The introductory chapter provides information about applicability and the different versions of the KPMG Audit Execution Guide and the KPMG Clara workflow.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KPMG Audit Execution Guide - ISA (KAEG-I) - International Version 2022
KAEG-I 2022 is effective for audits with periods beginning on or after December 15, 2021, and related reviews of interim financial information.
KAEG referencing
Introduction to the KPMG Audit Execution Guide
The introductory chapter provides information about the KPMG Audit Execution Guide, including content related to applicability, the different versions, structure, presentation, how to access guidance from within the KPMG Clara workflows and interaction with other manuals and other authoritative execution guidance.
Introduction to the KPMG Audit Execution Guide
KPMG Audit Execution Guide - PDF
KPMG Audit Execution Guide - ISA (KAEG-I) - International Version 2022
ISA 200 - 265
KAEG-I: ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
KAEG-I: ISA 210 Agreeing the Terms of Audit Engagements
KAEG-I: ISA 220 Quality Control for an Audit of Financial Statements
KAEG-I: ISA 230 Audit Documentation
KAEG-I: ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
ISA 300 - 450
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KAEG-I: ISA 320 Materiality in Planning and Performing an Audit
KAEG-I: ISA 330 The Auditor's Responses to Assessed Risks
KAEG-I: ISA 402 Audit Considerations Relating to an Entity Using a Service Organization

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ISA 210 Agreeing the Terms of Audit Engagements

View the Full Chapter for this Standard

ISA 210 *Agreeing the Terms of Audit Engagements*

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

Introduction, Objective and Definitions

International Standards on Auditing: ISA 210.01-05

Introduction

Scope of this ISA

1. This International Standard on Auditing (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 (Revised)[1] deals with those aspects of engagement acceptance that are within the control of the auditor. (Ref: Para. A1)

1 ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

3. 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:

   (a) Establishing whether the preconditions for an audit are present; and

   (b) 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.

Definitions

4. For purposes of the ISAs, the following term has the meaning attributed below:

Preconditions for an audit - The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise[2] on which an audit is conducted.

2 ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,* paragraph 13

5. For the purposes of this ISA, references to "management" should be read hereafter as "management and, where appropriate, those charged with governance."

ISA Application and Other Explanatory Material: ISA 210.A1

Application and Other Explanatory Material

Scope of this ISA (Ref: Para. 1)

A1. ISQM 1[7] deals with the firm's responsibilities regarding the acceptance and continuance of client relationships and specific engagements. The auditor's responsibilities in respect of relevant ethical requirements, including those related to independence, in the context of the acceptance of an audit engagement and insofar as they are within the control of the auditor are dealt with in ISA 220 (Revised).[8] This ISA deals with those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

7 *International Standard on Quality Management (ISQM) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements, paragraph 30*

8 ISA 220 (Revised), paragraphs 16 - 21

Preconditions for an Audit

International Standards on Auditing: ISA 210.06-08

Requirements

Preconditions for an Audit

6. In order to establish whether the preconditions for an audit are present, the auditor shall:

(a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and (Ref: Para. A2-A10)

(b) Obtain the agreement of management that it acknowledges and understands its responsibility: (Ref: Para. A11 - A14, A21)

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation; (Ref: Para. A15)

(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 (Ref: Para. A16 - A19)

(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.

Limitation on Scope Prior to Audit Engagement Acceptance

7. If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

Other Factors Affecting Audit Engagement Acceptance

8. If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:

(a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable, except as provided in paragraph 19; or

(b) If the agreement referred to in paragraph 6(b) has not been obtained.

ISA Application and Other Explanatory Material: ISA 210.A2-A21

Preconditions for an Audit

The Financial Reporting Framework (Ref: Para. 6(a))

A2. A condition for acceptance of an assurance engagement is that the criteria referred to in the definition of an assurance engagement are suitable and available to intended users.[9] Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Suitable criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. For purposes of the ISAs, the applicable financial reporting framework provides the criteria the auditor uses to audit the financial statements, including where relevant their fair presentation.

9 *International Framework for Assurance Engagements*, paragraph 17(b)(ii)

A3. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements and the auditor does not have suitable criteria for auditing the financial statements. In many cases the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs A8 - A9.

Determining the Acceptability of the Financial Reporting Framework

A4. Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include:

- The nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not-for-profit organization);
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users);
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
- Whether law or regulation prescribes the applicable financial reporting framework.

A5. Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. While all the information needs of specific users cannot be met, there are financial information needs that are common to a wide range of users. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as general purpose financial statements.

A6. In some cases, the financial statements will be prepared in accordance with a financial reporting framework designed to meet the financial information needs of specific users. Such financial statements are referred to as special purpose financial statements. The financial information needs of the intended users will determine the applicable financial reporting framework in these circumstances. ISA 800 discusses the acceptability of financial reporting frameworks designed to meet the financial information needs of specific users.[10]

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10 ISA 800 (Revised), *Special Considerations - Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks,* paragraph 8

A7. Deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable may be encountered after the audit engagement has been accepted. When use of that framework is prescribed by law or regulation, the requirements of paragraphs 19 - 20 apply. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, as required by paragraph 16, new terms of the audit engagement are agreed to reflect the change in the framework as the previously agreed terms will no longer be accurate.

General purpose frameworks

A8. At present, there is no objective and authoritative basis that has been generally recognized globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organizations that are authorized or recognized to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities, provided the organizations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Examples of such financial reporting standards include:

- International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board;
- International Public Sector Accounting Standards (IPSASs) promulgated by the International Public Sector Accounting Standards Board; and
- Accounting principles promulgated by an authorized or recognized standards setting organization in a particular jurisdiction, provided the organization follows an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders.

These financial reporting standards are often identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements.

Financial reporting frameworks prescribed by law or regulation

A9. In accordance with paragraph 6(a), the auditor is required to determine whether the financial reporting framework, to be applied in the preparation of the financial statements, is acceptable. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used in the preparation of general purpose financial statements for certain types of entities. In the absence of indications to the contrary, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared by such entities. In the event that the framework is not considered to be acceptable, paragraphs 19 - 20 apply.

Jurisdictions that do not have standards setting organizations or prescribed financial reporting frameworks

A10. When an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, or where use of the financial reporting framework is not prescribed by law or regulation, management identifies a financial reporting framework to be applied in the preparation of the financial statements. Appendix 2 contains guidance on determining the acceptability of financial reporting frameworks in such circumstances.

Agreement of the Responsibilities of Management (Ref: Para. 6(b))

A11. An audit in accordance with ISAs is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 6(b).[11] In certain jurisdictions, such responsibilities may be specified in law or regulation. In others, there may be little or no legal or regulatory definition of such responsibilities. ISAs do not override law or regulation in such matters. However, the concept of an independent audit requires that the auditor's role does not involve taking responsibility for the preparation of the financial statements or for the entity's related internal control, and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (including information obtained from outside of the general and subsidiary ledgers) in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the audit engagement in paragraphs 9 - 12.

11 ISA 200, paragraph A4

A12. The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation, and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution while those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger or public entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

A13. ISA 580 requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities.[12] It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other ISAs and, where necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

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12 ISA 580, *Written Representations,* paragraphs 10 - 11

A14. Where management will not acknowledge its responsibilities, or agree to provide the written representations, the auditor will be unable to obtain sufficient appropriate audit evidence.[13] In such circumstances, it would not be appropriate for the auditor to accept the audit engagement, unless law or regulation requires the auditor to do so. In cases where the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters, and the implications for the auditor's report.

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13 ISA 580, paragraph A26

Preparation of the Financial Statements (Ref: Para. 6(b)(i))

A15. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, *preparation* of the financial statements in accordance with the financial reporting framework includes *presentation*. In the case of a fair presentation framework the importance of the reporting objective of fair presentation is such that the premise agreed with management includes specific reference to fair presentation, or to the responsibility to ensure that the financial statements will "give a true and fair view" in accordance with the financial reporting framework.

Internal Control (Ref: Para. 6(b)(ii))

A16. Management maintains such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives due to the inherent limitations of internal control.[14]

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14 ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph A54

A17. An independent audit conducted in accordance with the ISAs does not act as a substitute for the maintenance of internal control necessary for the preparation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands its responsibility for internal control. However, the agreement required by paragraph 6(b)(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free of deficiencies.

A18. It is for management to determine what internal control is necessary to enable the preparation of the financial statements. The term "internal control" encompasses a wide range of activities within components of the system of internal control that may be described as the control environment; the entity's risk assessment process; the entity's process to monitor the system of internal control, the information system and communication; and control activities. This division, however, does not necessarily reflect how a particular entity may design, implement and maintain its internal control, or how it may classify any particular component.[15] An entity's internal control (in particular, its accounting books and records, or accounting systems) will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulation.

15 ISA 315 (Revised 2019), paragraph A91 and Appendix 3

A19. In some jurisdictions, law or regulation may refer to the responsibility of management for the adequacy of accounting books and records, or accounting systems. In some cases, general practice may assume a distinction between accounting books and records or accounting systems on the one hand, and internal control or controls on the other. As accounting books and records, or accounting systems, are an integral part of internal control as referred to in paragraph A18, no specific reference is made to them in paragraph 6(b)(ii) for the description of the responsibility of management. To avoid misunderstanding, it may be appropriate for the auditor to explain to management the scope of this responsibility.

Additional Information (Ref: Para. 6(b) (iii)b)

A20. Additional information that the auditor may request from management for the purpose of the audit may include when applicable, matters related to other information in accordance with ISA 720 (Revised). When the auditor expects to obtain other information after the date of the auditor's report, the terms of the audit engagement may also acknowledge the auditor's responsibilities relating to such other information including, if applicable, the actions that may be appropriate or necessary if the auditor concludes that a material misstatement of the other information exists in other information obtained after the date of the auditor's report.

Considerations Relevant to Smaller Entities (Ref: Para. 6(b))

A21. One of the purposes of agreeing the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when a third party has assisted with the preparation of the financial statements, it may be useful to remind management that the preparation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility.

How do we comply with the Standards?

[ISA | KAEGHDWC]

1 Meet the preconditions of the audit [ISA | 7608]

What do we do?

Meet the preconditions of the audit.

Why do we do this?

The preconditions are the minimum conditions for performing an audit. Without this foundation, we cannot start the audit.

Execute the audit

What are the preconditions of the audit of the financial statements? [ISA | 7608.12586]

The preconditions of the audit of the financial statements are events that happen before we accept to perform an audit. We:

- obtain agreement from management and those charged with governance that they acknowledge and understand their responsibility; and
- determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable

What are the responsibilities of management and, where appropriate, those charged with governance? [ISA | 7608.12583]

Management and, where appropriate, those charged with governance are responsible for:

- the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; and
- the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

They are also responsible for providing us with:

- access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
- additional information that we may request from management for the purpose of the audit; and
- unrestricted access to persons within the entity from whom we intend to obtain audit evidence.

How do we meet the preconditions of the audit of the financial statements? [ISA | 7608.159751]

How do we obtain agreement of management and, where appropriate, those charged with governance that they acknowledge and understand their responsibility? [ISA | 7608.12588]

We obtain this agreement that they acknowledge and understand their responsibility by obtaining a signed engagement letter.

Group Audit | How do we obtain agreement from group management and, where appropriate, those charged with governance that they acknowledge and understand their responsibility? [ISA | 7608.159584]

We obtain this agreement that they acknowledge and understand their responsibility by obtaining a signed engagement letter. See activity 'Establish an understanding of the terms of the audit' for further information.

How do we determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable? [ISA | 7608.12584]

We determine the appropriateness of the financial reporting framework to be applied in preparing the financial statements through CEAC, as part of our client and engagement continuance process.

Factors that are relevant to this determination include the following.

Relevant factors	Examples
Nature of the entity	Whether it is a business enterprise, a public sector entity or a not for profit organization.
Purpose of the financial statements	Whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users.
Nature of the financial statements	Whether the financial statements are a complete set of financial statements or a single financial statement
Law or regulation prescribes the applicable financial reporting framework	Whether local laws or regulations determine the applicable financial reporting framework

What do we do if management or those charged with governance impose a limitation on the scope of our work on the financial statements? [ISA | 7608.12589]

Management or those charged with governance may impose a limitation on the scope of our work on the financial statements for the proposed engagement.

We may believe that the limitation will result in us disclaiming an opinion on the financial statement. In this case, we don't accept the engagement, unless required by law or regulation to do so.

For engagements performed in the US, see US RMM 20.6.4.3.2 https://alex.kpmg.com/AROWeb/document/lfc/US_DPP_MANUALS_RMM_000/toc/US_DPP_MANUALS_RMM_020?tocref=US_DPP_MANUALS_RMM_000&x=0 for additional guidance.

What do we do if the preconditions of the audit of the financial statements are not met? [ISA | 7608.12590]

If the preconditions of the audit of the financial statements are not met, then we discuss this matter with management and those charged with governance. Unless, required by law or regulation, we do not accept the proposed audit engagement if:

- the financial reporting framework is unacceptable, except as provided in ISA 210.19 (see activity 'Perform certain procedures when law or regulation of the relevant jurisdiction impacts our auditor's report and consult'); or
- the agreement of management and those charged with governance that they acknowledge and understand their responsibility has not been obtained.