Part C Internal control

Chapter 8 Internal Control System

内部控制是一个单位为了实现其经营目标，保护资产的安全完整，保证会计信息资料的正确可靠，确保经营方针的贯彻执行，保证经营活动的经济性、效率性和效果性而在单位内部采取的自我调整、约束、规划、评价和控制的一系列方法、手段与措施的总称。通过学习本章节，你会了解到内控五大循环：营销和销售循环、存货管理循环、资本性采购循环、人事及薪金循环以及采购和付款循环。此外，你需要掌握内控五大要素：内部环境、风险评估、控制活动、信息与沟通以及内部监督。

Learning outcomes

- Describe control objectives, control procedures, control activities, direct controls, indirect controls and tests of controls.
- Describe and explain the five components of a system of internal control.

1. Sales cycle

Accounting system for sales, trade receivables and collection

PROCESS	PROCEDURES
Ordering	Customers place order with the sales department via fax or purchase orders. For credit sales customers, sales department will refer them to the credit department for authorization.

Credit evaluation	For new customers, credit control department will obtain the following documents from them to determine their financial status: 1) . Previous year audited accounts 2) . Last 6 months bank statements; and Based on these information, a credit limit and credit period will be decided for each customer and the details recorded in the credit evaluation form For existing customer, credit controller will ensure that the amount outstanding does not exceed the credit limit before approving the transaction. Following the approval by the credit control department, the sales department will issue a sale order to the customer to confirm acceptance of their order. Sales order is sequentially pre-numbered and issued in multiple copies. One copy each will be given to the customer and storekeeper with the remaining copy retained in the sales department for future reference.
Delivery	Based on the sale order received, storekeeper will arrange for the goods to be delivered to the customer and prepare a delivery order (or dispatch note). Delivery order is sequentially pre-numbered and issued in multiple copies. Two copies are usually sent to the customer for acknowledgement. The customer is required to return the 2nd copy on the spot to the lorry driver for forwarding to the accounts department to prepare the sales invoice. The 3rd copy is retained in the store for future reference.
Invoicing	Accounts department will proceed with the issuance of sales invoice upon receiving the delivery order. The quantity will be based on the delivery order whereas the price will be based on the master price list. Sales invoice is also sequentially pre-numbered and issued in duplicate copies. One will be sent to the customer and the 2nd copy retained in the accounts department,

Collection	When customers made payment, they will attach the remittance advice with the cheque and sent them to the accounts department. Credit control department will follow up with those credit customers whose debt remained unpaid on the due date. Usually, reminder letters will be sent to them. If the debt still remained unpaid after taking all the necessary action, the credit controller may initiate legal action against the customer or temporary withhold their credit facility.

Recording	Based on the sales invoice and remittance advice, the accounts staff will update the general ledger and sales ledger. The person who is responsible for updating the general ledger will be segregated from the person who is recording in the sales ledger. Periodically, there must be reconciliation between the control account and sales ledger by an independent person to confirm
Banking in	Collection received will be banked in promptly and completely. At the end of each month, the account department will send "Statement of Account" detailing the total debt payable and transactions during the month.

Addition:

Bad debt

- Authority of written off a bad debt should be given in writing
- An official independent of the cash receipt function should authorize writing-off a bad debt

Tests of control

- Carry out **Sequence test check** on invoice, credit note .dispatch notes, and orders, ensure no omission and duplicated
- Check the existence of evidence for authorization in respect of:
  - -Acceptance of order,
  - -dispatch of goods,
  - -raising of the invoice and credit note,
  - -pricing and discount,
  - -write off of bad debt
- Check both that the relevant signature exists and that the control has been applied.

- Seek evidence of checking arithmetical accuracy
- Check dispatch note and goods returned note to ensure they are referenced to sales invoices and credit note and vice versa
- Check the control account reconciliation has been applied.

2.Purchase cycle

Accounting system for purchase, trade payables and payment:

PROCESS	PROCEDURES
Requisition	Storekeeper informed purchase department of the need to replenish the inventory by raising a purchase requisition form (PRF) PRF is sequentially pre-numbered and issued in multiple copies. One copy is given to the purchase department whereas the other copy is retained by the storekeeper.
Ordering	Based on the PRF received, purchase manager will obtain quotations from various suppliers. The purpose of doing so is to ensure that the company obtains the most economical price for all things that they purchased. Following the evaluation of quotation submitted by the suppliers, the purchased manager will issue a purchase order (PO) to the short-listed supplier. PO is sequentially pre-numbered and issued in multiple copies. One copy each is given to supplier, storekeeper and accounts department and the 4^{th} copy retained by the purchase department.
Delivery	Based on the PO received, supplier will deliver the goods ordered to the storekeeper. The storekeeper is required to check the type and quantity of goods received against the PO before acknowledging receipt. He will them record the goods received on the goods received note (GRN). GRN is sequentially pre-numbered and issued in multiple copies. One copy each is given to the purchase and accounts department with the 3^{rd} copy being retained in the store.

Recording	Supplier will send purchase invoice to the accounts department. The accounts staff will then update the general ledger and purchase ledger based on the invoice received. Likewise, when payments are made, the person in charged will update the ledger accordingly. Periodic reconciliation will be carried out for some material trade payable between the supplier statement of accounts and purchase ledger. On top of that, there will be reconciliation between control accounts in the general ledger and purchase ledger balances. All these reconciliations will be performed by a separate person other than the one who is responsible for recording.
Payment	The method that is used is called ‘three-way matching’, i.e. between PO, GRN and original purchase invoice. The purpose of doing so is to ensure that goods paid for are authorized and have been received. The person in-charged will proceed with the preparation of cheque and obtain the necessary signatories for approval. At the same time, the invoice will be stamped “PAID" to prevent double payment.

Tests of control

- Walk-through test to ensure procedures are being followed
- Purchase order
  - -Evidence of a Sequence check
  - -Test for evidence of authority
  - -Adherence to authority limit
- Goods receivable note： Test for evidence of sequence check
- Goods returned note： Test for evidence of sequence check
- Purchase invoice
  - -Serial numbering
  - -Evidence of a sequence check
  - -Evidence of checking casts
  - -Evidence of Match with GReceiveNs and purchase orders
  - -Initial of invoice grid for work done

-Approval of purchase invoice

- Credit note： Test for evidence of matching credit notes to GReturnNs
- Payable ledger account and control account
  - Test for evidence of review of reconciliation
  - Evidence of authorization of adjustment to the account
- Review exception reports

3.Payroll system

Accounting system for payroll:

PROCESS	PROCEDURES
Recruitment / Resignation	For all staff that was employed, personnel department will have a detailed record of their family and education background, working experience and monthly salary. Personnel department is responsible for informing the payroll department of any new staff employed, their date of commencement and monthly salary so that the new staffs name can be included in the payroll. Likewise, for resignation, the respective departmental head must inform the personnel department of the last day of employment of the resigned staff and in return the personnel department will inform the payroll department.

Payment	There are two ways of making payment namely directly credit to the employee's bank account or in cash. The one that the auditor is more interested in is payment by cash as it possesses greater risk. For those employees who are paid in cash, their salary is usually not fixed and is dependent on either the number of hours worked or units produced. For those who are paid by hourly basis, they are required to record their number of hours worked on the clock card and certified by their superior. For those who are paid based on the number of units produced, they should record the number of units of output on the production sheet and get it certified by their superior. Payroll staff will prepare payroll based on the hours or units certified and proceed with the issuance of cash cheque. The cheque will be signed by the signatory who will ensure that the amount paid is accurate by performing a test count or comparing with budget or previous month amount. The cash withdrawn will be placed in envelops (called wage packet) according to the amount stated on the payroll. Usually, a pay slip will also be included in each envelop for the employee to acknowledge receipt.
Payout	The wage packets will be distributed to the workers on a scheduled date by a person who is independent from the production and payroll-department. The person in-charged will call out the name of those workers and ensure that their details are the same as those stated on the payroll. He must ensure that the worker acknowledges receipt of the wage packets and that no person can collect on behalf of somebody. Any unclaimed wage packets wil! be recorded and returned to the payroll department. Any staff who is absence on the payout day

4. Cash system

Segregation of duties is very important in a cash system, and the following duties should be segregated wherever possible:

- Receiving cash v banking
- Banking v cash book preparation
- Cash book preparation v bank reconciliations

- Drafting cheques v signing cheques
- Cheque signatories v cash book preparation

Control objective and control procedures

Stage 1	Request for payment • Valid business expenses	Standard cheque requisitions
Stage 2	Payment authorisation • Accurate • Advantage of credit terms	Agree to supporting documentation Approval by buyer or department Check credit terms utilised

Stage 3	Payment made or cash received Cash and cheques not misappropriated	Cheque payments • Custody unused cheques • Authority limits • >1 signature • No signing blank cheques • Restrictive crossing • Documentation stamped 'PAID' • Prompt dispatch of cheques Cash payments • Limited amounts • Restricted access • Cancellation of vouchers Cheques received by post • Safeguards to prevent interception of mail between receipt & opening • >1 person opening post • Cash diary • Receipts date stamped • Independent checks of cash diary to cashbook and bankings Cash collections • Restricted • Sequentially numbered receipts or cash registers with sealed till rolls • Agreement of cash to till rolls • Agree cash collections to subsequent bankings • Investigations of all shortages
Stage 4	Payments and receipts recorded Accurate and timely information re cash position	Monthly bank reconciliations prepared and approved

Control objectives summary:

- To ensure that all cash receipts are properly collected, recorded and banked
- To ensure that all cash payments are to proper purposes and have been authorized for payment

- To ensure that receipts and payments are recorded accurately and completely in the accounts

Test of control

1) Cash receipts
   - Attend mail opening and ensure the procedures are adhered to
   - Test independent check of cash receipts to bank lodgements
   - Test for evidence of arithmetical check on cash received records
   - Test for evidence of sequence check on receipt for cash
   - Test authorization of cash receipt
2) cash payment
   - inspect current cheque books for
     - sequential use of cheques
     - controlled custody of unused cheques
     - any signatures on blank cheques
   - Test paid invoices are marked 'paid' to avoid double payment
   - Arithmetical check on cash payment records, cash book
3) bank reconciliation
   - examine evidence of regular reconciliation, at least once per month
   - examine evidence of independent check of bank reconciliation
   - examine evidence of follow-up of outstanding items on bank reconciliation
4) Petty cash
   - Test petty cash vouchers for approval
   - Test for evidence of arithmetical check on petty cash record
   - Examine evidence of independence check of petty cash balance
   - Perform a surprise petty cash count and reconcile to petty cash records

5.Inventory

Other Control objective:

- Inventory levels are in keeping with the needs of business
- Value for money is achieved
- Goods delivered are what was ordered
- Quality of goods delivered are satisfactory
- Only valid liabilities are paid

Control objective and control procedures

Control objectives	Controls procedure
All movements authorized and recorded	Reception and checking of goods inward Inventory issues supported by appropriate documentation Maintenance of inventory records
Safeguard against loss, theft and damage	Segregation of duties between custody and recording Restricted assess to stores Environment controls e.g. temperature Regular inventory taking, comparison with inventory records and investigation of variances
Allowance made for slow moving, obsolete and damaged inventories	Review of movement reports Regular inventory taking

6.Revenue and capital expenditure

This area looks at expenditure on items other than purchases. The controls are similar to those over purchase.

For example:

- Capital expenditure over certain amounts will require authorisiation
- Regular revenue expense monitored by variance analysis on a monthly basis
- Capital items recorded in an Asset Register and assets checked against the register on a regular basis
- When assets are sold, the items will be checked against similar items or price guides to ensure the company receives fair value
- Ownership documents will be safely stored

7.Internal control components

ISA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment considers the components of an entity's internal control. It identifies the following components:

- **Control environment**

The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organisation, influencing the control consciousness of its people.

The control environment has many elements such as communication and enforcement of integrity and ethical values, commitment to competence, participation of those charged with governance, management's philosophy and operating style, organisational structure, assignment of authority and responsibility and human resource policies and practices.

- **Control activities**

Control activities are the policies and procedures which help ensure that management directives are carried out. Control activities, whether within information technology or manual systems, have various objectives and are applied at various organisational and functional levels.

- **Entity's risk assessment process**

For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework. It estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof.

- **Monitoring of controls**

Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. Management accomplishes the monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

- **Information and communication**

The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to initiate, record, process, and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities, and equity.

Exam focus point

The sales system/The purchases system/The payroll system/The inventory system/The bank and cash system/Non-current assets必考案例分析题

8.Report to management

Example of The cover letter:

Johnson & Johnson
Grange Road
London

The Board of
Directors
The Client Ltd
Queen's Road
UK
1 July 2023

Dear Sirs

2022 Audit
In accordance with our normal practice we set out in an appendix to this letter certain matters which arose as a result of our review of the accounting systems and procedures operated by your company during our recent interim audit.

We would point out that the matters dealt with in this letter came to our notice during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on your company's financial statements. In consequence our work did not encompass a detailed review of all aspects of the system and cannot be relied on necessarily to disclose defalcations or other irregularities or to include all possible improvements in internal controls.Our comments have been discussed with your finance director and the chief accountant, and we will consider these matters again in future audits. We look forward to receiving your comments on the points made. Should you require further information or explanation do not hesitate to contact us.This letter has been produced for the sole use of your company. It must not be disclosed to a third party, or quoted or referred to, without our written consent. We assume no responsibility to any other person.

We should like to take this opportunity to thank your staff for their co-operation and assistance during the course of our audit.

Yours faithfully

Johnson & Co.
ACCA

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Control environment

The entity’s risk assessment process

The entity’s process to monitor the system of internal control

The information system and communication

Control activities

The sales system

The purchases system

The payroll system

The inventory system

The bank and cash system

Non-current assets

2. 必做习题

(1) OT Revision Cases:

- Tests of Control : Bonsai Trading Co
- Communication on Internal Control: Cherry Blossom Co

(2) Quiz:

- Tests of controls ch12: Q1-5
- Deficiency ch13: Q1-5

(3) Constructed Response Revision Questions:

Internal Control:

- The sales system: Amberjack Co
- The purchase system: Comet Publishing Co
- The payroll system: Raspberry Co
- The cash system: Camomile Co
- The purchase+Payroll system: Swift Co
- The NCA system: Snowdon Co
- 综合题:Equestrian Co;Freesia Co

Part D Audit evidence

Chapter 9 Financial statement assertions and audit evidence

审计证据是审计人员表示审计意见和作出审计结论所必须具备的依据。通过学习本章节，你会了解到审计证据的定义以及财务报表认定相关内容。

Learning outcomes

- Explain the assertions contained in the financial statements.
- Discuss the relevance and reliability of audit evidence.

1. ISA 500

> ISA 500 requires the auditor 'obtain *sufficient, appropriate* evidence to be
>
> Quantity — Quality (relevant & reliable)
>
> able to draw reasonable conclusions on which to base the audit opinion.'

1.1 Sufficient evidence

Sufficiency is the measure of the quantity of audit evidence. The following factors should be considered when deciding whether or not sufficient evidence has been collected:

- ✓ risk assessment
- ✓ nature of the accounting and internal control systems.
- ✓ materiality
- ✓ auditors' cumulative knowledge and experience

The engagement partner will use judgment to decide on the level of audit evidence that is required.

Cost is never an excuse for collecting an insufficient amount of evidence.

1.2 Appropriate evidence

Evidence should be relevant and reliable.

a) Relevant

Relevant evidence is evidence that:

- The nature of the transaction or balance being tested
- The assertion being test

b) Reliable

The reliability of audit evidence is influenced by its **<u>source</u>** and nature.

Internal evidence (from the client company):
- Books and records
- Management representation

External evidence (from outside the company)
- Bank confirmation letter
- Lawyer confirmation letter

Self generated evidence
- Inspection
- observation

2. Financial statement assertions

The assertions listed in ISA 315 (Revised) are as follows (the changes made to the ISA are underlined):

2.1 Assertions about classes of transactions and events <u>and related disclosures :</u>

- Occurrence

the transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.

- Completeness

all transactions and events that should have been recorded have been recorded and all related disclosures that should have been included in the financial statements have been included.

- Accuracy

amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

- Cut–off

transactions and events have been recorded in the correct accounting period.

- Classification

transactions and events have been recorded in the proper accounts.

- Presentation

transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

2.2 Assertions about account balances <u>and related disclosures:</u>

- Existence

assets, liabilities and equity interests exist.

- Rights and obligations

the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

- Completeness

all assets, liabilities and equity interests that should have been recorded have been recorded and all related disclosures that should have been included in the financial statements have been included.

- Accuracy, valuation and allocation

assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded and related disclosures have been appropriately measured and described.

- Classification

assets, liabilities and equity interests have been recorded in the proper accounts.

- Presentation

assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

2.3 Assertions about presentation and disclosure:

- Occurrence and rights and obligations

this has been absorbed into the occurrence assertion under transactions. The reference to rights and obligations is retained in the account balance assertions.

- Completeness

reference to disclosure has been absorbed into completeness assertions of both transactions and account balances.

- Classification and understandability

classification remains an assertion in relation to transactions and has been added as an account balance assertion. The reference to understandability is included in the new assertion of presentation which is now included in both the transactions and account balances assertions. The presentation assertion in both has a new reference to transactions and account balances being appropriately aggregated or disaggregated.

- Accuracy and valuation

absorbed into the transactions assertion of accuracy and the account balance assertion has been extended to accuracy, valuation and allocation.

Exam focus point 注意下考点容易出文字题：
Classes of transactions and events and related disclosures
Account balances and related disclosures at the period end
Relevance and reliability of audit evidence

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Occurrence
Completeness
Accuracy
Cut–off
Classification
Presentation
Existence
Rights and obligations
Accuracy, valuation and allocation

2. 必做习题

(1) Quiz:

- Assertion-Inventory Ch22: Q1-5
- Assertion-Non-current Assets Ch23 : Q1-5

Chapter 10 Audit procedures

审计程序(Audit procedure)是指审计师在审计工作中可能采用的，用以获取充分、适当的审计证据以发表恰当的审计意见的程序。通过学习本章节，你会了解到获取审计证据的方法以及分析性程序的相关内容。

Learning outcomes

- Describe audit procedures to obtain audit evidence, including inspection, observation, external confirmation, recalculation, re-performance, analytical procedures and enquiry.
- Discuss substantive procedures for obtaining audit evidence.
- Discuss and provide examples of how analytical procedures are used as substantive procedures.

1. How does the auditor obtain evidence?

ISA 500 Audit Evidence identifies the types of procedures that the auditor can adopt to obtain audit evidence:

Audit procedures

Analytical procedures	The consideration of the relationships between figures in the financial statements or between financial and non-financial information. Used as part of the planning process to help identify areas of risk, and at the final review stage. Can also be used as substantive procedures.
Enquiry	Is a major source of audit evidence but results of enquiries usually need to be corroborative evidence. Seeking information from the client or external sources, formally or informally, orally or in writing e.g. bank confirmation letter
Inspection of record or documents & Inspection of tangible assets	The physical review or examination of records, documents and tangible assets
Observation	Watching a procedure being performed e.g. stocktaking

Recalculation	Checking the arithmetic accuracy of source documents and accounting records or performing independent calculations
Re-performance	Re-perform to ensure that procedures have been correctly performed.
Confirmation	A specific form of enquiry, may give good evidence of existence, may not necessarily give evidence of valuation. E.g. circularization of receivables

2. Analytical procedures

2.1 <ISA520>

- Analytical review procedure means the analysis of significant *ratios and trends.*
- auditors have to exercise their professional judgment.
- relationship between financial data and non-financial data deriving from the same period
- between comparable financial information from different periods/entities

2.2 An entity's financial information may be compared with:

- that of prior periods e.g. 2021, 2020, 2019
- anticipated results derived from budgets or forecasts
- predictive estimates e.g. estimated depreciation for the year
- similar industry information e.g. debtors days v. industry average

2.3 Analytical procedures also include the consideration of relationships:

- between elements of financial information that are expected to conform to a predicted pattern e.g. GP to sales
- between financial and relevant non-financial information e.g. payroll costs to number of employees

2.4 Analytical procedures are used at all stages of the audit

<u>In the planning stage</u>

- improve the auditor's understanding of the enterprise
- identify areas of potential audit risk (where the recorded value varies from the auditor's expectations)
- plan the nature, timing and extent of other audit procedures

<u>In the executing stage</u>

- as a substantive analysis.

- It is possible to confirm some (at least to a reasonable degree) items of account purely by performing analytical procedures.

<u>In the final stage</u>

- as part of overall review of F/S
- carry out an overall review of the information in F/S and compare it with other available data
- form an overall conclusion as to whether F/S are consistent with their knowledge of the entity's business

Exam focus point
audit procedure获取审计证据的方法与第14章结合出考题
Analytical procedures are used at all stages of the audit注意文字题

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Inspection

Observation

External confirmation

Recalculation

Re-performance

Analytical procedures

Enquiry

Analytical procedures

2. 必做习题

(1) Quiz:

- Audit procedures Ch15: Q1-5
- Analytical procedures Ch16: Q1-5

Chapter 11 Audit sampling

审计抽样是指注册会计师对具有审计相关性的总体中低于百分之百的项目实施审计程序，使所有抽样单元都有被选取的机会，为注册会计师针对整个总体得出结论提供合理基础。通过学习本章节，你会了解到审计抽样的重要性、定义以及分类等相关内容。

Learning outcomes

- Define audit sampling and explain the need for sampling.
- Identify and discuss the differences between statistical and non-statistical sampling.
- Discuss and provide relevant examples of the application of the basic principles of statistical sampling and other selective testing procedures.
- Discuss the results of statistical sampling, including consideration of whether additional testing is required.

1. Audit sampling

1.1 The need for sampling

It will usually be impossible to test every item in any accounting population because of the costs involved - remember the audit gives reasonable not absolute assurance. The audit evidence gathered, therefore, will be on a test basis - hence the need for the auditor to understand the implications and effective use of sampling.

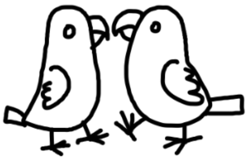
1.2 Definition

The definition of sampling set out in ISA 530 Audit sampling and other means of testing is:'Audit sampling' (sampling) involves the application of audit procedures to less than 100% of items within a class of transactions or account balance such that all sampling units have a chance of selection. This will enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can use either a statistical or a non-statistical approach. **ISA 530**

1.3 Statistical sampling

means any approach to sampling that has the following characteristics:

- random selection of a sample, and
- use of probability theory to evaluate sample results, including measurement of sampling risk.



advantages

√ disciplined

√ sample size is objectively determined

√ smaller sample sizes improve efficiency

√ bias is eliminated

disadvantages

- may be applied without due consideration of the suitability to the audit
- task to being performed (can be overcome through staff training, supervision and clear standards on sampling in audit manual)
- time consuming and therefore expensive

Statistical selection methods to be used

- random selection

all items in the population have an equal chance of selection e.g. generating a random number to determine which item or $ in the population is the first in the sample and using a sampling interval, usually based on tolerable error, to select subsequent items.

1.4 non-statistical

✓relies on the auditor's judgment to evaluate results and draw conclusions

✓more common in practice and can give acceptable results

Non-statistical selection methods to be used

- Judgmental or haphazard selection

Involves the auditor judgmentally selecting the items—picking say two invoices from each month, or focusing on a particular period do not usually count as statistical sampling because of the risk of bias in selecting the sample

1.5 Sampling risk

Sampling risk is the risk that the auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure.

1.6 Non-sampling risk

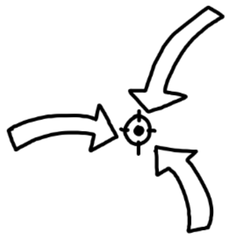
Non-sampling risk arises from factors that cause the auditor to reach an erroneous conclusion for any reason not related to the size of the sample. For example, ordinarily the auditor finds it necessary to rely on audit evidence that is persuasive rather than conclusive, the auditor might use inappropriate audit procedures, or the auditor might misinterpret audit evidence and fail to recognise an error.

arises from factors that cause the auditor to reach an erroneous conclusion for any reason not related to the size of the sample. For example, ordinarily the auditor finds it necessary to rely on audit evidence that is persuasive rather than conclusive, the auditor might use inappropriate audit procedures, or the auditor might misinterpret audit evidence and fail to recognise an error.

1.7 Tolerable error

Tolerable error is the maximum error in the population that the auditor would be willing to accept. And still conclude that the result from the sample has achieved the audit objective.

2. Sampling methods



- random selection
- systematic selection
- monetary unit sampling
- haphazard selection
- block selection

2.1 Random selection

This method of sampling ensures that all items within a population stand an equal chance of selection by the use of random number tables or random number generators. The sampling units could be physical items, such as sales invoices or monetary units.在这种方式下的抽样，强调每一个样本都有均等的机会被抽到。

2.2 Systematic selection

The method divides the number of sampling units（抽样单位 ）within a population（总体） into the sample size to generate a sampling interval. The starting point for the sample can be generated randomly, but ISA 530 recognises that it is more likely to be ‘truly’ random if the use of random number generators or random number tables are used. Consider the following example:

这种根据固定间隔来抽样的方式，首先先随机选择一个数作为开始数，然后随机如每隔 20 个数字进行抽样。在使用这种方式的抽样法时应注意间隔数刚好和样本数量中的某一种特定种类一致。

<u>Example 1</u>

You are the auditor of Jones Co and are undertaking substantive testing on the sales for the year ended 31 December 2010. You have established that the ‘source’ documentation that initiates a sales transaction is the goods dispatch note and you have obtained details of the first and last goods dispatched notes raised in the year to 31 December 2010, which are numbered 10,000 to 15,000 respectively.

The random number generator has suggested a start of 42 and the sample size is 50.

You will therefore start from goods dispatch note number (10,000 + 42) 10,042 and then sample every 100th goods dispatch note thereafter until your sample size reaches 50.

2.3 Monetary unit sampling

The method of sampling is a value-weighted selection whereby sample size, selection and evaluation will result in a conclusion in monetary amounts. The objective of monetary unit sampling (MUS) is to determine the accuracy of financial accounts.

这是根据金额的权重来进行抽样的方式。就是把总体中的单元货币单位作为抽样单位，总体中每一金额单位即每一元钱被抽中的机会是相等的。因此，总体中某一项目被抽中的概率等于该项目的金额占总体金额的比例，金额越大的实物单元被选出的概率越大，越容易被审计人员关注。

<u>The steps involved in monetary unit sampling are to:</u>

- determine a sample size
- select the sample
- perform the audit procedures
- evaluate the results and arriving at a conclusion about the population.

For example, a payables balance of $7,000 can be understated by $7, $70, $700 or $7,000 and the auditor will clearly be interested in the larger misstatement.

2.4 Haphazard selection

The auditor selects the sample without following a structured technique – the auditor would avoid any conscious bias or predictability. 随意抽样

2.5 Block selection

This method of sampling involves selecting a block (or blocks) of contiguous items from within a population. Block selection is rarely used in modern auditing merely because valid references cannot be made beyond the period or block examined. In situations when the auditor uses block selection as a sampling technique, many blocks should be selected to help minimise sampling risk. 整群抽样

An example of block selection is where the auditor may examine all the remittances from customers in the month of January. Similarly, the auditor may only examine remittance advices that are numbered 300 to 340.

Exam focus point

audit sampling and the need for sampling/sampling methods常考文字题。

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Audit sampling

Statistical and non-statistical sampling

Random selection

Systematic selection

Monetary unit sampling

Haphazard selection

Block selection

2. 必做习题

(1) Quiz:

Sampling risk Ch19: Q1-5

Chapter 12 Computer-assisted audit techniques

计算机辅助审计技术，是指利用计算机和相关软件，使审计测试工作实现自动化的技术。通过学习本章节，你会了解到数据测试和审计软件等相关内容和概念。

Learning outcomes

- Explain the use of automated tools and techniques in the context of an audit, including the use of audit software, test data and other data analytics tools.
- Discuss and provide relevant examples of the use of automated tools and technqiues including test data,audit software and other data analytics tools.

1. Test data

Description

- Test data is data generated by the auditor, which is then processed using the client's computer systems. The objective of test data is to ensure that the controls within the system are operating properly. If this is the case, then erroneous items should be rejected. Consequently, test data should contain data of both a valid and an invalid nature.
- It may be processed during a normal production run ('live[1] test data) or during a special run at a point in time outside the normal cycle ('dead' test data).
- An integrated test facility requires the establishment of a dummy unit (e.g. department or employee) against which the auditor's test data transactions are processed during the normal production cycle.

Uses

- Performing reasonableness checks on input by inputting transactions outside predetermined ranges.
- Confirming exception reporting facilities by inputting a batch of transactions with known exceptions and comparing the exception report with the expected results.
- Ensuring that programmed controls work effectively.

Examples of Test Data

Sales

Input an order into the clients system that would cause a customer to exceed their credit-limit. If the controls are working properly the order should not be accepted, or should raise a query whether you are sure you wish to proceed with the order. Input a negative number of items on an order. The system should reject it as invalid. Input incomplete customer details such as not including their address or credit card details. The system should not process the order unless all details have been submitted.

Cautions

- Test data should be run 'live' if possible. If not possible it is necessary to ensure that programs used are identical to or are the actual programs used by the client.
- Any fictitious items included as test data must be retrieved from files before the client uses those files in normal processing otherwise errors could be created by the auditor.
- If test data is to be run 'dead', there must be adequate computer time available, and the special run required must not prove unduly expensive.
- Since controls are being tested, all discrepancies between predicted and actual results must be fully resolved and documented, irrespective of financial amounts involved

2. Audit software

Description

Software specially designed for audit purposes. It is used to process the client's data in order to check that the figures themselves are correct. Typically, audit software is used for reperformance tests and re-analysis of information.

Package programs are generalised programs designed to:

- read computer files
- select information
- perform calculations
- create data files, and
- print reports in a format specified by the auditor.

Purpose-written programs are designed to perform audit tasks in specific circumstances.

Uses

- Selecting a sample of records from a file (e.g. random selection of goods despatched notes or selection of all inventory items valued over a certain amount).
- (NB: Mere sample selection is not a substantive procedure.)
- Checking computations and calculations by reperformance (e.g. verifying the accuracy of an aged receivable's listing or stratification of an inventory file).
- Reorganising data (e.g. preparing an aged inventory schedule, or reordering the receivables ledger by size of balance).
- Comparing two or more different files (e.g. comparing sales invoices with the receivables ledger to ensure that all invoices have been posted, or comparing inventory held at two different dates).
- Performing detailed analytical review (e.g. receivable days by customer, inventory turnover by product).

Cautions

- Client's files must not be corrupted or damaged.
- Files used for testing must be complete, accurate and identical to, if not the same as, files currently used by the client.
- Computer audit programs must be amended to account for developments in the client's applications.

Considerations affecting use

- Computer knowledge of the audit team.
- Cost/benefit analysis.
- Time available (CAATs take a long time to set up. Incorporate the use of CAATs into the planning of this year's audit for use next year).

Exam focus point **Explain the use of automated tools and techniques in the context of an audit, including the use of audit software, test data and other data analytics tools/Discuss and provide relevant examples**

3. Advantages to the auditor of using CAAT's

- CAAT's may be the only way to test controls within a computer system.
- CAAT's enable the auditor to test a large number of items quickly and accurately.
- CAAT's enables the accounting records to be tested rather than the printouts.
- Whilst expensive at first, once set up, CAAT's can be cost effective so tong as the client keeps the same accounting system.

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Audit software

Test data

2. 必做习题

(1) Quiz:

CAAT Ch21: Q1-5

Chapter 13 The work of others

在审计实操中当审计人员由于自身知识水平的限制，无法解决问题时可以利用专家的工作。通过学习本章节，你会了解到利用专家和内部审计师工作时需要考虑的因素。

Learning outcomes

- Discuss why auditors rely on the work of others.
- Discuss the extent to which external auditors are able to rely on the work of experts, including the work of internal audit.
- Explain the audit considerations relating to entities using service organisations.
- Explain the extent to which reference to the work of others can be made in the independent auditor's report.

1.ISA 620 Using the work of an Expert

- Auditors should have a ***general*** knowledge about business matters, and may need to obtain evidence in the form of reports, opinions, valuations or statements from an ***expert in special areas.***
- should obtain ***sufficient, appropriate audit evidence*** when using an expert's work.

a) Determine the need to use the expert. (materiality of items/risk/quantity & quality of other evidence, should get ***client's permission*** to employ or employed by the client.)

b) Competence and objectivity (qualification, experience, license and not from the client's?)

c) Scope of the expert's work (per consultation between client, auditor and specialist)

d) Assess the work of the expert (auditor should assess the expert's work, if unsatisfactory, should discuss with them and ask for a second expert if required.)

e) Should ***review*** expert's work and take **responsibility** for that finally, ***no reference*** made to the use of expert in the ***auditor's report,*** (only if give a modified report -need refer, should get expert's permission)

2.ISA 610 Rely on the internal auditor's work

External auditor must obtain a ***sufficient understanding*** of the ***internal audit*** function/and consider the extent to *re/yon\he* internal auditor's work.

<u>Before any reliance is made, assessing the internal audit functions in terms of:</u>

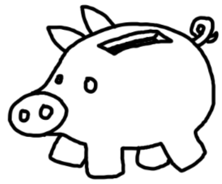
(a) ***The organization status***

- be able to plan and carry out their work as they wish
- have access to the highest level of management (BOD/audit committee)
- communicate fully with external auditor
- be free of any operating responsibility

(b) ***The scope of the internal audit function***

- including not only in financial area
- recommendations in systems set up and should check whether it is implemented.

(c) ***Due professional care***



- work should be properly planned, supervised, and reviewed
- have audit manuals/working papers

(d) ***Technical competence***

- qualification, experience, training, recruitment policy

(e) ***The relationships of the internal auditors***

- should coordinate well with the management, external auditors, the audit committee and other review agencies.

<u>If the internal auditor function has been assessed as reliable, the specific work should be evaluated to ascertain its adequacy.</u>

<u>Evaluating specific internal audit work</u>

- Adequate technical training and proficiency of staff performing the work
- Assistants work properly supervised, reviewed and documented
- Sufficient and appropriate audit evidence obtained
- Appropriate conclusions drawn
- Reports consistent with results of work performed
- Exceptions or unusual matters properly resolved
- Need to test the work of the internal audit department to confirm its adequacy

If the auditor assesses both the function and the specific work to be reliable and adequate, the work will be relied on and reduced levels of testing will be performed.

Exam focus point **Why auditors rely on the work of others/Discuss the extent to which external auditors are able to rely on the work of experts, including the work of internal audit**

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Qualification

Experience

license

Due professional care

Technical competence

2. 必做习题

(1) Quiz:

The Work of Others Ch18: Q1-5

Chapter 14 The audit of specific items

实质性程序包括实质性分析程序和细节测试。实质性分析程序是指先考虑科目的金额与哪些因素有关，这些因素间怎样联系，进而对科目的金额做出一个预测，把这个期望值和客户的账面数比较，通过发现和询问差异原因，来判断科目的金额是否存在错报。细节测试主要是指通过检查全体、抽样、选取特定项目等方式来检查会计凭证，进而判断是否存在错误的会计处理。通过学习本章节，你会了解到审计不同会计科目的相关程序。

Learning outcomes

- For each of the account balances stated in this sub-capability.
- Explain the audit objectives and the audit procedures to obtain sufficient, appropriate evidence in relation to: Receivables/Inventory/Payables and accruals/Bank and cash/Tangible and intangible non-current assets/ Non-current liabilities, provisions and contingencies/Share capital, reserves and directors' emoluments.

1. The audit of Receivables and Prepayments

1.1 Receivables circularization

Method:

- Sending letters to a sample of debtors and asking them to confirm their balance at the year-end.

Purpose

- Provides third party, documentary evidence of existence and rights and obligations

Circularization methods

Positive

This is the most common method. Customers are asked to reply directly to the auditors either agreeing with the balance shown in the letter, or disagreeing and stating the balance per their records.

Negative

Customers are asked to reply only if they disagree with the balance shown. This method is appropriate if the client has good internal control and there are a large number of small value accounts. It is however rarely used in practice.

Advantages:

- Independent evidence
- External evidence
- Relatively efficient

Disadvantage:

- The client may not reply

1.2 Procedure

Letters and replies

- Preferably sent out after the year end (otherwise additional procedures required)
- On the company's letterhead and signed by the client
- Enclose a copy of the customer's year end statement
- Letters posted by the auditor.
- All replies should be sent directly to the auditor in a prepaid envelope.

Sample

- Material balances
- Old unpaid accounts
- Accounts
  - — Written-off during the period under review
  - — With credit balances

Follow **UP:** failure to respond

Positive circularization only

- Send a second letter within 2 weeks
- Fax a copy of the letter to the customer
- Contact the customer by telephone
- Ask a responsible official independent of the sales ledger department, to investigate
- Adopt alternative procedures

Follow up: disagreements

Positive and negative circularization

- Dispute
  - — identify reason
  - — consider need for provision
- cut off problems (invoices or cash receipts)
  - — Extend cut off testing?
- receipts posted to wrong account

- Evidence of other miss posting?
- customers who are also suppliers netting off balances
  - Allowed?
- Teeming and lading
  - detailed testing of cash receipts if suspected

<u>Alternative procedure</u>

- agree brought forward figures to last year's audit file
- check cash received after Y/E
- obtain a list of the individual balances from the receivables ledger, check the cast and agree the total to the trade receivables figure in the F/S
- obtain a list of credit balances in the receivables ledger and obtain explanations from management
- verify valid sales orders and delivery notes

All disagreements and non-replies must be followed up and their effect on total debtors evaluated.

1.3 Bad and doubtful debts

Procedures:

<u>Stage 1: Identify doubtful debts</u>

- Check the aging on the aged debtors report
- Discuss with the directors all balances
  - over 60 to 90 days old
  - the credit controller identifies as being doubtful
- Review correspondence from
  - customers
  - lawyers
  - debt collection agencies
- Examine credit notes issued after the year end

<u>Stage2: Review provisions</u>

- Specific provisions
  - Necessary?
  - Adequate?
- General provisions
  - Calculation correct?
  - consistent with prior years
  - compare prior year provision to actual bad debts incurred

1.4 Cut off testing

For a sample of pre year end GDN agree

- excluded from inventory records
- invoices in sales & debtors

For a sample of post year end GDN agree

- included in inventory records
- invoices not in sales or debtors

Sample of pre year end goods returns notes agree

- included in inventory records
- credit notes in returns & debtors

Sample of post year end goods returns notes agree

- excluded from inventory records
- credit notes not in returns or debtors

1.5 Analytical review

Calculate the trade receivables collection period and compare to last year to assess reasonableness

1.6 Presentation and disclosure

Check that the figures disclosed in the F/S agree to the audited figures

1.7 Related to I/S

Check posting and validity of:

- Bad debt write offs
- Movements on bad debt provision

1.8 Recoveries of TR Prepayments

- Agree to supporting documentation and check calculations
- Review of B/S to ensure all prepayments have been identified
- Analytical review to test for reasonableness

2. Audit of Trade Payable and Accruals

2.1 General approach

- Obtain a list of the individual balances from the payables ledger, check the cast and agree the total to the trade payables figure in the F/S
- Obtain a list of debit balances in the payables ledger and obtain explanations from management
- Agree brought forward figures to last year’s audit file

2.2 Supplier statement reconciliation

Agreeing a sample of the client's reconciliation of supplier statements to the purchases ledger provides evidence of existence, completeness and rights and obligations

Looking for understatement so, when selecting sample, consider:

- major suppliers
- balances where a large number of transactions have taken place
- low or nil balances

Seek explanations for all differences

- cash in transit
- goods in transit
- other differences

2.3 Payable circularization

Not usually performed as the reconciliation of supplier statements provides such strong third party evidence to confirm the **Existence of TP.**

May be however be performed if:

- Supplier statement are not available
- it is thought client is deliberately trying to understate creditors

2.4 completeness

- Investigate any supplier names that were shown on last year's payables listing but do not have a balance showing in this year's account
- Review after date invoices and payments and ensure they have been provided for at the Y/E as appropriate
- Analytical review

2.5 Cut off testing

For a sample of pre year end GRN agree

- included in inventory records
- invoice in purchases and liabilities

For a sample of post year end GRN agree

- excluded from inventory records
- invoices not in purchases or liabilities

For a sample of pre year end returns

- excluded from inventory records
- credit note in returns and liabilities

For a sample of post year end returns

- included in inventory
- credit note not in returns or liabilities

2.6 Presentation and disclosure

- Check that the figures disclosed in the F/S agree to the audited figures

2.7 Accruals

- review:
  - expense items where an accrual might be expected
  - previous year's accruals
  - invoices received and cash paid straight after the year end
- check calculation
- agree to supporting documentation

3. The audit of Inventory

Inventory includes:

- Raw materials and consumables
- Work in progress
- Finished goods and goods for resale

Audit assertions

Completeness

Valuation

Existence

Rights and obligations

Substantive tests

3.1 Completeness & Existence

The physical inventory count (stocktaking)

physical inventory count procedures are vital as they provide evidence about the quantities and conditions of inventories and WIP.

Methods:

Year end counts and perpetual inventory systems

The procedures apply to all inventory counts whether as a one-off year end exercise or where inventory is counted on a rolling basis throughout the year

- **Year end counts**
  - ✓ Full count at the year end, before or after the year end
  - ✓ Reliability of audit evidence dependant on length of time between inventory count and year end, client's internal controls and quality of inventory movement records

- **Perpetual inventory systems**

Where the client has a continuous inventory system, where a theoretical 'book inventory figure' is always known, there are both advantages and disadvantages for the auditor.

Advantages

- The auditor is less time constrained and can pick and choose particular locations and inventory lines at any time to ensure the system is working properly.
- Slow moving and damaged inventory should be identified and adjusted for in the clients' records on a continuous basis therefore the inventory valuation should be more reliable

Disadvantages

- The auditor will need to gain sufficient evidence that the system operates correctly at all times, not just at the time of the count.
- Additional procedures will need to be devised to ensure that the year end inventory figure is reliable, even though it may not have been counted at that date.

Perpetual inventory: management has a program of inventory counting thorough the year

1) if perpetual inventory is used, auditors will check that management:

- ensures that all inventory lines are counted at least once a year.
- maintains adequate inventory records that are kept up-to-date.
- has satisfactory procedures for inventory counts and test counting.
- investigates and corrects all material differences.

2) audit plan

-attend one of the inventory counts to observe and confirm that instructions are being adhered to.

- comparing quantities counted by the auditors with the inventory records, obtaining and verifying explanations for any differences, and checking that the client has reconciled count records with book inventory records.

- review the year's inventory counts to confirm the extent of counting, the treatment of discrepancies and the overall accuracy of records, if matters are not satisfactory, auditors will only be able to gain sufficient assurance by a full count at the year-end.

-assuming a full count is not necessary at the year-end, compare the listing of inventory with the detailed inventory records, and carry out other procedures, such as, cut-off, analytical procedures, to gain further comfort.

Planning the attendance at physical inventory count

—before the physical inventory count

Attendance at an inventory count gives an evidence of the **Existence. Ownership and Completeness** of inventory.

Planning inventory count

Purposes	Audit work
Gain knowledge	■ review previous year's arrangement ■ discuss with management inventory count arrangement and significant changes
Assess key factors	■ the nature and volume of inventory ■ risks relating to the inventory ■ the identification of high value items ■ method of accounting for inventory ■ location of inventory and how it affects inventory control and recording ■ internal control and accounting systems to identify potential area of difficulty
Plan procedures	■ ensure a representative selection of locations, inventory and procedures are covered ■ ensure sufficient attention is given to high value item ■ arrange to obtain from 3rd parties' confirmation of inventory they hold

Before the physical inventory count, auditors have to ensure that:

- coverage of count is appropriate
- count instructions have been reviewed

Review of Inventory Count Instructions

Audit area	Instruction content
Organization of count	■ supervision by senior staff including senior staff not normally involved with inventory ■ tidying and marking inventory to help counting ■ restriction and control of the production process and inventory movements during the count ■ identification of damaged, obsolete, slow-moving, 3rd party held and returnable inventory

Counting	■ systematic counting to ensure all inventory is counted ■ teams of two counter: one counting, another recording, and they must be independent to each other
Recording	■ serial numbering and the control of all returned inventory sheets ■ inventory sheets are completed in ink and signed ■ information to be recorded on the count records (including location and identity, count unites, quantity counted, condition of items, stage reached in the production process) ■ recording of quantity, conditions, and stage of production of WIP ■ recording of the last numbers of goods inwards and outwards and of internal transfer records ■ reconciliation with inventory records and investigation and correction of any differences.

Attendance at Physical Inventory Count

During the count, auditors should:

1) check the count is being carried out according to the count instructions

2) carry out test count

3) determine whether the cut-off problems exists or not

- Audit plan:

- check the client's staff are following instructions
- perform test counts to ensure procedures and internal controls are working properly (applied as described)
- ensure that the procedures for damaged, obsolete and slow-moving inventory operate properly
- confirm that inventory held on behalf of 3ra party is separately identified and accounted for
- conclude whether the count has been properly carried out and is sufficiently reliable as a basis for determining the existence of inventories

- gain an overall impression of the levels and values of inventory held so that the auditors may, in due course, judge whether the figure for inventories in the financial statements is reliable

- when carrying out test counts, the auditor should select items from the count record and from the physical inventory and check one to the other, to confirm the accuracy of the count records. If the result of the test counts are not satisfactory, the auditors may request inventory to be recounted.
- The auditors should concentrate on high value inventory.
- The auditor's working papers should include:

- details of their observation and tests the manner in which that are relevant and material to the inventories being counted or measured have been dealt with by the client
- instances where the client's procedures have not been satisfactory carried out
- items for subsequent testing, such as photocopies of inventory sheets
- details of the sequence of inventory sheets
- the auditors' conclusion

<u>After the Physical Inventory Count</u>

After the inventory count, the auditors should check that final inventory sheets have been properly complied from count records and that book inventory has been appropriately adjusted.

<u>Audit plan: following up the inventory count</u>

- trace items that were test counted to final inventory sheets
- check all count records have been included in Final inventory sheets
- check final inventory sheets are supported by count records
- ensure that continuous inventory records have been adjusted to the amounts physically counted or measured, and the differences ha e been investigated
- confirm cut-off by using details of the last serial number of goods inwards and outwards notes, and of movements during the count
- check replies from 3rd parties about inventories held by or for them
- confirm the client's final valuation of inventory has been calculated correctly

<u>Other tests:</u>

Third party confirmations

3.2 Appropriate carrying value

IAS 2 Inventories

Inventory must be valued at the lower of cost and net realisable value where:

- Cost is the expenditure incurred in the normal course of business in bringing the product to its present location and condition. This includes the purchase price and production costs appropriate to the location and condition of the inventory. Production costs include costs specifically attributable to the units of production, production overheads and other attributable overheads.
- Net realizable value (NRV) is the estimated or actual selling price (net of trade discounts but before settlement discounts) less all further costs to completion and all costs to be incurred in marketing, selling and distributing the goods.

NRV may be less than cost where there has been:

- increase in costs or fall in selling price
- physical deterioration of inventories
- product obsolescence
- a management decision manufacture and sell products

at a loss

Auditors should compare cost and net realizable value on a line by line basis

Testing cost

Raw materials and bought in components

- On a sample basis agree from inventory records to supplier invoices
- Comfirm that a suitable basis of valuation e.g. FIFO is being used consistently.

Work in progress and finished goods

- Obtain a schedule of the standard cost calculations
- Agree costs attributable to production:
  - direct expenses to supplier invoices
  - direct labor to wage records and time summaries
- Production and other overheads
  - Include:
    - Depreciation
    - Supervisory staff wages
    - Repairs
  - Exclude

- Overtime
- Idle time
- General management time
- Unrelated service department costs e.g. marketing

— Allocated on the basis of normal activity.

— Review normal level of activity used by comparing with

- volume of production the facilities are designed to achieve
- previous year and budgets

— Compare the overheads absorbed to the actual costs

<u>Testing net realizable value</u>

Identify, items worth less than cost

- Review system for identifying slow moving, obsolete or damaged inventory
- Check slow moving, obsolete or damaged inventory identified during the inventory count has been written down
- Review inventory movement reports to identify slow moving items

Determine the NRV of those items

- Review post year end sales prices, orders, board minutes and sales department forecasts
- Review, competitor adverts for evidence of price erosion

<u>Comparing</u>

Compare the NRV calculated to the amount shown in the inventory valuation reports

3.3 Right and obligations

<u>Cut off testing</u>

A cut-off error occurs if a inventory movement and sale (or purchase) do not occur in the same accounting period.

Illustration 1

An invoice for metal costing $1m arrived on 5 April 2000 for goods received on 30 March 2000. The company's year end is 31 March. The invoice must be included as a purchase and a liability. If it is not entered in the records until after the new period has begun, liabilities and purchases for the year ending 31 March 2000 will both be understated by $1m and profits overstated by $1m.

Illustration 2

If goods, costing $10,000, are invoiced to a customer and erroneously included in closing inventories there will be an element of double counting and profits will be overstated by $10,000.

The management should have adequate procedures to ensure that movements into, within and out of inventories are properly identified and reflected in the accounts.

Procedures in manufacturing enterprise must encompass the:

- Purchase and receipt of goods
- Requisitioning of raw materials
- Transfer of completed WIP to finished goods inventory
- Sale and dispatch of finished goods

Testing cut off:

- Agree a sample of pre and post year end GRNs to purchase invoices and ensure the purchase has been recorded in the correct period
- Agree a sample of pre and post year end GDN to sales invoices and ensure the income has been recorded in the correct period

Other tests:

- Analytical review
- Inventory count attendance
- Third party confirmations
- Checking invoices and contracts

3.4 Analytical review

- Calculate inventory turnover and compare to last year to assess reasonableness
- Calculate gross profit percentage and compare to prior year to assess reasonableness

3.5 Inventory held at third parties

- Where the client has inventory at locations not visited by the auditor, the auditor normally obtains **confirmation** of the quantities, value and condition from the holder.
- The auditor needs to consider whether the holder is sufficiently independent to be able to provide relevant, reliable evidence.
- As with confirmations from receivables, the auditor requests details from the

party holding the inventory on behalf of the client to confirm its existence.

- The confirmation request will be sent by the client to those parties identified by the auditor.
- The reply should be sent directly to the auditor to prevent it being tampered with by the client.
- Problems can occur if the third party uses a different description to that of the client and as always, a response is not guaranteed.

3.6 Other audit evidence about inventory

- For specialised inventory - livestock, property, food in restaurants, significant work in progress - it will be necessary to obtain evidence from experts
- The auditor needs to obtain evidence of the value of the inventory.

✓ Cost information can be obtained from invoices and price lists.

✓ The costs of manufactured inventory can be obtained from invoices and costing records.

✓ The opinion of independent experts may be obtained.

4. Audit of Cash and Bank

Audit assertions

Completeness

Existence

Valuation

Rights and obligations

Substantive Test

4.1 Bank reconciliation

The Bank reconciliation statement

	$
Balance per bank	x
Add:outstanding deposits	x
Less:unpresented cheques	(x)
Balance per cashbook	x

Test procedures:

Review the year end bank reconciliation statement

- Agree to:
  - — bank confirmation letter
  - — bank statements
  - — cashbook

- Check arithmetic accuracy
- Trace outstanding deposits to:
  — cash book prior to the year end
  — after date bank statements
- Trace the outstanding cheques to:
  — paying in slips to confirm they were paid in before the year end
  — after date bank statements
- Vouch other items e.g. bank charges to supporting documentation to ensure there are no fictitious reconciling items

4.2 The bank letter (bank confirmation reports)

- Direct confirmation of bank balances gives the auditor independent, third-party evidence.
- The format of the letter is usually standard and agreed between the banking and auditing professions.
- Issues covered are:
  -the client's name
  -the confirmation date
  -balances on all bank accounts held
  -any documents or other assets held for safekeeping
  -details of any security given
  -details of any contingent arrangements- guarantees, forward currency purchases or sales, letters of credit.

- The auditor needs the client to give the bank authorisation to disclose the necessary information. (In some jurisdictions such disclosures are illegal so bank letters cannot be used at all)
- Ensure that all banks that the client deals with are circularised.
- When items on the bank letter are dealt with, tick them off and cross-reference to the relevant working paper to make it easy to see that there are no outstanding items.
- The balances for each bank account should be agreed to the relevant bank reconciliation at the year end; interest charges should be agreed to the interest expense account in the general ledger; details of loans should be agreed to the disclosure in the balance sheet to ensure it is correctly classified into the current and non current elements.

4.3 Cash count

If cash balances are material a cash count may be carried out.

Procedures:

Planning

- Identify where cash is held and establish time of count
- Perform on surprise basis, without informed in advance
- Enquire into and document the procedure for reimbursing the cash spent,

Count

- Count all balances at the same time
- List all of the items present e.g. notes, vouchers
- The custodian should sign the record as evidence of agreement
- Ensure any IOU's have been properly authorized and are collectible
- Agree total to the accounting records
- Investigate any differences

Follow up procedures

- Review the petty cash book for unusual/large items

4.4 Bank and cash - general approach

- Obtain a list of all bank accounts, cash balances and bank loans and overdrafts and agree to totals to figures included in current assets and current liabilities in the financial statements
- Obtain a copy of the client's bank reconciliation, cast and agree the balances to the cash book and bank letter
- Trace all **outstanding lodgements** and **unpresented cheques** to pre-year-end cash book and post-year-end bank statements
- Ensure all accounts in the bank certificate are included in the financial statements
- Ensure bank loans and overdrafts are not offset against positive bank balances in the financial statements
- Count the petty cash in the cash tin at the end of the year and agree the total to the balance included in the financial statements

Note. It is vital for an auditor conducting a cash count to do so in the presence of a member of the client's staff and to obtain a signature for the amounts handed back into the client's custody.

- It is important to ensure amounts cannot be moved between tills and that proper cut-off procedures are in place where there are multiple cash balances.

4.5 Income statement and other account entries related to bank and cash

- Bank loans, overdrafts and bank deposits all have interest implications.

- The bank letter needs to be disclosed in the financial statements.

5.The Audit of Tangible Non-Current Assets

5.1 Accounting rules- IAS 16:

- Property, plant & equipment are tangible assets held for use in the production or supply of goods, for rental or for administrative purposes.
- It will be carried at cost less accumulated depreciation & accumulated impairment loss.

- The allowed alternative treatment is to carry such assets at revalued amount.
- Revaluation surpluses are credited to equity 'revaluation surplus', subject to offset previous revaluation decrease for the same asset first ; revaluation deficits should be expensed, unless they can be charged against a revaluation surplus in equity for the same assets.
- The depreciable amount (cost -residual value) should be allocated on a systematic basis over the useful life. Note that land is not depreciable.
- Where assets are disposed of, the profit & loss should be the difference between disposal proceeds & carrying amount.

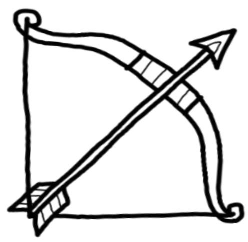
5.2 Tangible non-current assets are usually classified as:

- Land and buildings
- Plant and machinery
- Motor vehicles
- Fixtures and fittings

Most companies maintain a **non-current asset register** that contains the following details for each asset:

<u>Identification</u>

- Serial number
- Description
- Manufacturer's name
- Location



<u>Carrying value</u>

- Gross cost or valuation
- Estimated useful economic life
- Depreciation method/annual charge
- Depreciation provision
- Net book value

Auditors use the **non-current asset register** as the basis for their testing.

5.3 Audit assertions

Completeness

Appropriate carrying value

Existence

Rights and obligations

<u>Substantive tests</u>

5.4 Completeness

- Select a sample of assets visible at the client premises and inspect the assets register to ensure they are included.
- Select a sample of assets from the assets register and inspect to ensure they are included in the F/S
- Examine the repairs and maintenance accounts in the general for large and unusual items that may be capital in nature

5.5 Valuation

- For a sample of assets, agree cost to purchase invoice ensuring all relevant cost have been included.
- If any assets have been constructed by the company, obtain analysis of cost incurred and agree to supporting documentation.
- Select a sample of assets from the register and check the opening balance to ensure they are agree to the F/S
- Reperform depreciation calculations by
- Assess depreciation policies for reasonableness and consistency
- Assets have been revalued during the year
    - Agree new valuation to valuer's report
    - Consider the requirement of the IAS16
    - Consider the Asset revaluations
        - Experience and qualification of valuer
        - Independence of valuer
        - Scope of work, methods and assumptions used
        - Regularity of valuations
- Take note of their condition and usage in case of impairment

5.6 Existence

- Physically verify a sample of assets from the fixed asset register

5.7 Rights and ownership

- Verify title deeds for properties

- Inspect registration documents for vehicles
- Verify ownership by insurance documents

Examine title documents for other assets

- suppliers invoices
- lease agreements

5.8 Additions

- Vouch additions to supporting documentation e.g. suppliers invoice
- Physically verify a sample of additions
- Review P&L accounts e.g. repairs for items that should not have been capitalised
- Review deprecation charges
- Ensure additions have been allocated to the correct fixed asset account

5.9 Disposals

- Vouch disposals to supporting documentation
- Ensure disposals removed from the fixed asset register
- Check calculation of profit or loss

5.10 Disclosure

- Agree opening balance with prior year F/S
- Compare depreciation rate in use with those disclosed
- For revalued assets, ensure appropriate disclosed made
- Agree breakdown of assets

6. The audit of Non-current Liabilities

6.1 Loan payables

Substantive tests

Obtain a schedule of loans showing:

- name of lender
- date of loan
- maturity date
- interest rate
- security
- movements during the year

Agree:

- Case and cross cast
- Opening balances

- To trial balance and draft accounts
- Agree loan balance to the loan statement

Obtain direct confirmation from lenders:

- amounts outstanding
- accrued interest
- assets held as security

Agree new loans to:

- loan agreements
  — term of the loan
  — security, if any
  — restrictions on the company's borrowing powers
  — need to comply with certain conditions e.g. maintenance quick ratio
- receipt of monies in cash book and nominal ledger
- board minutes

Review redemptions during the year:

- board minutes
- paid cheques and cash book entries

Re-compute

- interest charge and interest accrual
- premiums or discounts on redemptions
- Agree interest payment to the loan agreement and the bank statements

Check the disclosure of loans and debentures

- Analyse relevant disclosures of interest rates, amounts due to ensure complete and accurate

6.2 Provisions and contingencies

IAS 37, Provisions, contingent liabilities & contingent assets

(i) Provisions:

- Defined as **liabilities** of **uncertain timing** or **amount.**
- Auditor's main task is to decide whether they have been set up properly in accordance with IAS 37.

IAS 37 : provision should be the best estimate of the expenditure required to settle the obligation.

(ii) Contingencies:

— **A contingent asset** is **a possible asset** that arises from past events and whose existence will be **confirmed** only by the **occurrence/non-occurrence** of one or more **uncertain future events**

not within the entity's **control.** *<e.g. insurance claims>*

— **A contingent liability** is a **possible obligation** that arises from **past events,** and whose existence will be confirmed only by the occurrence/non-occurrence of one or more **uncertain future events** not wholly within the control of the enterprise. Or a **present obligation** but is **not recognized** because it is **not probable** that an outflow that an **outflow of resources** required to settle the obligation, or the **amount** can't be measured reliably.

— Contingent assets should be **disclosed** where an **inflow** of economic benefits is **probable.**

— Contingent liabilities should be **disclosed, unless** the possibility of an **outflow** of resources is **remote.**

<u>the major type of contingent issue</u>

— -guarantees to third parties

— -damages and costs in legal actions pending

— -claims under guarantees or warranties

Contingent liabilities are disclosed in the financial statements:

- nature
- estimate of financial effect

6.3 Substantive tests

- Discuss the matter giving rise to the provision with the client to verify whether an obligation exists
- Obtain conformation from the clients lawyers as to the possible outcome and probability of having to make a payment
- Review subsequent events.
- Obtain a letter of representation

7. Accounting estimates

Directors and management are responsible for making estimates that can include:

— Allowance to reduce inventories and receivable to their NRV

— depreciation charges

— amounts of deferred tax

— losses on construction contracts in progress

— most contingent liabilities

Estimates are often made in conditions of uncertainty regarding the outcome of events that have occurred or are likely to occur in the future. As a result, the audit evidence obtained is generally less than conclusive which means auditors have to exercise more judgment in respect of accounting estimates than they do in other areas of the audit.

Substantive tests

1) Review and test methods used by the management to make accounting estimates

- Consider assumptions on which the estimate is based
  - Reasonable in view of prior period results?
  - Consistent with those used for other accounting estimates?
- Data used
  - accurate, complete and reliable
  - appropriately analysed and projected
- Test calculations
- Compare previous estimates with actual results

2) Compare with an independent expert opinion and the management's estimate

3) Review subsequent events which provide evidence about the estimate.

Other examples:

1. **Revenue:**
2. **Wages:**
3. **R&D:**
4. **Equity:**

Exam focus point **Receivables/Inventory/Payables and accruals/Bank and cash/Tangible and intangible non-current assets/ Non-current liabilities, provisions and contingencies/Share capital, reserves and directors' emoluments必考案例分析题**

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Receivables

Inventory

Payables and accruals

Bank and cash

Tangible and intangible non-current assets

Non-current liabilities, provisions and contingencies

Share capital, reserves and directors' emoluments

2. 必做习题

(1) Quiz:

- Accounting estimates Ch17: Quiz 1-5
- External Confirmations, Receivables and Sales Ch24: Quiz 1-5
- Share Capital, Reserves and Directors' Remuneration Ch25: Quiz 1-5
- Loans, Bank and Cash Ch26: Quiz 1-5
- Liabilities, Provisions and Contingencies Ch27: Quiz 1-5

(2) OT Revision Cases:

Ch15: Assertions, Audit Evidence and Procedures: Newthorpe Engineering

Ch22-27: The Audit of Specific Items:

- Galartha
- Lancaster Co
- Torres Leisure Club Co
- Chestnut & Co
- Sherwood Machines Co
- Ash Co
- Newthorpe, Tourex & Pudco
- Chester Co

(3) Constructed Response Revision Questions:

The Audit of Specific Items:

- Gooseberry
- Triggerfish Co
- Dashing Co
- Airsoft Co
- Hyacinth Co
- Encore Co
- Sagittarii & Co

Part E Review and reporting

Chapter 15 Audit review and reporting

注册会计师在前述审计报告之前，需要完成审计复核的任务，通过学习本章节，你会了解到关联方、期后事项、可持续性经营、管理当局声明书、质量控制和审计报告等相关内容。

Learning outcomes

- ISA 550 Related party.
- ISA 560 Subsequent events.
- ISA 570 Going concern.
- ISA 580 Management representation.
- ISA 220 Quality control.
- Audit report (ISA 700 701 705 706).

1. ISA 570 Going concern

When preparing F/S, the directors should assess whether there are significant doubts about an entity's ability to continue as a going concern.

The auditor's responsibility is to consider the appropriateness of management's use of the going concern assumption, and whether there are adequate disclosures regarding uncertainties about the entity's ability to continue as a going concern.

1.1 The indicator of going concern problem -financial

- operation losses
- overdue accounts payable
- dependence on short-term finance for long-term needs
- working capital deficiencies and poor liquidity ratios
- high gearing and /or borrowing in excess of limits
- default on dividend or interest payment, or loan repayments
- excessive levels of current assets

1.2 The indicator of going concern problem -operating

- failure to replace outdated non-current assets
- potential losses on long-term construction contracts
- loss of key staff, customer, supplier, major market, franchise, licence
- obsolescence of main product, or excessive reliance on a new product
- labour difficulties

- major litigation
- changes in legislation

If doubts exist, the auditor's evaluation of management's assessment will be more extensive

1.3 Typical audit procedures

- review cash flow forecasts and post-year-end management account to analyse trends in performance
- assess the state of the industry in which the client operates
- review correspondence with major customers, suppliers and the bank for evidence of dispute
- discuss management's assessment with key managers and obtain written representations where appropriate.

1.4 Effect on audit report

Where the going concern assumption is appropriate but a material uncertainty exists,

* if adequate disclosure is made, the auditor should express an unqualified opinion but modify the auditor's report' by adding an emphasis of matter paragraph.
* In extreme cases (for example where there are multiple uncertainties) the auditor may consider to express a disclaimer of opinion.
* If adequate disclosure is not made, the auditor should express a qualified or adverse opinion, making specific reference to the fact.
* -If, in the auditor's judgment, the entity will not be able to continue as a going concern, the auditor should express an adverse opinion.
* -If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor should consider the need to modify the auditor's report as a result of the limitation on the scope of the auditor's work

2.ISA 560 Subsequent events

1) **between B/S date and date of audit report**
   ensure all material events in this period are properly reflected in F/S
2) **between the date of audit report and issue of F/S**
   auditor's obligations are ended once they made their report. If they find something material, they should discuss with directors and consider the implications for audit report.
3) **after F/S is issued**
   auditors have no obligation, but if they find the subsequent events will require them change report, they should discuss with directors and consider

the implications for audit report.

Adjusting events	Non adjusting events
Provide additional evidence of conditions existing at the balance sheet date	Do not concern conditions existing at the balance sheet date
Examples: ● Resolution of court case ● Impairment of asset ● Fraud or error	Examples: ● Issue of shares or debentures ● Loss of assets due to fire or flood ● Discontinuance of operations ● Disposal of major subsidiary
Treatment: Change financial statements if material	Treatment: Disclose if material: Nature of event Estimate of financial effect Statement that reliable estimate cannot be made

Procedures

Auditors should perform procedures to identify subsequent *events* that might adjustment or disclosure, up to the date of their audit report.

Procedures include:

- **enquiring into management procedures** for the identification of subsequent events **reading minutes of members' and directors' meetings,** and of audit and executive committee meetings, and enquiring about matters not yet minute
- **reviewing accounting records** including budgets, forecasts and interim information
- making enquiries of directors
- **normal post balance sheet work** performed in order to verify year-end balances
- **obtaining a letter of representation - this will be dealt with later in this'chapter**

Procedures after the date of the audit report

- Although auditors do not have a duty actively to search for evidence of events occurring after the date of the audit report but before the financial statements have been issued, they should not ignore any knowledge which they acquire, from whatever source. If they feel that the information would have altered their audit opinion, had they been aware of it prior to the date of their report, then they should discuss the matter with the directors.

- Directors should be encouraged to amend financial statements where required, if they have not yet been sent to members, and auditors should issue a new audit report on the new financial statements.
- If the financial statements have already been issued to the members, directors are permitted in certain circumstances to revise the accounts. In such circumstances, auditors are required to issue a new audit report and also to report on whether the financial statements have been revised correctly.
- Whenever a new audit report is issued, auditors should update their subsequent events review up to the date of the new report.
- Where directors refuse to amend financial statements where auditors consider this to be necessary, auditors should consider speaking at the relevant Annual General Meeting taking legal advice and consider the possibility of withdrawing their audit repot. The last option is rarely used in practice.
- Auditors have no duty to enquiry specifically into events occurring after the general meeting, but they should inform the directors of any event materially affecting the financial statements. They may also wish to consider taking legal advice on their own position.

3. ISA 550 Related party

-parents and subsidiaries, associates and joint ventures
-directors
-key management
-those controlling more than 20% of the voting rights
-the close families and companies controlled by any of the above
the client should **disclose** the existence of related parties, and transactions with related parties

4.ISA 580 Management representation

<u>Letter of Representation (Management Representation)</u>

- ISA 580 ' Management Representations '
- Representations from management should generally be restricted to matters that cannot be verified by other audit procedures
- It is a written confirmation of oral representation avoids confusion and disagreement. The matters mentioned in the letter should be discussed with those responsible for giving the written confirmation, to ensure that they understand what they are confirming. The written confirmations are normally

required of appropriately senior management, only matters which are material to the financial statements should be included.

- When the auditors receive such representations they should:

  a) seek corroborative audit evidence from sources inside or outside the entity.

  b) evaluate whether the representation made by management appear reasonable and are consistent with other audit evidence obtained, including other representations.

  c) consider whether the individuals making the representations can be expected to be well informed on the particular matters

- The ISA makes an important point: representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. If the auditor is unable to obtain sufficient and appropriate audit evidence regarding a matter which has, or may have a material effect on the financial statement and such audit evidence is expected to be available, this will constitute a limitation in the scope of audit, even if a representation from management has been received on the matter.

- The auditor should include in the audit working papers evidence of management's representation in the form of a summary of oral discussion with management or written

- representation from management.

  A written representation is better than an oral representation in a form of audit evidence and take the form of:

  a) a representation letter from management

  b) a letter from the auditors outlining the auditors' understanding of management's representations, duly acknowledged and confirmed by management

  c) relevant minutes of meetings of the board of directors or similar body or a signed copy of the financial statements

- If management refused to provide a representation that the auditor considers necessary, this constitutes a scope limitation and the auditor should express a qualified opinion or a disclaimer of opinion.

  In these circumstances, the auditors should consider whether it is appropriate to rely on other representations made by management during the audit.

- The importance of discussion with management regarding the content of the letter of representation at the early stage:

  a) director may disagree with what the auditors wish them to sign

  b) negotiation between client and auditor, the letter to be redrafted until it is acceptable to both of them

c) management representation letter is often regarded as a critical piece of audit evidence and if it is left to a late stage in the audit, there will be a pressure on the auditor and client, then negotiation may be difficult.

Letter of representation-summary

- written confirmation of oral representation
- avoiding confusion and disagreement
- only used on material matter(s)
- restricted to the area where can not be verified by other audit procedures
- cannot be a substitute (replacement) for other audit evidence, otherwise, constitute limitation on scope
- refuse by management, the auditor will issue the qualified audit report or disclaimer of opinion, and the auditor will consider reliance on the other letters

(Entity Letterhead)

(To Auditor) (Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 2022 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of (or 'present fairly, in all material respects,') the financial position of ABC Company as of December 31, 2022 and of the results of its operations and its cash flows for the year then ended in accordance with (indicate relevant financial reporting framework).

We acknowledge our responsibility for the fair presentation of the financial statements in accordance with (indicate relevant financial reporting framework)

We confirm to the best of our knowledge and belief, the following representations:

Include here representations relevant to the entity. Such representations may include:

- There have been no irregularities involving management or employees who have a significant role in the accounting and internal control systems or hat could have a material effect on the financial statements.
- We have made available to you all books of account and supporting documentation and all minutes of meetings of shareholders and the board of directors(namely those held on March 15, 2022 and September 30,

2022, respectively)

- We confirm the completeness of the information provided regarding the identification of related parties.
- The financial statements are free of material misstatements, including omissions.
- The Company has complied with all aspects of contractual agree that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities have a material effect on the financial statements. In the event of non-compliance.
- We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statement.
- We have no plans to abandon lines of product or other plans or intentions that with result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of net realizable value
- The Company has satisfactory title to all assets and there are no liens or encumbrances on the company's assets, except for those that are disclosed in Note X to the financial statements.
- We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and have disclosed in Note X to the financial statements all guarantees that we have given to third parties.
- Other than ... described in Note X to the financial statements, there have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or Notes thereto.
- The ... claim by XYZ Company has been settled for the total sum of XXX which has been properly accrued in the financial statements. No other claims in connections with litigation have been or are expected to be received

(Senior Executive Officer) (Senior Executive Officer)

Auditors will often seek representations form directors individually as well as collectively, confirming that all transactions have been disclosed.

Unadjusted audit differences

During the course of the audit the auditor will have identified, errors within the accounts balances and transactions. For example, a number of debtors may not agree, or perhaps the auditor considers that stock has been miscounted. Ideally, the auditor should persuade management to adjust the financial statements for the effect of these differences.'

If management do not agree to adjust the financial statements for these known or actual errors, then the auditor must consider their impact on the view given in the financial statement (ISA 320 Audit Materiality).

Also, ISA 320 requires the auditor to consider the potential impact of the extrapolated or estimated errors on the view given by the financial statements.

As discussed in earlier chapters, auditors require reasonable assurance that items in the financial statements are not materially misstated. (Auditors should in the first instance extend audit procedures if the results of audit sampling indicate otherwise.) The auditor should summarise and assess the actual and extrapolated audit different before reaching a final audit conclusion and deciding modified audit opinion.

A 'summary of audit differences', which usually includes previous year comparatives normally included in the firm's planning documentation.

Conclusion

Having completed the detailed testing, the auditor should carry out an overall review of the financial statements for consistency, presentation and completeness.

Analytical procedures arc an important part of this review.

The post balance sheet period needs to be considered to determine (in addition to going concern considerations) whether or not all post balance sheet events have been reflected in the financial statements.

Representations from management on certain items appearing in the financial statements may be required which provide additional evidence to support the assertions contained in the financial statements.

The auditor will consider the impact of unadjusted differences on the view give by the financial statements and whether or not a modified audit opinion is required

5.Quality control

In line with ISA 220 *Quality Control for an Audit of Financial Statements*,

Supervision and reviewing of the assistants' work

5.1 Supervision

During the audit, the supervisor should keep track of the progress of the audit engagement to ensure that the audit timetable is met and should ensure that the audit manager and partner are kept updated of progress.

The competence and capabilities of individual members of the engagement team should be considered, including whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the audit.

In addition, part of the supervision process should involve addressing any significant matters arising during the audit, considering their significance and modifying the planned approach appropriately.

The supervisor would also be responsible for identifying matters for consultation or consideration by the audit manager or engagement partner.

5.2 Review

The supervisor would be required to review the work completed by the assistants and consider whether this work has been performed in accordance with professional standards and other regulatory requirements and if the work performed supports the conclusions reached and has been properly documented.

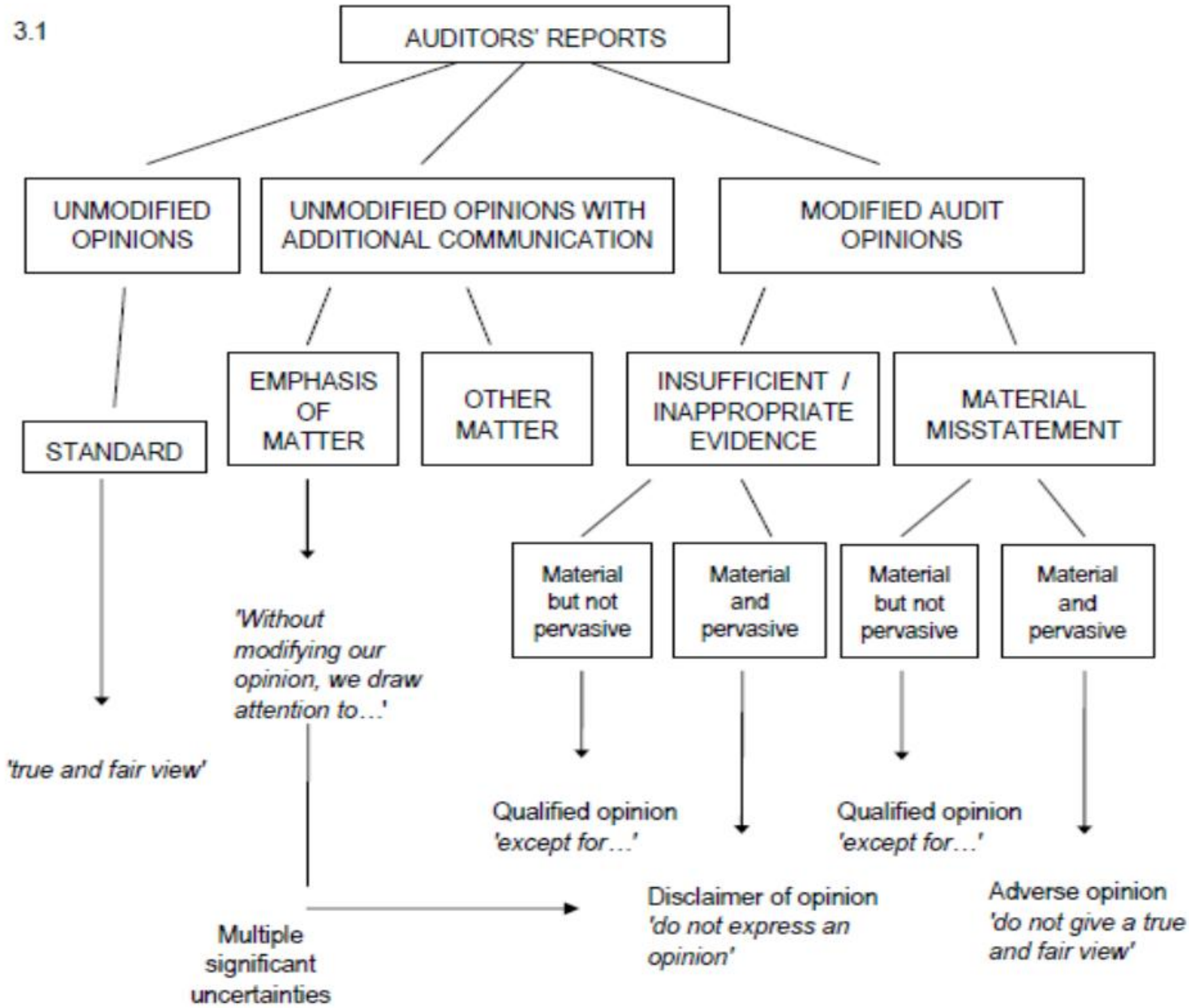
The supervisor should also consider whether all significant matters have been raised for partner attention or for further consideration and where appropriate consultations have taken place, whether appropriate conclusions have been documented.

6. Audit report

Auditor's reports are covered by the following ISAs.

- ISA 700 Forming an opinion and reporting on financial statements
- ISA 701 Communicating key audit matters in the independent auditor's report
- ISA 705 Modifications to the opinion in the independent auditor's report
- ISA 706 Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report

3.1



6.1 Unmodified opinions in the auditor's report

An **unmodified opinion** is the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In our opinion, the financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of ABC Company as of December 31, 20X2, and (*of*) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on the financial statements

We have audited the financial statements of ABC company, which comprise the statement of financial position as at 31 December 20X2, and statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor ***considers*** internal control relevant to the entity's preparation and fair presentation of the financial statements in order to *design audit procedures that are appropriate* in the circumstances, but *not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.* An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements **present fairly**, **in all material respects**, (or give a true and fair view of) the financial position of ABC Company as at 31 December 20X2, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other legal and regulatory requirements
[Form and content of this section of the auditor's report will vary depending on the nature ofthe auditor's other reporting responsibilities.]

[Auditor's signature]
[Date of the auditor's report]
[Auditor's address]

6.2 Key audit matters

ISA 701 *Communicating key audit matters in the independent auditor's report* sets out the auditor's responsibility to communicate KAMs.

Definition:

Key audit matters-Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Matters which the auditor may determine to be KAMs include:

•Areas of **higher risk** of material misstatement, or 'significant risks' identified in line with ISA 315 (eg at the planning stage)

• **Significant judgements** in relation to areas where management made judgements

•The effect of **significant events or transactions**

The key part of the definition of KAMs above is that these are the **most significant matters**. Identifying the most significant matters involves using the auditor's **professional judgement**.

Other factors to consider when determining KAMs include:

•The importance of the matter to intended **users' understanding**, including **materiality**

•The nature of the underlying accounting policy relating to the matter or the **complexity** or **subjectivity** involved

•Any **misstatements** related to the matter

•The nature and extent of **audit effort** needed to address the matter

•The nature and severity of **difficulties** in applying audit procedures, obtaining evidence or forming conclusions, including **more subjective judgements**

•The severity of any **control deficiencies**

•Whether **several separate issues** interacted, eg if a long-term contract had repercussions in several areas (revenue recognition, litigation or contingencies).

KAMs are communicated in a separate subsection of the auditor's report. The description of each KAM says **two main things**:

ISA 701.13

The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:

(a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and

(b) How the matter was addressed in the audit.

Illustrative key audit matters:

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Goodwill

Under IFRSs, the Group is required to annually test the amount of goodwill for impairment. This annual impairment test was significant to our audit because the balance of XX as of December 31, 20X2 is material to the financial statements. In addition, management's assessment process is complex and highly judgmental and is based on assumptions, specifically [describe certain assumptions], which are affected by expected future market or economic conditions, particularly those in [name of country or geographic area].

Our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the forecasted revenue growth and profit margins for [name of business line]. We also focused on the adequacy of the Group's disclosures about those assumptions to which the outcome of the impairment test is most sensitive, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill.

The Company's disclosures about goodwill are included in Note 3, which specifically explains that small changes in the key assumptions used could give rise to an impairment of the goodwill balance in the future.

Revenue Recognition

The amount of revenue and profit recognised in the year on the sale of [name of product] and aftermarket services is dependent on the appropriate assessment of whether or not each long-term aftermarket contract for services is linked to or separate from the contract for sale of [name of product]. As the commercial arrangements can be complex, significant judgment is applied in selecting the accounting basis in each case. In our view, revenue recognition is significant to our audit as the Group might inappropriately account for sales of [name of product] and long-term service agreements as a single arrangement for accounting purposes and this would usually lead to revenue and profit being recognised too early because the margin in the long-term service agreement is usually higher than the margin in the [name of product] sale agreement.

Our audit procedures to address the risk of material misstatement relating to revenue recognition, which was considered to be a significant risk, included:

• Testing of controls, assisted by our own IT specialists, including, among others, those over: input of individual advertising campaigns' terms and pricing; comparison of those terms and pricing data against the related overarching contracts with advertising agencies; and linkage to viewer data; and

•Detailed analysis of revenue and the timing of its recognition based on expectations derived from our industry knowledge and external market data, following up variances from our expectations.

6.3 ISA 706 Emphasis of matter paragraphs and other matter paragraphs

(Modified Report but unmodified opinion)

6.3.1 Emphasis of matter paragraph

An emphasis of matter paragraph is a paragraph included in the auditor's report. It refers to

• Matter appropriately presented or disclosed in the financial statements; but that

• In the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

Examples include:

• An uncertainty relating to the future outcome of exceptional litigation or regulatory action

• A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position

Where an emphasis of matter paragraph is used:

a)It comes immediately after the opinion paragraph

b)It is entitled 'Emphasis of matter'

c)The paragraph makes a clear reference to the matter being emphasised and where The relevant disclosures are in the financial statements

d)The paragraph must state that the auditor's opinion is not modified in respect of the matter emphasised

Emphasis of Matter We draw attention to Note X to the financial statements which describes the uncertainty related to the outcome of the lawsuit filed against the company by XYZ Company. Our opinion is not qualified in respect of this matter.

6.3.2 Other matter paragraph

An other matter paragraph is a paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements (outside the scope of the financial statements) that, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Examples include the situation where the Chairman's Report is not consistent with the financial statements or the prior year figures have not been audited.

6.4 ISA 705 Modifications to the opinion in the independent auditor's report

Modified Report (modified opinion)

The auditor will give a modified audit report when:

a)The auditor concludes, based on the evidence obtained, that the financial statements as a whole are not free from material misstatement; or

b)The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Two 'level's of modified opinion

I.Material but not pervasive where the circumstances prompting the misstatement are material

II.Material and pervasive where the financial statements could be misleading.

A pervasive opinion means either that:

It is not possible for the auditors to provide an opinion on the financial statements; or

There is a fundamental disagreement between themselves and management over the accounting treatment or disclosures.

Types of modified opinion

Nature of circumstances	*Material but not pervasive*	*Material and pervasive*
Financial statements are materially misstated	QUALIFIED OPINION	ADVERSE OPINION
Auditor unable to obtain sufficient appropriate audit evidence	QUALIFIED OPINION	DISCLAIMER OF OPINION

Example 1: Qualified opinion due to material misstatement

Qualified Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 2022, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of ABC Company as at December 31, 2022, and (*of*) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for qualified opinion

The company's inventories are carried in the statement of financial position at xxx. Management has not stated inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from International Financial Reporting Standards. The company's records indicate that, had management stated the inventories at the lower of cost and net realisable value, an amount of xxx would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Example 2: Adverse opinion due to material misstatement with a pervasive effect

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X2, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the financial statements do not present fairly (or *do not give a true and fair view of*) the financial position of ABC Company as at December 31, 2022, and (*of*) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for adverse opinion

As explained in Note X, the Group has not consolidated subsidiary XYZ Company that the Group acquired during 2022 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under IFRSs, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

Example 3: Qualified opinion due to inability to obtain sufficient appropriate audit evidence

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 2022, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of ABC Company as at December 31, 2022, and (*of*) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for qualified opinion

With respect to inventory having a carrying amount of $X the audit evidence available to us was limited because we did not observe the counting of the physical inventory as at 31 December 2022, since that date was prior to our appointment as auditor of the company. Owing to the nature of the company's records, we were unable to obtain sufficient appropriate audit evidence regarding the inventory quantities by using other audit procedures.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Example 4: Disclaimer of opinion due to inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements

Disclaimer of Opinion

We were engaged to audit the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 2022, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Basis for disclaimer of opinion

We were not appointed as auditors of the company until after December 31, 2022 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 2020 and 2022 which are stated in the statement of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerised accounts receivable system in September 2022 resulted in numerous errors in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the statement of financial position at a total amount of xxx as at December 31, 2022. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of profit or loss, statement of changes in equity and cash flow statement.

Exam focus point

ISA 560 Subsequent events/ISA 570 Going concern 常出现于最后一道题的最后一问；ISA 220 Quality control掌握文字理论；Audit report (ISA 700 701 705 706)必考。

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Related party

Subsequent events

Going concern

Management representation

Quality control

Audit report

KAM/EOM/OM

2. 必做习题

(1) Quiz:

- Written representation Ch20: Quiz 1-5
- Audit Finalisation Ch29: Quiz 1-5
- The Auditor's Report on Financial Statements Ch30: Quiz 1-5
- Going Concern Ch31: Quiz 1-5

(2) OT Revision Cases:

Ch20: Written Representations: Crighton Co

Ch30: The Auditor’s Report on Financial Statements: Cremorne; Paprika

Ch31: Going Concern: Cors Co; Mulberry Co

Ch29: Audit Finalisation:

- Violet & Co
- Savage & Co
- Bullfinch.com
- Viola Co
- Strawberry Co
- Panda Co

Chapter 16 Documentation Techniques

审计工作底稿是注册会计师对其执行的审计工作所做的完整记录，是指审计人员在审计工作过程中形成的全部审计工作记录和获取的资料. 通过学习本章节，你会了解到审计底稿的方法和类型。

Learning outcomes

- Explain the need for, and the importance of, audit documentation.
- Describe the form and contents of working papers and supporting documentation.
- Explain the procedures to ensure safe custody and retention of working papers.
- Explain how auditors record systems of internal control including the use of narrative notes, flowcharts and questionnaires.

1. Narrative notes

Narrative notes consist of a written description of the system; they would detail what occurs in the system at each stage and would include any controls which operate at each stage.

Advantages of this method include:

- They are simple to record; after discussion with staff members, these discussions are easily written up as notes.
- They can facilitate understanding by all members of the audit team, especially more junior members who might find alternative methods too complex.

Disadvantages of this method include:

- Narrative notes may prove to be too cumbersome, especially if the system is complex or heavily automated.
- This method can make it more difficult to identify missing internal controls as the notes record the detail but do not identify control exceptions clearly.

2. Questionnaires

Internal control questionnaires (ICQs) or internal control evaluation questionnaires (ICEQs) contain a list of questions; ICQs are used to assess whether controls exist whereas ICEQs assess the effectiveness of the controls in place.

Advantages of this method include:

- ➢ Questionnaires are quick to prepare, which means they are a timely method for recording the system.

- They ensure that all controls present within the system are considered and recorded; hence missing controls or deficiencies are clearly highlighted by the audit team.

Disadvantages of this method include:

- It can be easy for the staff members to overstate the level of the controls present as they are asked a series of questions relating to potential controls.
- A standard list of questions may miss out unusual or more bespoke controls used by the company.

3. Flowcharts

Flowcharts are a graphic illustration of the internal control system for the sales system. Lines usually demonstrate the sequence of events and standard symbols are used to signify controls or documents.

Advantages of this method include:

- It is easy to view the system in its entirety as it is all presented together in one diagram.
- Due to the use of standard symbols for controls, it can be effective in identifying missing controls.

Disadvantages of this method include:

- They can sometimes be difficult to amend, as any amendments may require the whole flowchart to be redrawn.
- There is still the need for narrative notes to accompany the flowchart and hence it can be a time-consuming method.

4. Audit working papers

ISA 230 Documentation states that auditors should document matters which are ***irfportant*** in providing ***evidence*** to support the audit opinion and that the audit was carried out in accordance with ISAs'.

4.1 Why do we need working papers?

The job of working papers is to:

- provide a record of the basis for the auditor's report
- provide evidence that the audit was conducted in accordance with ISAs and legal and regulatory requirements.
- To assist with the planning, performance, supervision and review of the audit.
- To aid the auditors defense if subsequently sued for negligence.

Principles

There are two major principles

- **If it's not recorded, it didn't happen.**

If there is nothing on file, there is no evidence that the necessary procedures were completed, so there can be no basis for the audit opinion.

- **If it can't be understood, it might as well not have happened.**

Clarity is important for two reasons

- Completeness - If the working papers are easy to understand it will be more obvious if anything has been omitted.
- Efficiency - Working papers need to be reviewed for quality control purposes and to ensure that the audit opinion is justified. The reviewer may be at a senior level in the firm and therefore time will be charged at an expensive rate. Clear working papers will keep the time spent and therefore the costs to a minimum.

4.2 Structure and layout

The file

There are two broad areas to the file.

- The control part consisting of:
  -the planning section
  -the completion and review section.
- The main working papers are divided into the relevant sections of the financial statements, e.g. non-current assets, inventories receivables, etc.

This represents a hierarchical or pyramid structure so that:

- the figures in the financial statements are supported by the detailed working papers in the various sections
- the matters arising and errors revealed on each section are summarised at the review and completion stage
- the audit strategy and plan, recorded in the planning section, are translated into action in the underlying sections
- each working paper on file either summarises the information on other working papers or supports the conclusions reached on another working paper and this is demonstrated by a system of indexation and cross referencing.

Individual sections of the file

Each section of the file also follows hierarchical principles with:

- lead schedule
- section summary/matters arising
- supporting schedules
- Transactions/other detailed testing.

The working papers in each section will normally include:

The lead schedule

Client: XYZ Ltd		Reference J1
Year end: 31 December 2021	Prepared by: AB	Date
Subject: Debtors	Reviewed by	Date

	Ref	Draft	Adjustments	This year Final	Last Year Final
		£	£	£	£
Trade debtors					
Less bad debt provision					
Other debtors					
Prepayments					

Summary of work done	Ref.
Circularization of material debtors carried out	J10
Receivables ageing reviewed and discussed with xxxxx	J20
Correspondence with disputed accounts reviewed	J21
Material other debtors agreed to confirmation or after date receipts	J30
Material invoices agreed to invoices and payment and calculations checked	J40

Conclusion (J2) Subject to satisfactory resolution of dispute with CDE Ltd debtors are fairly stated.

This is an example of the lead schedule for the accounts receivable section.

Note

- The headings- client, year end, subject, preparer, reviewer.
- The account headings, which correspond to the analysis of accounts receivable in the note to the financial statements.
- Comparative figures.
- The suggested column headings, draft, adjustments and final, which allow the reviewer to see adjustments made to the client's original figures, while ensuring the final column agrees to the financial statements.
- Cross-references to supporting schedules.
- Brief summary of work done.
- Conclusion.

Section summary (matters arising)

- A schedule that summarises:
  - what you did
  - why you are confident in your conclusions
  - important issues for the partner and manager to consider.

Supporting schedules

Either:

Sub-categories, e.g. For non-current assets:

- land and buildings
- plant and machinery
- IT equipment
- Motor vehicles.

IT-based working paper system Advantages

- Takes the conformity advantages of audit packs to another level.
- Cross-referencing and compliance with indexation system become automatic.
- Incomplete work is highlighted automatically.

Disadvantages

- can be expensive to install
- Need for extensive (and costly) training.

4.3 Custody and retention of working papers

Who owns the working papers?

The **auditor** does. This is important because:

- Access to the working papers is controlled by the auditor, not the client, which is an element in preserving the auditor's independence.
- In some circumstances care may need to be taken when copies of client generated schedules are incorporated into the file.

Security

Working papers must be kept secure.

- Audits are expensive exercises. If the files are lost or stolen, the evidence they contain will need to be recreated, so the work will need to be done again. The auditors may be able to recover the costs from their insurers, but otherwise it will simply represent a loss to the firm. Either way, prevention is better than cure.
- By its nature, audit evidence will comprise much sensitive information that is confidential. If the files are lost or stolen, the auditor's duty of confidentiality will be compromised.
- There have been cases of unscrupulous clients altering auditors' working papers to conceal frauds.

The implications of IT based audit systems are also far reaching.

- By their nature, laptops are susceptible to theft, even though the thief may have no interest in the contents of the audit file. Nevertheless, all the problems associated with re-performing the audit and beaches of confidentiality remain.

It is more difficult to be certain who created or amended computer based files than manual

- files - handwriting, signatures and dates have their uses - and this makes it harder to detect whether the files have been tampered with.

Retention

ISA 230 states that audit documentation should be retained for **five** years from completion of the audit. Many firms keep working papers for longer than this because information may still be required for tax purposes.

All of this means that firms need to make arrangements for:

- Secure storage of recent files
- Archiving older files
- Archiving and backup of IT-based files.

4.4 The content of file

Working papers include:

- Letter of engagement
- Knowledge of the business
- Risk assessments
- Materiality calculations
- Details of accounting and internal control systems
- Ratio analysis
- Audit programmes
- Audit procedures
- Communications with experts, third parties and other auditors
- Management letter
- Management representation letter
- Checklists
- Draft financial statements and audit report

Working papers should always show:

- name of the client
- balance sheet date
- file reference
- subject
- name of person preparing
- date of preparation
- name of person reviewing
- date of review

For recurring audits the working papers are split between the.

- Permanent file
  - — items of continuing importance including

    - copies of legal documents
    - previous year's audited accounts
    - systems notes
    - Correspondence
- current file
    — all of the current year's working papers

Exam focus point
Narrative notes/Flowcharts/Questionnaires: ICQ/ICEQ掌握文字题； need for, and the importance of, audit documentation/contents of working papers and supporting documentation掌握文字题。

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Letter of engagement
Knowledge of the business
Risk assessments
Ratio analysis
Audit procedures
Management letter
Management representation letter
Audit report
Narrative notes
Flowcharts
Questionnaires: ICQ/ICEQ

2. 必做习题

(1) Quiz:

- Working papers Ch6: Quiz 1-5
- Internal control questionnaires Ch9: Quiz 1-5

Chapter 17 Not-for-profit organisations

审计非营利组织是政府机构和其他不以营利为主要目的的组织，如学校、医院、科研机构、图书馆和慈善机构等。通过学习本章节，你会了解到审计非营利性组织和小型企业的审计风险。

Learning outcomes

- Apply audit techniques to not-for-profit organisations.
- Apply audit techniques to small organisations.

1. Auditing not-for-profit organizations

If a full audit is to be carried out, because it is required by either statute or the organization's constitution, the auditors must consider the following:

- Risk factors
- Internal controls should be in place
- Audit approach
- Problems with small organizations

Risk factors

Inherent risk

- Donations and cash receipts
- Restricted funds
- Restrictions imposed by constitution

Control risk

- Board of trustees
  - Time spent
  - Skills & qualification
  - Frequency & regularity of meetings
  - Independence
- Lack of segregation of duties
- Competence of volunteer staff

Internal controls should be in place

Income

Collecting boxes

- Numerical control
- Sealing
- Regular control
- Dual control over counting & recording

Postal receipts

- Dual control over opening
- Immediate recording
- Independent checks

Grants

- Income correctly

applied ***Expenditure***

Restricted funds

- Separate records
- Trustees requirements

Grants

- Record all requests and decisions
- Ensure money properly spent

<u>Overall audit approach</u>

In principle, the approach to auditing an NFP should be exactly as studied so far, in accordance with auditing standards. The same ideas of audit planning, risk assessment, testing of controls, etc can be applied to auditing an NFP

Focus on:

- Completeness income
- Overstatement expenses
- Misapplication fund

Income

-Can be serious problem for the auditor; since it is usually be accounted for on a cash basis, with little accompanying documentation.

-Detailed analytical procedures and written representations from managers can assist the auditors

Expenditure

-The NFP is likely to have certain stated aims, so expenditure must be consistent with these aims.

Audit report

-A limitation of scope qualification will be inevitable if the auditor cannot prove the completeness of income.

<u>Problems with small not for profit organizations</u>

- Lack of segregation of duties
- Unqualified staff
- Volunteer resent formal procedures

2.Auditing small organizations

Owned by one or two individuals who control the operation and are involved on a day-to- day basis with the transactions problems with small company audit

- the restricted scope for segregation of duties due to small number of employees
- the domination of the business by senior management
- lack of effective management supervision (no qualified accountant to guide)
- informal/inadequate record-keeping
- lack of checks on management itself (easy for management to override control)
- management/owner may spend more time on sales/marketing while not on accounts
- management may mix up personal expenses with company expenses
- auditors may have to prepare accounts, if so, should clearly state in the engagement letter and get client accept full responsibility.
- control risk is generally assessed as **high** and emphasis will be aimed towards **substantive testing.**
- management representation will be relied on but auditors should **not solely** rely on that.
- analytical review may not be applied due to insufficient information .(e.g. no budget, forecast)

Independence issue

- Auditors may be involved with accounting, taxation and may act in executive position.
- Cost pressure, (auditors may tend to restrict costs and audit time)

Arguments for/against whether or not requiring an audit for small company

<u>For not requiring an audit</u>

- Audited accounts(simple) in small companies serve only a compliance function and add little to management's knowledge and understanding of the business
- Audit fee is relatively expensive to a small co, and money can be used elsewhere.
- Audited accounts filed a few months after the year end are of little value to trade suppliers and customers, (already established a trading relationship)
- Bankers will be in a position to make specific conditions for providing finance (little need for a statutory audit.)

<u>For requiring an audit</u>

- --most auditors consider that still

worthwhile to audit a small company at a reasonable cost

- --added credibility of the audited accounts and provide information for various stakeholders.
- -the audit is necessary to protect the creditors (important in view of the limited liability of shareholders.)
- --minority shareholders can also access to full and reliable information about the company.
- --provides good discipline which is important when small companies grow into large companies.

Impact on risk

Decreased by:

- Proprietor may exercise effective control
- Proprietor's close involvement may prevent nr detect

errors Increased by:

- Lack of distinction between personnel and business transactions
- Profit may be manipulated

Internal controls

Limited although may be able to test and place some reliance on those operated by the proprietor or established through observation (if not actually documented)

Non-audit work

- Writing up the books
- Drawing up a trial balance
- Ascertaining year-end adjustments

The fact that the auditor has undertaken some accounting work for the client does not diminish the need for a proper audit. Separate teams of staff are usually allocated to the accounting and audit work

Audit approach

1) Substantive approach with no or very limed use of test of controls
2) Perform extensive analytical review procedures
3) Review
    - Expense accounts for personal items
    - Transactions after the year-end

4) Obtain management representations

Exam focus point
Apply audit techniques to not-for-profit organisations/Apply audit techniques to small organisations

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

not-for-profit organisations

small organisations

2. 必做习题

(1) Quiz:

Small Business and Not-for-Profit Organisations Ch28: Quiz 1-5

