ACCA

PAPER AA

AUDIT AND ASSURANCE
(AA-INT)

FOR EXAM UNTIL JUNE 2024

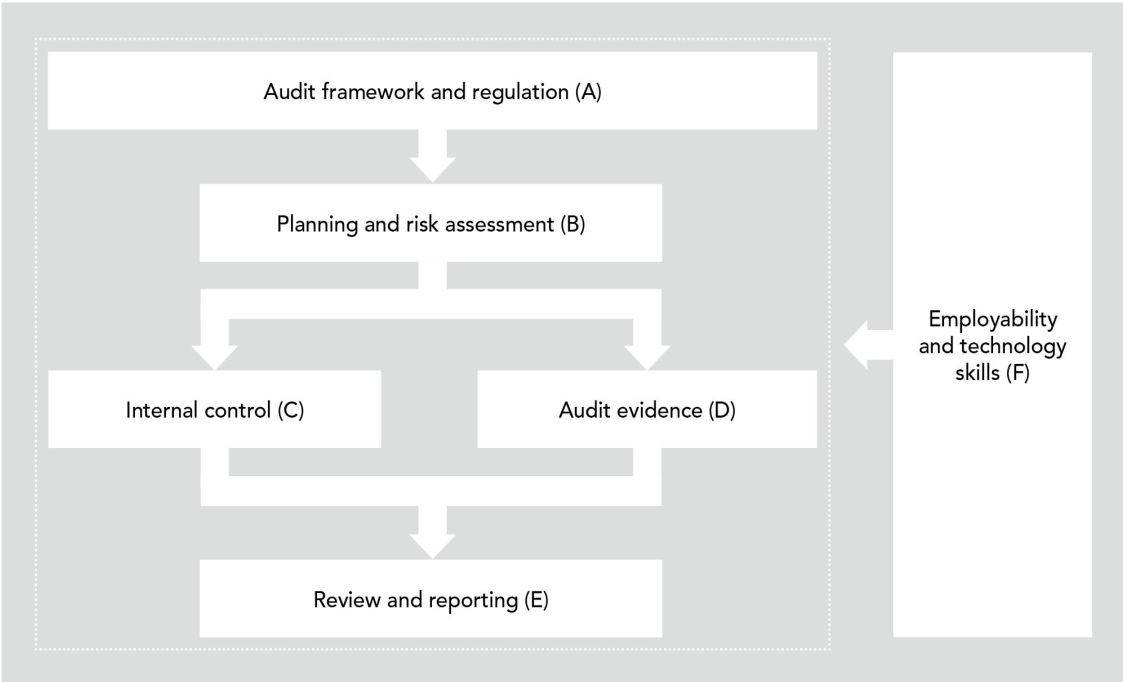
Introduction of AA

1. Aim 课程目标

To develop knowledge and understanding of the process of carrying out the assurance engagement and its application in the context of the professional regulatory framework.

2. Syllabus 课程大纲

- Audit framework and regulation
- Planning and risk assessment
- Internal control
- Audit evidence
- Review and reporting
- Employability and technology skills



3. Exam format 考试形式

The syllabus is assessed by a three-hour computer based examination. All questions are compulsory. The exam will contain both computational and discursive elements. Some questions will adopt a scenario/case study approach. Prior to the start of the exam candidates are given an extra 10 minutes to read the exam instructions.

Section A

Section A of the exam comprises three 10 mark case-based questions. Each case has five objective test questions worth 2 marks each.

Section B

Section B of the exam comprises one 30 mark question and two 20 mark questions.

Section B of the exam will predominantly examine one or more aspects of audit and assurance from planning and risk assessment, internal control or audit evidence, although topics from other syllabus areas may also be included.

Total 100 marks

4. Pass rate 历年考试通过率

Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23	Jun 23
43	39	39	38	44	39	44	40	40	45

Professionalism, creativity and internationalism are the greatest traits of audit.

Contents

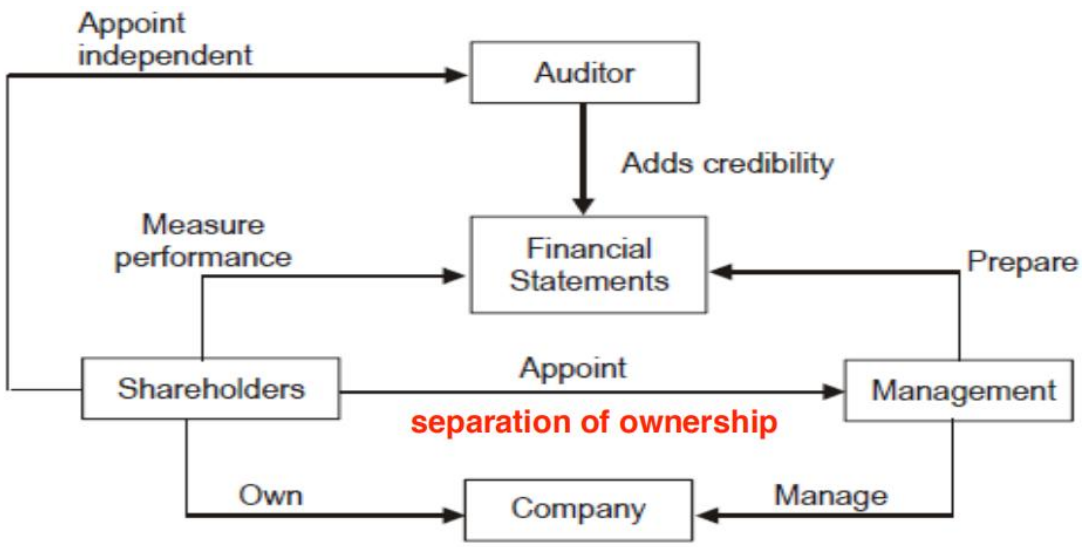
Part A Audit framework and regulation

Chapter 1 The concept of audit and other assurance engagements

审计课程是ACCA基础课程阶段唯一的一门审计相关课程，它详细介绍了财务报表的整个审计流程。通过学习本章节，你会了解到审计与鉴证业务的基本概念，包括鉴证业务要素和分类、审计的定义、目标和责任、以及重要的国际审计准则。

Learning outcomes

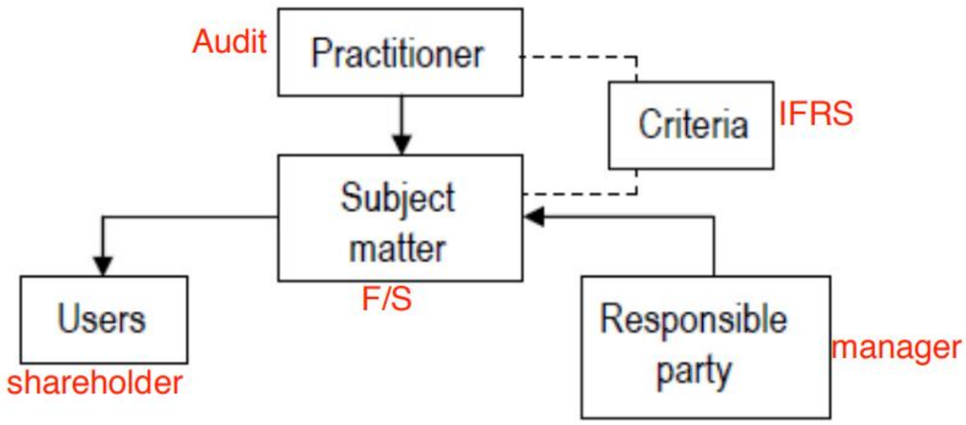
- Identify and describe the objective and general principles of external audit engagements.
- Explain the nature and development of audit and other assurance engagements.
- Discuss the concepts of accountability, stewardship and agency.
- Define and provide the objectives of an assurance engagement.
- Explain the five elements of an assurance engagement.
- Describe the types of assurance engagement.



1. What is assurance service?

1.1 **Assurance** is the auditors' self-satisfaction as to the extent of reliability regarding an assertion made by one party (audit client, i.e., financial manager) for use by another party (reader and user of audited financial statements, normally they are the investors, i.e., shareholders). To provide assurance auditors must assess the collected audit evidence as a result of external auditors' procedures and then express a conclusion. The degree of satisfaction achieved and, therefore, the level of assurance provided is determined by the procedures performed and their results.

1.2 Five elements of an assurance engagement:



In accordance with **ISAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information***, an assurance engagement will require:

① **Three-party relationship**

-The intended user who is the person who requires the assurance report.

-The responsible party, which is the organisation responsible for preparing the subject matter to be reviewed.

-The practitioner (i.e. an accountant) who is the professional who will review the subject matter and provide the assurance.

② **Subject matter**

The subject matter is the data which the responsible party has prepared and which requires verification.

③ **Suitable criteria**

The subject matter is then evaluated or assessed against suitable criteria in order for it to be assessed and an opinion provided.

④ **Appropriate evidence**

The practitioner must ensure that they have gathered sufficient appropriate evidence in order to give the required level of assurance.

⑤ **Assurance report**

Last, an assurance report provides the opinion which is given by the practitioner to the intended user.

1.3 Two types:

① **Reasonable assurance engagement: (**Example: **Statutory Audit)**

External auditor will:

- Gather sufficient and appropriate evidence
- Do enough work to be able to draw rational conclusions
- Give a report in the form of **positive assurance.**

However, there are also a number of inherent limitations involved in auditing including:

♦ Use of testing

♦ Limitations of accounting and internal control systems

♦ Persuasive rather than conclusive nature of evidence

As a result auditors can only gain **reasonable assurance** that the financial statements are free from **material** misstatement.

A positive assurance report means that the auditor has carried out sufficient work to be able to state that financial information is free from material error.

② **Limited assurance engagement: (**Example: **Review)**

External auditor will:

- Gather sufficient and appropriate evidence to be satisfied that the subject matter is plausible in the circumstances
- Give a report in the form of **negative assurance.** However, the assurance level given is **moderate.**

A negative assurance report means that nothing has come to the attention of the audit, which indicates the financial information being reported on has errors in it. However, the extent of the work carried out is normally less, which means that less reliance can be placed on this report.

<u>The advantages of providing negative assurance include:</u>

➢ The user of the financial information receives some comfort that the information is correct, even though that assurance is less than positive assurance.

➢ The report adds some credibility to the financial information because it has been reviewed by a professional accountant.

➢ For the preparer, the report will be more cost effective than obtaining a full positive assurance report.

	Statutory Audit	Review
Level of assurance	High	Moderate
Report provided:	Positive assurance	Negative assurance
Types of assurance	Reasonable assurance	Limited assurance

2. What is external audit?

2.1 Definition:

An external audit is defined as the: *…independent examination of and expression of opinion on the financial statements of an organization.* It is the process of a group of independent professional person, check or review FS according to engagement letter and general accepted auditing standards, then present their opinion.

2.2 Objectives:

enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework, and financial statements comply with relevant statutes or law.

2.3 Purpose:

ensure that the financial statements are objective, free from manipulation, and relevant to users.

2.4 The auditor's general responsibility: is to plan and perform the audit to provide reasonable assurance that financial statements are free of misstatement and give a true and fair view. The auditor's opinion enhances the credibility of financial statements by providing a high, **but not absolute, level of assurance that they give a** 'true and fair view / are presented fairly'

2.5 Limitations of external audits:

- **Sampling** – it is not practical for an auditor to test 100% of transactions and so they have to apply sampling methodologies in selecting balances/transactions to test. Therefore, there could be an error in an item not selected for testing by the auditor.
- **Subjectivity** – financial statements include judgemental and subjective areas and therefore the auditor is required to use their judgement in assessing whether the financial statements are true and fair.

- **Inherent limitations of internal control systems** – an internal control system is operated by people and hence is liable to human error. In addition, there is the possibility of controls override by management and of collusion and fraud. It is impossible to remove all of these inherent limitations and as the auditor relies on the internal control systems, this can reduce the usefulness of the audit.
- **Evidence is persuasive not conclusive** – the opinion is based on audit evidence gathered; however, while this evidence can indicate possible issues affecting the audit opinion, evidence involves estimates and judgements and hence does not give a definite conclusion.
- **Audit report format** – the format of the opinion is determined by International Standards on Auditing. However, the terminology used is not usually understood by non-accountants. This means that users may not actually understand the audit opinion given.
- **Historic information** – the audit report is often issued some time after the year end, and so the financial information can be quite different to the current position. In the current marketplace where companies' financial positions can change quite quickly, the audit opinion may no longer be relevant as it is out of date.

2.6 <u>Rights</u>:

- Unrestricted access to books and records.
- To receive information and explanations from the officers of the company.
- To receive notice of and attend company meetings.
- To receive notice of any intention to propose his removal, and to make written representations in such circumstances.
- To Requisition an Extraordinary General Meeting (EGM) on his resignation and to attend and be heard at that meeting.

2.7 <u>Duties</u>

- To report to the members on whether the financial statements give a true and fair view and have been properly prepared.
- To form an opinion as to whether **(RAPID)**
  - Adequate **R**eturns have been received from branches not visited
  - **A**ccounting record are consistent with the financial statements
  - **P**roper accounting records have been kept
  - All **I**nformation and explanations have been received from the officers
  - The **D**irectors' report is consistent with the financial statement
- The auditor must report if not satisfied with any above points.
- To state certain items in the audit report, if not given in the financial statements

■ To make a statement of circumstances when they cease to hold the office of auditor.

2.8 The audit client's responsibility

■ Prepare financial statements, which comply with legislation and accounting standards

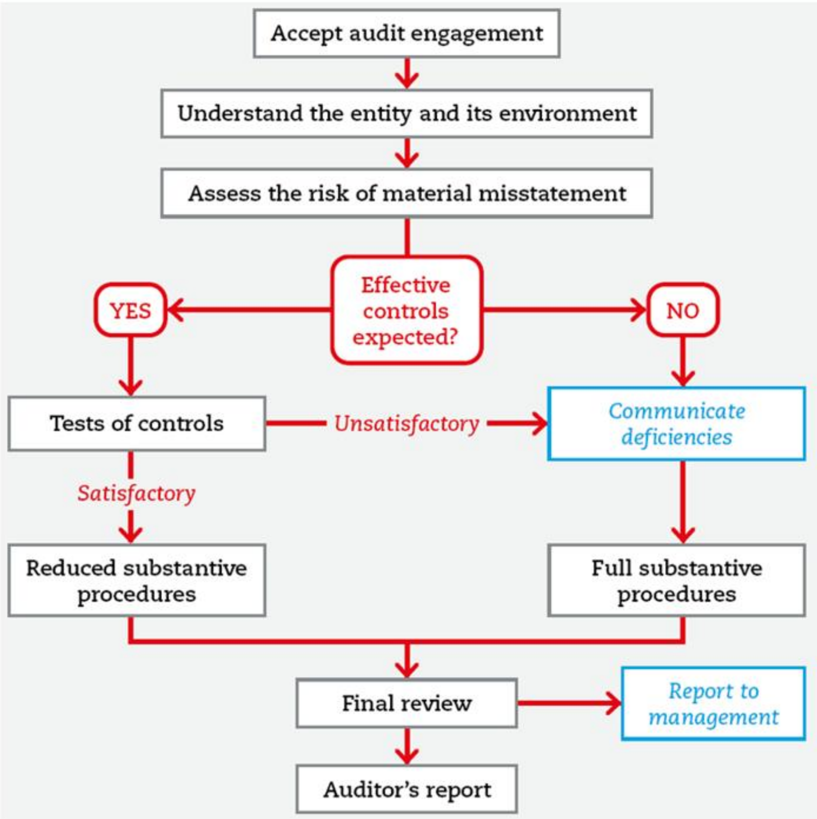
■ Keep proper accounting records

■ Safeguard the company's assets and to prevent fraud and errors

■ Deliver audited financial statement to any appropriate court or government agency

■ Establish internal control system and keep their running in efficient way

2.9 Audit Cycle



3. What is not audit?

- Guaranty
- Tax reviewer
- Consultant
- Fraud inspector

4. Types of audit

4.1 External audit VS Internal audit

	External	Internal
Objective:	Provide opinion	Advise management
Appointed by:	Shareholders or directors	Audit committee
Reports to:	Shareholders	Audit committee
Status:	Independent	Employee
Legal basis	Legal requirement	Not a legal requirement
Reports on& Responsibility	The truth and fairness of the financial statements and their compliance with the Companies Act and Accounting Standards	A wide range of issues including risk management and internal controls and corporate governance
Scope	Financial focus	All areas of the organization
Standards	ISAs	IIA
Approach	Risk— based	Increasingly risk-based

4.2 Interim audit—Final audit—Continuous audit

① Interim audit

The interim audit is that part of the audit which takes place before the year end. The auditor uses the interim audit to carry out procedures which would be difficult to perform at the year end because of time pressure. There is no requirement to undertake an interim audit; factors to consider when deciding upon whether to have one include the size and complexity of the company along with the effectiveness of internal controls.

Typical procedures undertaken during the interim audit include consideration of inherent risks, documenting and testing of internal controls, testing of profit and loss transactions for the year to date and identification of potential problems which may affect the final audit work.

② Final audit

The final audit will take place after the year end and concludes with the auditor forming and expressing an opinion on the financial statements for the whole year subject to audit. It is important to note that the final opinion takes account of conclusions formed at both the interim and final audit.

Typical work carried out at the final audit includes follow up of items noted at the inventory count, obtaining confirmations from third parties, analytical reviews of figures in the financial statements, substantive procedures of account balances and transactions, review of events after the reporting period and going concern review.

4.3 Account based audit—System based audit—Risk based audit

5. Key terms

5.1 Materiality

Materiality is defined in ISA 320 as follows:

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

In assessing the level of materiality, there are a number of areas that should be considered. First the auditor must consider both the amount (quantity) and the nature (quality) of any misstatements, or a combination of both. The quantity of the misstatement refers to the relative size of it and the quality refers to an amount that might be low in value but due to its prominence could influence the user's decision, for example, directors' transactions.

The assessment of what is material is ultimately a matter of the auditor's professional judgement, and it is affected by the auditor's perception of the financial information needs of users of the financial statements and the perceived level of risk; the higher the risk, the lower the level of overall materiality.

In calculating materiality, the auditor should also set the performance materiality level.

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

Where size is an issue materiality is often set as a percentage as follows:

- PBT 5%
- Total assets 1%

Calculations are flexible and should be reassessed during the audit.

5.2 True and fair

True – Information is factual and conforms with reality in that there are no factual errors. In addition it is assumed that to be true it must comply with accounting standards and any relevant legislation. Lastly true includes data being correctly transferred from accounting records to the financial statements.

Fair – Information is clear, impartial and unbiased, and also reflects plainly the commercial substance of the transactions of the entity.

5.3 How are auditors appointed and removed?

1) Appointment

By the shareholders (members):

- At the company's annual general meeting (AGM);
- Appointment runs from end of AGM until the end of the next AGM.

By the directors:

- Can appoint the first auditor and fill a 'casual vacancy', but needs members' approval at next AGM.

2) Removal

The authority for removing auditors lies with the shareholders, not the directors.

The shareholders may remove the auditors by ordinary resolution with special notice.

- Simple majority at a general meeting of the company
- Notice of the resolution must be sent to the auditor
- **Auditors can make a written statement of the circumstances** or **a statement that there are no such circumstances.**
- Auditors also have the right to speak at the general meeting

3) Resignation

- Auditors must provide the company with written notice to resign.
- On receipt of such a notice the directors must call a general meeting as soon as possible.
- The auditors have to submit a statement of the circumstances surrounding their resignation.

6. Why we need audit

1) Academic Basis

- agency theory

Agency relationships occur when one party, the principal, employs another party, the agent, to perform a task on their behalf. For example, directors can be seen as the agents of shareholders, employees as the agents of directors and external auditors as agents of shareholders.

- Accountability

Accountability means that people in positions of power can be held to account for their action.—For example; directors are accountable to the shareholders and to society at large for making decisions on behalf of the company's owners and using the assets of the company efficiently and effectively.

- Stewardship

Stewardship is the responsibility to take good care of resources. This relationship, where one person has a duty of care towards someone else, is known as a 'fiduciary relationship'. For example; directors have a duty of stewardship of the company's assets.

2) legal requirement: statutory audit

- securities exchange
- information comparable and reliable
- international regulation

3) Corporate governance requirements

4) Consulting and advice, improve operating efficiency

Advantages and disadvantages of having an audit

Advantages

-Settling disputes between proprietors /managers.
-Help with valuation on sale /merger of a business.
-Help with applications to third parties for finance.
-Auditor may be able to give constructive advice to management.
-Help to improve corporate governance.
-Improve efficiency.
-Helpful to risk management and going concern.

Disadvantages

-Audit fee
-Management time

7. International and national standard setting and regulation

7.1 THE RULES AND WHO SETS THEM

Conduct of Audit is governed by three sets of rules:

- Code of ethics
- Auditing Standards (ISAs)
- Company law

7.2 Setting auditing standards

KEY INTERNTIONAL STANDARDS ON AUDITING (ISAs) in AA

We have already mentioned that ISAs are produced by the International Audit and Assurance Standards Board (IAASB), a technical standing committee of IFAC.

	Title	**AA**	**AAA**
	International Standards on Auditing (ISAs)		
	Glossary of Terms	✓	✓
	International Framework for Assurance Engagements	✓	✓
	Preface to the International Quality Management, Auditing, Review, Other Assurance and Related Services Pronouncements	✓	✓
ISA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with ISAs	✓	✓
ISA 210	Agreeing the Terms of Audit Engagements	✓	✓
ISA 220 (Revised)	Quality Management for an Audit of Financial Statements	✓	✓
Amendments	Conforming amendments to ISAs and Related Material Arising from the Quality Management Projects	✓	✓
ISA 230	Audit Documentation	✓	✓
ISA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements	✓	✓
ISA 250 (Revised)	Consideration of Laws and Regulations in an Audit of Financial Statements	✓	✓
ISA 260 (Revised)	Communication with Those Charged with Governance	✓	✓
ISA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	✓	✓
ISA 300	Planning an Audit of Financial Statements	✓	✓

	Title	AA	AAA
ISA 315 (Revised 2019)	Identifying and Assessing the Risks of Material Misstatement	✓	✓
Amendments	Conforming and consequential amendments to other ISAs Arising from ISA 315 (Revised 2019)	✓	✓
ISA 320	Materiality in Planning and Performing an Audit	✓	✓
ISA 330	The Auditor's Responses to Assessed Risks	✓	✓
ISA 402	Audit Considerations Relating to an Entity Using a Service Organisation	✓	✓
ISA 450	Evaluation of Misstatements Identified during the Audit	✓	✓
ISA 500	Audit Evidence	✓	✓
ISA 501	Audit Evidence – Specific Considerations for Selected Items	✓	✓
ISA 505	External Confirmations	✓	✓
ISA 510	Initial Audit Engagements – Opening Balances		✓
ISA 520	Analytical Procedures	✓	✓
ISA 530	Audit Sampling	✓	✓
ISA 540 (Revised)	Auditing Accounting Estimates and Related Disclosures	✓	✓
ISA 550	Related Parties		✓
ISA 560	Subsequent Events	✓	✓
ISA 570 (Revised)	Going Concern	✓	✓
ISA 580	Written Representations	✓	✓
ISA 600 (Revised)	Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)		✓
ISA 610 (Revised)	Using the Work of Internal Auditors	✓	✓
ISA 620	Using the Work of an Auditor's Expert	✓	✓

ISA 700 (Revised)	Forming an Opinion and Reporting on Financial Statements	✓	✓
ISA 701	Communicating Key Audit Matters in the Independent Auditor's Report	✓	✓
ISA 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report	✓	✓
ISA 706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	✓	✓
ISA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements		✓
ISA 720 (Revised)	The Auditor's Responsibilities Relating to Other Information	✓	✓
	International Standards on Quality Management (ISQMs)		
ISQM 1	Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements		✓
ISQM 2	Engagement Quality Reviews		✓
	Conforming and consequential amendments to the IAASB's other standards as a result of the new and revised quality management standards (Jan 2022)		✓
	International Standards on Assurance Engagements (ISAEs)		
ISAE 3000 (Revised)	Assurance Engagements other than Audits or Reviews of Historical Financial Information	✓	✓
	Non-authoritative guidance on applying ISAE 3000 (Revised) to extended external reporting assurance engagements (April 2021)		✓

	Title	AA	AAA
ISAE 3400	The Examination of Prospective Financial Information		✓
ISAE 3402	Assurance Reports on Controls at a Service Organisation		✓
	International Auditing Practice Notes		
IAPN 1000	Special considerations in auditing financial instruments		✓

	International Standards on Related Services (ISRSs)		
ISRS 4400 (Revised)	Engagements to Perform Agreed-Upon Procedures Regarding Financial Information		✓
ISRS 4410 (Revised)	Compilation Engagements		✓
	International Standards on Review Engagements (ISREs)		
ISRE 2400 (Revised)	Engagements to Review Historical Financial Statements		✓
ISRE 2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity		✓
	Ethical Guidelines		
	ACCA's Code of Ethics and Conduct (January 2022)	✓	✓
	IESBA's International Code of Ethics for Professional Accountants (Revised 2021)		✓
	IESBA Quality Management Related Conforming Amendments to the Code (Apr 2022)		✓
	IESBA Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code (Apr 2022)		✓

	Other documents – Corporate Governance		
	The UK Corporate Governance Code as an example of a code of best practice (Revised July 2018)	✓	✓
	FRC Guidance on Audit Committees (Revised April 2016) as an example of guidance on best practice in relation to audit committees	✓	✓
	FRC Audit Quality – Practice aid for audit committees (December 2019) – as an example of best practice and practical issues in respect of audit committees		✓
	Other Documents – ACCA		
	ACCA's Anti-money Laundering Guidance for the Accountancy Profession		✓
	Other documents - IAASB		
	IAASB Discussion Paper: Fraud and Going Concern in an Audit of Financial Statements (Oct 2020)		✓
	IAASB Towards Enhanced Professional Skepticism (August 2017)		✓
	IAASB Frequently Asked Questions: Reporting Going Concern Matters in the Auditors Report (Aug 2022)		✓
	IAASB Auditor Considerations Regarding Significant Unusual or Highly Complex Transactions (September 2010)		✓
	IAASB The consideration of climate related risks in an audit of financial statement (Oct 2020)		✓
	Integrated Reporting Working Group: Supporting Credibility and Trust in Emerging Forms of External Reporting: Ten Key Challenges for Assurance Engagements (January 2018)		✓
	Other documents - Technology		
	IAAAB Support material: Using Automated Tools and Techniques when Identifying Risks of Material Misstatement in Accordance with ISA 315 (Revised) (Nov 2020)		✓
	IAASB Support material: Using Automated Tools and Techniques in Performing Audit Procedures (Sep 2020)		✓
	IAASB Addressing risk of overreliance on technology arising from the use of automated tools and techniques and from information produced by an entity's system (Mar 2021)		✓
	IAASB Feedback Statement – Exploring the Growing Use of Technology in the Audit with a Focus on Data Analytics (January 2018)		✓
	IAASB Support Material Related to Technology: Audit Documentation when using Automated Tools and Techniques (April 2020)		✓

IFAC has four standard-setting boards:

- IAASB: The International Auditing and Assurance Standards Board
- IESBA: The International Ethics Standards Board for Accountants
- IAESB: International Accounting Education Standards Board
- IPSASB: The International Public Sector Accounting Standards Board

7.3 The standards setting process

- IAASB identifies new projects based on a review of auditing developments and suggestions from interested parties.
- IAASB then appoints a project task force to work up the detail of the standard.
- There may be consultation through a round table meeting or the issue of a consultation paper for comment.
- A draft standard is then produced for public exposure, usually for a period of 120 days, during which interested parties may submit their comments. Comments are a matter of public record and posted on the IAASB's website.
- The project task force considers the comments and amends the draft standard as appropriate.
- If there are significant changes there may be another exposure period.
- When the standard is finalized it is formally approved by a meeting of the IAASB at which there must be a quorum of 12 members.

7.4 The relationship between international and national standards and regulation

Because IFAC is simply a grouping of accountancy bodies, it has no legal standing in individual countries. Countries therefore need to have arrangements in place for:

- Regulating the audit profession
- Implementing auditing standards

National Regulatory bodies:

- Enforce the implementation of auditing standards
- Have disciplinary powers to enforce quality of audit work
- Have right to inspect audit to monitor audit quality

There are two possible schemes for regulation at the national level:

- Self regulation by the audit/accountancy profession.
- Regulation by government or by some independent body set up by government for the purpose.

National standard setters

- May set their own auditing standards

- Modify their own standards to bring them into line with ISAs
- May adopt and implement ISAs, possible after modifying them to suit national need

Exam focus point
Five elements of an assurance engagement
Reasonable assurance engagement VS Limited assurance engagement
The auditor's general responsibility
Limitations of external audits
External audit VS Internal audit
Interim audit VS Final audit
Materiality
True and fair

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Assurance engagement
Subject matter
Reasonable assurance engagement
Limited assurance engagement
Guaranty
Tax reviewer
Consultant
Fraud inspector
Interim audit
Final audit
Continuous audit
Materiality
Performance materiality

2. 必做习题

(1) Quiz:

Audit and Other Assurance Engagements: Quiz 1-5
External audit: Quiz 1-5

(2) OT Revision Cases:

Audit and Other Assurance Engagements: Nadas & Co; Doge & Co
External audit: Geopard & Co

Chapter 2 Corporate governance

公司治理是通过一套包括正式或非正式的、内部或外部的制度或机制来协调公司与所有利益相关者之间的利益关系，以保证公司决策的科学性与公正性，从而最终维护各方面的利益。公司治理的目标不仅是股东利益的最大化，而且是保证所有利益相关者的利益最大化。通过学习本章节，你会了解到英国和美国的公司治理模式、非执行董事的职能以及审计委员会的相关概念。

Learning outcomes

- Discuss the provisions of international codes of corporate governance (such as OECD) that are most relevant to auditors.
- Describe good corporate governance requirements relating to directors' responsibilities (e.g. for risk management and internal control) and the reporting responsibilities of auditors.
- Evaluate corporate governance deficiencies and provide recommendations to allow compliance with international codes of corporate governance.
- Analyse the structure and roles of audit committees and discuss their benefits and limitations.

1. Introduction

1.1 What is corporate governance?

Corporate governance is the system by which companies are directed and controlled. According to the UK *Corporate Governance Code* the 'purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company'.

1.2 The key to good corporate governance

The key to good and effective corporate governance is to ensure that executive directors are rewarded at appropriate levels for their effort and skill, whilst ensuring that they act in the best interests of the company and its stakeholders.

1.3 External auditors responsibility for reporting on corporate governance

① Listed companies following the **Combined Code** in the **UK**, or other applicable guidance in respect of corporate governance, must include a corporate governance statement in the annual report. The auditors are not required to 'audit' this statement but must review it for inconsistencies with other information contained within the annual report. If inconsistencies are found, there may be an impact on the audit report in two ways:

② In the **US**, the requirements are more stringent. **Sarbanes Oxley** states that the auditors must attest as to whether the company has complied with corporate governance requirements. Therefore, they must give an opinion as to the effectiveness of the company's internal control system amongst other things. Therefore there is significantly more risk involved with auditing US listed companies who are covered by Sarbanes Oxley.

2. The OECD principles of corporate governance

In 1999 the Organization for Economic Co-operation and Development (OECD), took a hand.

<u>The Six Principles:</u>

2.1 Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. In other words, making sure everyone involved is aware of their individual responsibilities so no party is in doubt as to what they are accountable for.

2.2 The rights of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights. As we saw in Chapter 1, the directors are the stewards of the company and should be acting in the best interests of the shareholders. However, the existence of the corporate collapses mentioned above proves that this isn't always the case and shareholders need protecting from such people.

2.3 The equitable treatment of shareholders

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

2.4 The role of stakeholders in corporate governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

2.5 Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company. Therefore, the annual financial statements should be produced on a timely basis and include all matters of interest to the shareholders. For any matters of significance arising during the year, these should be communicated to the shareholders as appropriate.

2.6 The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. The introduction of audit committees and non executive directors on the board is the usual way for monitoring management. Non executive directors are not involved in the .day to day running of the company and are therefore more independent. They can evaluate the effectiveness of the executive board on its merits and make sure they are carrying out their duties properly.

3. How companies are run

There are two basic models of board structure:

- The two tier board
- The unitary board

3.1 Two tier board

In continental Europe, the 'two tier' board is common. This is made up of:

- the executive board which takes day to day decisions in the running of the company.
- the supervisory board, which oversees the executive board and is made up of representatives of employees, investors and others. Major decisions are referred to the supervisory board for approval and which acts as a check on the actions of the executive board.

Disadvantage of this structure:

- The structure can be cumbersome and difficult to administer.
- The supervisory board may not have access to the information it needs on a sufficiently timely basis.
- It has been suggested that investors and some of the other stakeholders represented are reluctant to discuss many key issues in the presence of employees' representatives.

3.2 Unitary board

The structure of boards of directors is different in the UK and many other English-speaking countries.

The main points to note are:

- Single board of directors ('unitary' board).
- Distinction between executive and non-executive directors. (Executive directors are often referred to as 'management'.)
- Oversights of management's actions are by non-executive directors and by subcommittees, e.g. audit committee, remuneration committee.

3.3 Non-executive directors

Non-executive directors are usually employed on a part-time basis and do not take part in the routine executive management of the company.

Their role is as follows:

- Participation at board meetings.
- To provide experience and business contacts which strengthen the board,
- Membership of sub-committees, e.g. audit committee, which should be by independent and knowledgeable non-executive directors.

Almost all listed companies in the UK and USA now have audit and remuneration committees as they are effectively a requirement of stock exchanges.

Advantages:

- Oversight of the whole board.
- Often act as a 'corporate conscience'.
- They bring external expertise to the company.

Disadvantages:

- They, and the sub-committees, may not be sufficiently well-informed or technically competent.
- They are subject to the accusation that they are staffed by an 'old boy' network and may fail to report significant problems and approve unjustified pay rises.

4. Corporate governance in action

4.1 Challenges for companies

We will now look at four aspects of corporate governance in action which are regarded as crucial if public companies are to be well run.

- Segregation between the roles of chairman and chief executive officer (CEO).
- Audit Committees; Other Committees, e.g. nominations and remuneration.
- Risk management.
- Internal audit, which will be discussed in Session 3 later.

4.2 Segregation of roles

Best practice and strongly recommended under corporate governance codes in many jurisdictions (e.g. the 'Combined Code' governing listed companies in the UK) is that the roles of:

- Chairman of the board and
- Chief executive officer.

should be held by different individuals.

<u>The chairman's role</u>

- Non executive.
- Ensures full information and full discussion at board meetings.
- Ensures satisfactory channels of communication with the external auditors.
- Runs the board of directors
- Ensures the effective operation of sub-committees of the board.

<u>The Chief executive's role</u>

- Ensures the effective operational functioning of the company.
- It is important that there is a distinction between the chief executive and chairman as effectively one person assuming both roles is a conflict of interests. The chief executive heads up the executive directors and the chairman heads up the non executives.
- Not only that, but having one person in both roles means there is a lot of power vested in that one person. They would be able to sway the decisions taken by the board. Those decisions may not be made in the best interests of the shareholders but in the best interests of the directors.

4.3 Audit Committees

An audit committee is a committee consisting of non-executive directors which is able to view a company's affairs in a detached and independent way and liaise effectively between the main board of directors and the external auditors

<u>Best practice (composition) for listed companies:</u>

- The company should have an audit committee of at least three non-executive directors (or, in the case of smaller companies, two).
- At least one member of the audit committee should have recent and relevant financial experience.

<u>The objectives of the audit committee</u>

- Increasing public confidence in the credibility and objectivity of published financial information.
- Assisting directors (particularly executive directors) in meeting their responsibilities in respect of financial reporting.

- Strengthening the independent position of a company's external auditor by providing an additional channel of communication.

The function of the audit committee

- Monitoring the integrity of the financial statements.
- Reviewing the company's internal financial controls.
- Monitoring and reviewing the effectiveness of the internal audit function.
- Making recommendations in relation to the appointment and removal of the external auditor and their remuneration.
- Reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process.
- Developing and implementing policy on the engagement of the external auditor to supply non-audit services.
- Reviewing arrangements for confidential reporting by employees and investigation of possible improprieties **('whistle blowing').**

Advantages

In addition to meeting the objectives stated above, audit committees have the following advantages.

- It may improve the quality of management accounting, as it is well placed to criticise internal functions.
- It should lead to better communication between the directors, external auditors and management.

Disadvantages

Audit committees may lead to:

- fear that their purpose is to catch management out
- non-executive directors being over-burdened with detail
- additional cost in terms, at least, of time involved.

The audit committee and internal audit

Best practice is that the audit committee should:

- ensure that the internal auditor has direct access to the board chairman and to the audit committee and is accountable to the audit committee.
- Review and assess the annual internal audit work plan.
- Receive periodic reports on the results of internal audit work.
- Review and monitor management's responsiveness to the internal auditor's findings and recommendations.
- Meet with the head of internal audit at least once a year without the presence of management.
- Monitor and assess the effectiveness of internal audit in the overall context of the company's risk management system.

4.4 Other committees

① <u>The nomination committee</u>

- The function of the nomination committee is to suggest suitable candidates for appointment to the board and other senior posts.
- The nomination committee should ensure that the best person is chosen for the job. If there was not such a committee in place and the decision was down to one person, an inappropriate appointment could be made. It could be just that the person is not the most suitable. However, it could be that appointment is made of someone who will back up the person making the appointment in board decisions and it could be a way of fixing board votes.

② <u>The remuneration committee</u>

The function of the remuneration committee is to determine fair rates of pay and other compensation - pension rights, share options etc - for management and other senior employees.

- The remuneration committee should ensure that directors are not paid excessive amounts.

Exam focus point **Corporate governance注意案例分析题** **Non-executive directors/ Audit Committee注意文字理论题**

5. Risk management

Risk Management Process

① Establish the context

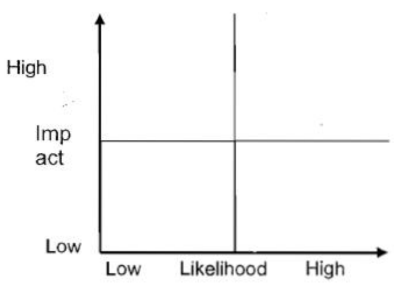
② Risk identification

③ Risk analysis:

consequences(impact) and likelihood

④ Risk Evaluation: is a prioritized list of risks

⑤ Risk treatment: TARA model



⑥ Monitoring and review

⑦ Communication and consultation

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

The two tier board

The unitary board

Audit Committee

Nomination committee

Remuneration committee

Risk management committee

Prioritize

TARA model

2. 必做习题

(1) Quiz:

Corporate governance: Quiz 1-5

(2) OT Revision Cases:

Corporate governance: Serena; Bluebird Enterprises

Chapter 3 Professional ethics and ACCA's Code of Ethics and Conduct

审计职业道德是指审计人员在从事审计工作时所遵循的行为规范，包括职业道德、职业纪律、专业胜任能力及职业责任等行为标准。通过学习本章节，你会了解到职业道德五项基本要求、影响审计师独立性的威胁以及应对措施、同时还需掌握利益冲突和保密性原则的相关内容。

Learning outcomes

- Define and apply the fundamental principles of professional ethics of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.
- Define and apply the conceptual framework, including the threats to the fundamental principles of self-interest, self-review, advocacy, familiarity, and intimidation.
- Discuss the safeguards to offset the threats to the fundamental principles.
- Describe the auditor's responsibility with regard to auditor independence, conflicts of interest and confidentiality.

1. Professional ethics

1.1 THE IFAC & ACCA CODES and the Conceptual Framework

IFAC has also issued a code of ethics, as has the ACCA.

Both the IFAC and ACCA codes have the same roots and are, to all intents and purposes identical.

Both follow a conceptual framework which identifies:

- Fundamental principles of ethical behaviour
- Potential threats to ethical behaviour
- Possible safeguards which can be implemented to counter the threats

1.2 Fundamental principles

- Integrity
- Objectivity
- Professional competence& Due care
- Confidentiality
- Professional behavior

The formal definitions of the fundamental principles are as follows:

- **Integrity:**

Members should be straightforward and honest in professional and business relationships.

- **Objectivity:**

Members should not allow bias, conflicts of interest or undue influence of others to override professional or business judgements.

- **Professional competence and due care:**

Members have a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. Members should act diligently and in accordance with applicable technical and professional standards when providing professional services.

- **Confidentiality:**

Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority or unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties.

- **Professional behaviour:**

Members should comply with relevant laws and regulations and should avoid any action that discredits the profession.

2. The threats of maintenance of objective & independence

Five potential threats:

- Self-interest
- Self-review
- Advocacy
- Familiarity
- Intimidation

2.1 Self-interest Threat

Financial or other interests of members or their close family. For example, if the auditor or a member of their family owns shares in a client they will want the client to do well in order for a dividend to be paid and for the share price to increase. Clearly the auditor cannot be objective in this situation. They will be reluctant to raise any issues that could adversely affect the performance of the client as this would result in personal financial loss.

- undue dependence on total fees from a client;
- loans or guarantees made to or from a client;
- close personal or business relationships with a client;
- audit team member negotiating employment with a client;
- financial interest in a client;
- gifts and hospitality; and
- concern over losing a client or employment security

A firm or audit team member must not accept gifts and hospitality from an audit client unless the value is trivial and inconsequential.

Examples:

(1) Breuger Co has offered the auditor an additional fee for issuing an unmodified audit opinion for the current reporting year.

(2) Douglas Lu, the auditor of Ayeland Bank, is also a customer of the bank. Ayeland Bank has offered Douglas Lu preferential rates on his loan and overdraft facilities.

(3) Tucker Chartered Accountants, a relatively new audit firm, is conducting the audit for Tubbletown Co. During a recent conversation, Tubbletown's CEO wished Tucker success in its future ventures and promised to take up the offer of non-audit services from Tucker if an unmodified audit opinion is issued on completion of the audit.

2.2 Self-review Threat

A self-review threat occurs when the auditor has to re-evaluate work completed by himself e.g. if the external auditor prepared the financial statements and then audited them, or if the external auditor advised on the implementation of the financial reporting system of the client.

- reporting on the operation of systems after being involved in their design or implementation;
- a member of an engagement team having previously been employed by the client in a position that directly influenced the subject matter (e.g. financial statements); and
- business decisions or data being reviewed and justified by the person responsible for making those decisions or preparing those data.

Examples:

(1) Dregger & Co, currently appointed as the auditor of Turnbally Co, was previously engaged by Turnbally Co to design and implement its digitalised financial control system.

(2) Mariana, the audit manager for the statutory audit of Ruger Co, was previously engaged as a non-executive director of Ruger and the chair of Ruger's audit committee.

2.3 Advocacy Threat

This may occur when the auditor is asked to promote the client's position or represent them in some way. In this situation the auditor would have to be biased in favour of the client and therefore cannot be objective. This could happen if the client asked the auditor to promote their shares for a stock exchange listing or if the client asked the auditor to represent them in court.

- promoting shares in an audit client;
- acting as an advocate on behalf of an audit client in litigation or disputes with third parties;

- commenting publicly on future events in particular circumstances, having made assertions without detailing the assumptions; and
- where information is incomplete or advocating an argument which is unlawful.

Examples:

(1) Pally & Co has been asked to make representations supporting its audit client, Baroo Co, in applying for loan facilities from a consortium of banks because Pally & Co had issued unmodified opinions on Baroo’s financial statements for a few years.

(2) Balsyer Co, impressed with the quality of work performed by TT Chartered Accountants on its statutory audit, has invited TT to be its reporting accountants for its upcoming initial public offering (IPO) and accompanying promotions to institutional investors.

2.4 Familiarity Threat

A familiarity threat occurs when the auditor is too sympathetic or trusting of the client because of a close relationship with them. This may be because a close friend or relative of the auditor works in a key financial role for the client. The auditor may trust their friend or relative to not make mistakes and therefore not review their work as thoroughly as they should and as a result allow material errors to go undetected in the financial statements.

- Over-familiarity (e.g. close or immediate family member) with management such that professional judgement could be compromised;
- Long association with business contacts influencing business decisions;
- Acceptance of gifts or preferential treatment, unless the value is insignificant; and
- A former partner of the audit firm becoming a director, officer or employee of a client in a position to exert direct influence over the financial statements (or other subject matter of the engagement).

Examples:

(1) The CEO of Rublus Co is also the wife of the engagement partner for the company’s statutory audit.

(2) Patrick, a former partner in Delim & Co has joined Pack Co as finance director. Patrick was the audit engagement partner of Pack Co in previous years and Delim & Co is still Pack Co’s auditor this year.

2.5 Intimidation Threat

An intimidation threat arises where the professional accountant may be deterred from acting objectively by actual or perceived pressures, including attempts to exercise undue influence over the accountant.

- the threat of dismissal (as an employee) or replacement (as an auditor), for example, over a disagreement about the application of an accounting principle;
- a dominant personality attempting to influence the presentation of financial information or controlling relations with auditors (e.g. their appointment);
- being threatened with litigation; and
- being pressurised to reduce necessary work to reduce costs or fees.

Examples:

(1) The finance director of Belmont Co has informed the auditor that the company might start looking for a new auditor in the event of an unfavourable audit opinion.

(2) Balsi Co’s management has informed the auditor, Truf & Co, that it would hold Truf & Co liable for any drop in share price if the audit opinion is unfavourable.

For audit clients that are public interest entities, the Code states that where total fees from the client (for the audit and any non-audit services) represent more than 15% of the firm's total fees for two consecutive years, the firm shall:

- Disclose this to those charged with governance
- Conduct a review, either by an external professional accountant or by a regulatory body. This review can be either before the audit opinion on the second year's financial statements is issued (a 'pre-issuance review'), or after it is issued (a 'post-issuance review').
- If total fees significantly exceed 15%, then a post-issuance review may not be sufficient, and a pre-issuance review will be required

3. Possible safeguards

3.1 Specific safeguards

- **Segregation of duties** - may be necessary if:

✓ The firm is acting for .a number of clients with conflicting interests. Different teams would normally be assigned to individual clients

✓ The firm is carrying out non-audit services as well as audit services for the same client. Again a different team would be used for, e.g. payroll work

✓ Where there are movements of personnel between the audit firm and the client, e.g. if someone from the firm is going to join an audit client, they should be moved off the audit immediately.

- **Review** - the consideration of one person's work by someone else. In particular the use of 'hot reviews' by a second partner before the audit report is signed as a check on the appropriateness of the firm's opinion.
- **Rotation** - changing the staffing arrangements for audit assignments on a periodic basis especially, as a safeguard against the familiarity threat. In the UK, for listed companies the audit engagement partner must rotate every five years and for private companies it is recommended that they rotate every seven years.
- **Ceasing to act** - if it is impossible to use other safeguards, the firm should resign or not accept the appointment.

3.2 Other issues

- **Slow-balling**

Firms may be tempted to quote a very low audit fee in order to win a new client. They would then seek to make their money back by either raising future fees, or by doing lucrative other services for the client.

There is no outright ban on this process, but it is dangerous.

- **Opinion Shopping**

Whilst shareholders appoint auditors, the Directors typically seek out a potential firm for the shareholders to vote on. The Board might be tempted to interview several firm until it found one that accepted its accounting methods.
Any firm of auditors should not accept such nomination.

3.3 Confidentiality

General rule: client's affairs should not be disclosed to third parties without the **client's consent** or used by the accountant for his personal benefit.
A public accountant shall treat as confidential any information about a client's business affairs acquired in the course of professional work and will neither use, or appear to use that information for his personal advantage or the advantage of a third party.
A Public accountant may disclose or produce such information, documents or records without the consent of his client:

- in accordance with the law
- upon the lawful order of a competent authority
- upon the order of the Board or Inquiry Committee

Rules of Professional Conduct:
If a member acquires knowledge indicating that a client may have been guilty of some default or unlawful act, he should normally raise the matter with the management;
If not satisfactory, he should consider reporting the matter to non-executive directors or to the client's audit committee;
If this is not possible or fails to resolve the matter he may with to consider making a report to a third party after seek the legal advice.
Disclosure to third party:

- **Obligation:**

  Terrorist offences or **drug trafficker** or compulsion by **court order, money laundering.** In addition, auditors must make disclosure if compelled by the process of law, for example under a court order or summons, under which they are obliged to disclose information.

- **Voluntary:**

Four areas below:
① Public interest – An auditor may disclose information which would otherwise be confidential if disclosure can be justified in the 'public interest'. This would be perhaps if those charged with governance are involved in fraudulent activities;
② Protect a member's interest – Members/auditors may disclose information to

defend themselves against a negligence action, disciplinary proceedings or if suing for unpaid fees;

③ Authorised by statute/laws – There are cases of express statutory provision where disclosure of information to a proper authority overrides the duty of confidentiality;

④ Non-governmental bodies – Auditors may be approached by non-governmental bodies seeking information concerning suspected acts of misconduct not amounting to a crime or civil wrong. Disclosure should only be made to those bodies with statutory powers to compel disclosure.

3.4 Conflicts of Interest

Members should place their clients' interests before their own and should not accept or continue engagements which threaten to give rise to conflicts of interest between the firm and the client

<u>The steps to be taken by the auditor are:</u>

- Both the client and its competitor should be notified
- Advising one or both clients to seek additional independent advice.
- The use of separate engagement teams ('Chinese wall')
- Procedures to prevent access to information, for example, strict physical separation of both teams, confidential and secure data filing.
- Clear guidelines for members of each engagement team on issues of security and confidentiality. (audit engagement letters)
- Potentially the use of confidentiality agreements signed by employees and partners of the firm.
- Regular monitoring of the application of the above safeguards by a senior individual in Piano & Co not involved in either audit.

Exam focus point
Fundamental principles 注意文字理论题
Threats to independence + safeguard 注意案例分析题
Confidentiality/Conflicts of Interest 注意文字理论题

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Integrity

Objectivity

Professional competence& Due care

Confidentiality

Professional behavior

Self-interest

Self-review

Advocacy

Familiarity

Intimidation

Rotation

Confidentiality

Conflicts of Interest

2. 必做习题

(1) Quiz:

Professional ethics: Quiz 1-5

(2) OT Revision Cases:

Professional ethics: LV Fones; Willow Co; Horti & Co; Stark Co

Chapter 4 Internal Audit

内部审计是"外部审计"的对称。由部门、单位内部专职审计人员进行的审计。目的在于帮助部门、单位的管理人员实行最有效的管理。内部审计，是一种独立、客观的确认和咨询活动，它通过运用系统、规范的方法，审查和评价组织的业务活动、内部控制和风险管理的适当性和有效性，以促进组织完善治理、增加价值和实现目标。通过学习本章节，你会了解到建立内部审计的影响因素、局限性、内审外包的优缺点、内审的智能以及内部审计报告的相关内容。

Learning outcomes

- Discuss the scope of internal audit and the limitations of the internal audit function.
- Explain outsourcing and the associated advantages and disadvantages of outsourcing the internal audit function.
- Discuss the nature and purpose of internal audit assignments including value for money, IT, financial, regulatory compliance, fraud investigations and customer experience.
- Discuss the nature and purpose of operational internal audit assignments.

1. Introduction

1.1 IIA (Institute of Internal Auditors) definition

- Independent, objective assurance and consulting activity
- Designed to add value and improve an organization's operations
- Helps an organization accomplish its objectives
- Brings a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

1.2 The need for internal audit, therefore will depend on:

- scale, diversity and complexity of activities
- number of employees
- cost/benefit considerations
- the desire of senior management to have assurance and advice on risk and control.

➢ In a **large, public company, therefore there is** a need for internal audit.

➢ In a **small, owner managed business** there is unlikely to be a need for internal audit because the owners are able to exercise more direct control over operations, and are accountable to fewer stakeholders

2. Limitations of the internal audit

- **Lack of independence** - can internal audit be truly independent of the organization of which it is a part?
- **Variation of standards** - not uniform across the profession. Compare this with external auditors who, on a global basis, have ISAs against which their performance can be measured.
- **Expectations gap** - problem of what the internal auditor's role is perceived to be.
- **Understanding of internal audit - negative view by some.** Perhaps seen as 'checking up' on other employees on behalf of 'the bosses'.

3. Consideration of outsourcing the internal audit

3.1 Advantages

- Greater focus on cost and efficiency of the internal audit function.
- Staff may be drawn from a broader range of expertise.
- Risk of staff turnover is passed to the outsourcing firm.
- Specialist skills may be more readily available.
- Costs of employing permanent staff are avoided.
- May improve independence.
- Access to new market place technologies, e.g. audit methodology software without associated costs.
- Reduced management time in administering an in-house department.

3.2 Disadvantages

- Possible conflict of interest if provided by the external auditors (In some jurisdictions - e.g. the UK, the ethics rules specifically prohibit the external auditors from providing internal audit services).
- Pressure on the independence of the outsourced function due to, e.g. threat by management not to renew contract.
- Risk of lack of knowledge and understanding of the organization's objectives, culture or business.
- The decision may be based on cost with the effectiveness of the function being reduced.
- Flexibility and availability may not be as high as with an in-house function.
- Lack of control over standard of service.
- Risk of blurring of roles between internal and external audit, losing credibility for both.

4. Internal audit assignments

4.1 Financial internal audits

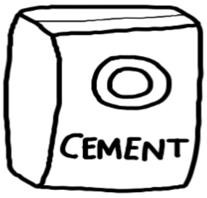
Financial auditing was traditionally the main area of work for the internal audit department. It embraces

- the conventional tasks of examining records and evidence to support financial and management reporting in order to detect errors and prevent fraud
- analysing information, identifying trends and potentially significant variations from the norm.

4.2 Operational internal audit

We will now look at operational internal audit in practice, considering four of the main areas where such an approach is commonly used

- Procurement
- Marketing
- Treasury
- human resources.



4.3 Regulatory compliance

The IAD could help to monitor compliance with regulations**.**

4.4 Value for money audits

Value for money (VFM) is concerned with obtaining the best possible combination of services for the least resources, it is therefore the pursuit of 'Economy', 'Efficiency' and 'Effectiveness'- often referred to as the 3Es.

- Economy – Keeping the cost of resources used to a minimum.
- Efficiency – The relationship between the output from goods and services and the resources used to produce them.
- Effectiveness – How well the organisation's objectives have been achieved.

4.5 Audits of Information technology

Information technology audits review and report on all aspects of systems including hardware, applications, controls and systems development.

We do this mainly from the external auditor's point of view, which is to ascertain whether or not the company's systems provide a reliable basis for the Preparation of financial statements, and whether there are internal controls - mechanisms built into the systems - which are effective in reducing the risk of misstatement.

The internal audit approach to IT will cover this entire but with some additional objectives.

- Does the system represent value for money/best value?
- Were the controls over awarding contracts for IT installations effective?

4.6 Monitoring asset levels

The IAD could undertake physical verification of property, plant and equipment (PPE) . There is likely to be a significant level of PPE and the asset register must be kept up to date to ensure continuous production. If significant negative differences occur, this may be due to theft or fraud.

4.7 Cash controls

Some employees are paid in cash rather than bank transfer, therefore on a weekly basis cash held is likely to be significant, therefore the cash controls in payroll should be tested to reduce the level of errors.

4.8 Fraud investigations

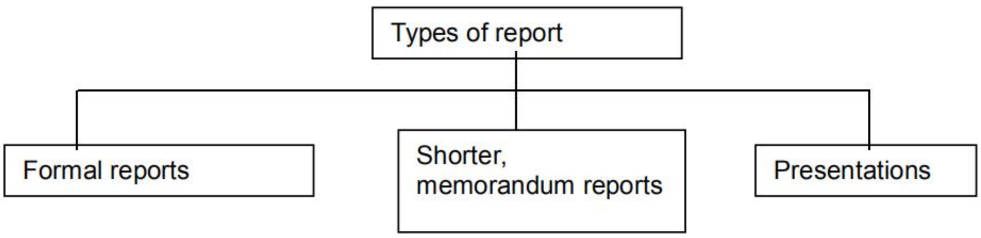
The IAD can be asked to investigate any specific cases of suspected fraud as well as review the controls in place to prevent/detect fraud.

5. Internal audit reporting

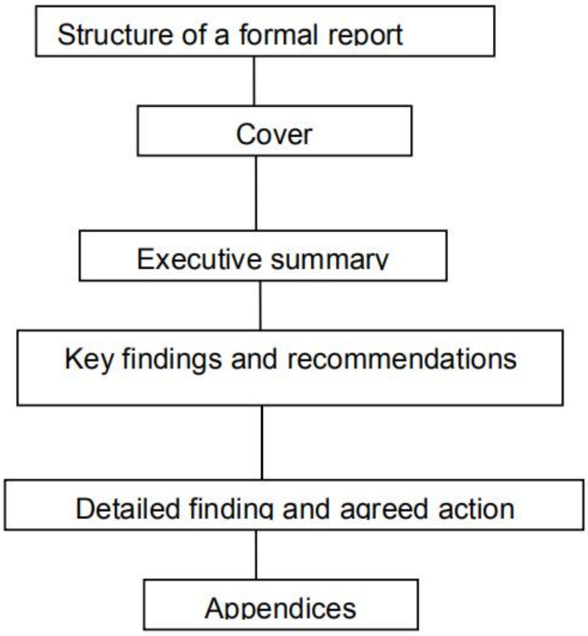
5.1 Key principles

- Who is the report for?
- Consider the purpose and structure of the report
- Keep short and sweet
- Include Measurable/quantifiable outcomes
- Fairness

5.2 Types of report provided in internal audit assignments



5.3 Structure of a formal report



Exam focus point **THE NEED FOR INTERNAL AUDIT/ LIMITATIONS OF THE INTERNAL AUDIT/ CONSIDERATION OF OUTSOURCING THE INTERNAL AUDIT/ INTERNAL AUDIT ASSIGNMENTS以上内容注意文字题。**

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

IIA (Institute of Internal Auditors)

Expectations gap

Procurement

Marketing

Treasury

human resources

Economy

Efficiency

Effectiveness

2. 必做习题

(1) Quiz:

Internal Audit: Quiz 1-5

(2) OT Revision Cases:

Internal Audit: Bush-Baby Hotels Co

Part B Planning and risk assessment

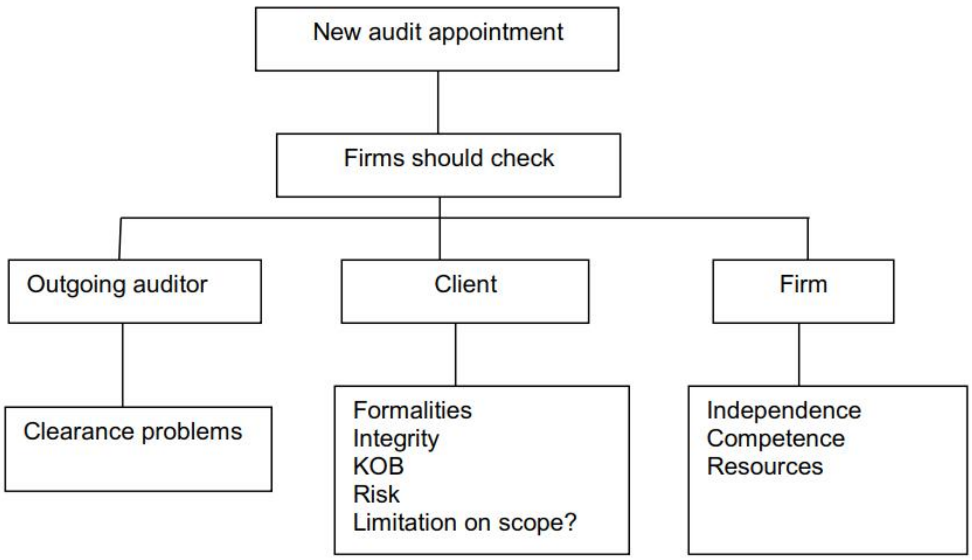
Chapter 5 obtaining and accepting audit engagements

审计业务约定书是会计师事务所与委托人共同签订的，据以确认审计业务的委托与受托关系，明确委托目的、审计范围及双方责任与义务等事项的书面合约，具有法定约束力。通过学习本章节，你会了解到业务约定书的内容和目的等相关内容。

Learning outcomes

- Explain the preconditions for an audit.
- Explain the process by which an auditor obtains an audit engagement.
- Discuss the importance and purpose of engagement letters and their contents.

1. Client Screening



2. The engagement letter

ISA210 -Terms of audit engagements

The engagement letter is designed to:

- provide written confirmation of the auditors' acceptance of the appointment
- help reduce misunderstanding

Engagement letters are tailored to meet the needs of each engagement. However they generally cover:

- objective of the audit
- Management's responsibility for the financial statements
- The scope of the audit including reference to legislation and professional standards
- A description of audit procedures including their inherent limitations
- The form of reports to be issued
- Use of the work of internal audit
- Risk assessment matters
- The auditor's use of specialists
- Deadlines
- Access to information
- Communications between the auditor and the client
- A reference to other services
- The basis of fees
- Complaints procedures and jurisdiction
- The need for co-operation and agreement of terms.

The letter is addressed to the Board of Directors and must be signed by a senior official to show that the terms have been accepted.

Engagement letters remain in force form one year to the next although should be reviewed annually to ensure the terms they outline are still valid. A new letter <u>may</u> be sent every year to emphasize its importance to clients.

A new letter <u>must</u> sent if if there has been a change in:

- legal or professional requirements
- statutory duties
- Professional duties

Exam focus point
Client Screening和Engagement letters 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

Client Screening

Engagement letters

KOB

Inherent limitations

2. 必做习题

(1) Quiz:

Auditor Appointment: Quiz 1-5

Chapter 6 Assessing audit risks

审计计划是注册会计师为了完成各项审计业务、达到预期的审计目标，在具体执行审计程序之前编制的工作计划。通过学习本章节，你会了解到审计战略和审计计划的区别、审计计划的重要性、审计计划的流程以及审计风险等相关概念。

Learning outcomes

- Explain the components of audit risk.
- Describe the audit risks in the financial statements.
- Explain the auditor's response to each risk.
- Define and explain the concepts of materiality and performance materiality.
- Explain and calculate materiality levels from financial information.

1. Audit strategies and the plan

Overall, the auditor should formulate an overall audit strategy which is translated into detailed audit plan for audit staff to follow.

1.1 Audit strategy

the formulation of the general strategy for the audit, which includes:

- sets the **direction** for the audit
- describes the expected **scope and conduct** of the audit
- provides **guidance** for the development of the audit plan

1.2 Audit plan

sets out the **nature, timing** and **extent** of planned audit procedures which are required to **implement the overall audit strategy,** serves as a set of instructions to assistants involved in the audit and as a means to control the proper execution of the work.

2. The importance of audit planning

The purpose of planning is to ensure that the risk that the F/S may be misstated is reduced to an acceptable level. Therefore, the auditor should plan the audit work so that the engagement will be performed in an effective manner.

2.1 The importance of audit planning is required for the following reasons:

- To develop a general strategy and detailed approach for the specific nature, timing and extent of the audit work, which will help to ensure that the audit is carried out in an efficient and timely manner.
- Attention is devoted to the important areas. Audit planning will also help to identify problem areas so they can be addressed in a timely fashion.

- To determine the amount of work to be carried out and therefore assist in determining the number of staff required to perform the audit work.
- To provide a document as a reference for an initial discussion of the approach to the audit with the company's audit committee. The plan will also help ensure that audit work is coordinated with client staff, Eg. For production of specific documentation to assist the auditor.
- To act as a basis for the production of the audit program.

2.2 Matters to be considered

- the auditor's knowledge of the business
- understanding the accounting and internal control systems
- risk and materiality
- the nature, timing and extent of procedures
- co-ordination, direction, supervision and review

3. The planning process

3.1 Planning is essentially a four-stage process

Stage One: Obtaining or updating. **Knowledge of the business (KOB)**

Stage Two: Preparing the detailed audit approach

Stage Three: Making administrative decision e.g. staffing and budgets

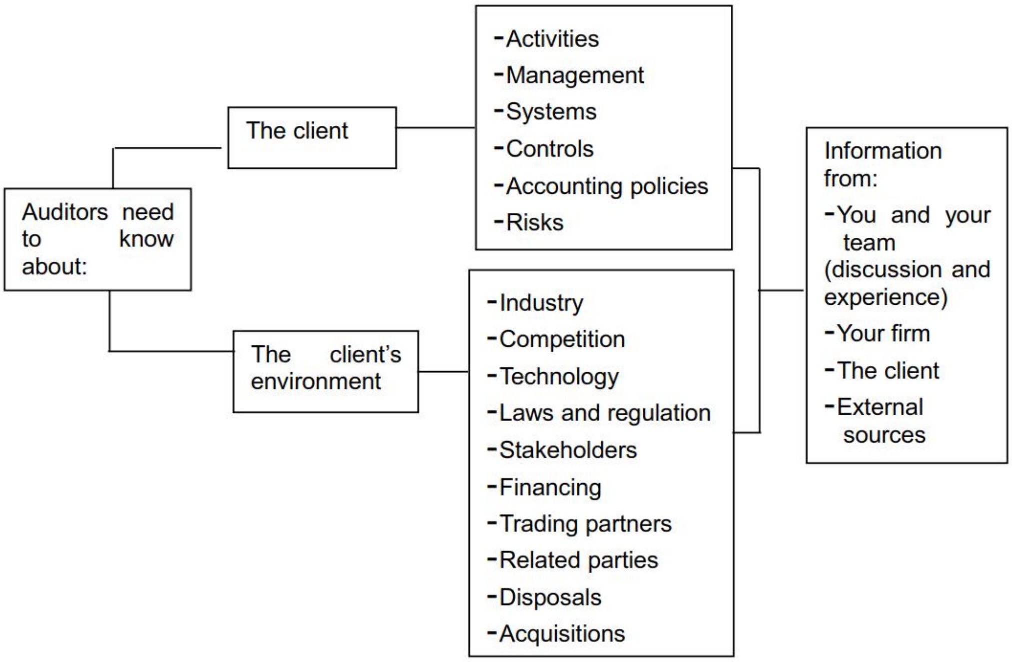
Stage Four: Preparing planning documentation

Stage One: Obtaining or updating Knowledge of the business (KOB)

The auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor's judgment, may have a significant effect on the financial statements or on the examination or audit report.

3.2 Stage One: Understanding the entity and its environment

ISA 315 "Understanding the entity and its environment and assessing the risks of material misstatement" states that the auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and sufficient to design and perform further audit procedures.



3.3 Stage Two: Preparing the detailed audit approach

In preparing the detailed audit approach the following issues need to be considered:

- accounting and control systems (this will be covered in later sessions)
- risk
- materiality (session 1)
- nature, timing and extent of procedure

Audit risk

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

AUDIT RISK=INHERENT RISK * CONTROL RISK * DETECTION RISK

Inherent risk

This is the susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

Control risk

This is the risk that a misstatement could occur in an assertion about a class of transaction, account balance or disclosure, and that the misstatement could be material, either individually or when aggregated with other misstatements, and will not be prevented or detected and corrected, on a timely basis, by the entity's internal control.

Detection risk

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

The interrelationship of the three components of audit risk is outside the scope of this current article. Paper F8 students, however, will typically be expected to have a good understanding of the concept of audit risk, and to be able to apply this understanding to questions in order to identify and describe appropriate risk assessment procedures.

Control environment

It refers to management's awareness, attitude and action (3As) towards risk, the company's organizational structure, the existence of a budgetary system and the existence of an internal audit department would also be factors relevant the a consideration of the control environment.

Control procedures (PAPAMOSS)

The auditor will also consider the control procedures which are specific procedures established in the internal control system to prevent and detect errors and misstatements in the financial statements. There are the following control procedures:

1) Physical:
   - custody of assets
   - restricted access to authorized personnel
   - important for valuable, portable and exchangeable assets
2) Authorization and approval:
   - appropriate responsible person
   - authorized limit must be specified
3) Personnel:
   - capabilities commensurate with responsibilities
   - qualification, selection and continuous training are important features
4) Arithmetical and accounting:
   - all recorded transactions should be authorized
   - correct and accurate processing
   - checks include checking of totals, reconciliation control totals and trial balance

5) Management:
- review of management accounts and comparison with budgets
- internal audit function should exist

6) Organization:
- organization plan clearly defined
- identification of lines of reporting and controls

7) Supervision: day to day transactions supervised by responsible officer

8) Segregation of duties:

authorization
execution
custody
recording

functions must be separated and performed by different individuals

Nature, timing and extent of procedures

If, following their preliminary assessment of control risk, the auditors decide to place some reliance on the client's internal control system they will have to conduct a series of tests of controls (or compliance tests.)

Tests of controls are designed to check that the control systems actually exist and have operated effectively throughout the period. If the tests are successful the auditors will be able to reduce the number of substantive tests carried out. Substantive tests are designed to detect material misstatements in the financial statements.

Using a combination of tests of controls and, substantive tests increases the efficiency of the audit because tests of controls are quicker and therefore cheaper than substantive testing.

The auditors may decide not to place any reliance on the internal control system for a number of reasons including:

- The company is small and, as a result, unlikely to have effective controls
- It is apparent from the understanding of the accounting and control system that controls are inadequate
- Previous years' auditing have revealed inadequate controls

In this instance, the auditors will only carry out substantive testing.

3.4 Stage Three: Making administrative decisions

Once the detailed audit approach has been determined a number of administrative matters must be dealt with to help ensure the smooth running of the audit. These include:

- preparing a detailed time budget
- booking audit staff
- allocating audit work between the interim and final audit
- agreeing with management
  - — timing of the inventory count
  - — deadlines for preparation of the trial balance and final accounts
- arranging for client staff to prepare certain summaries and. analysis
- organizing the use of experts where necessary

3.5 Stage four: Preparing planning documentation

There are essentially two forms of planning documentation:

-Overall audit plan

-Individual audit programs

An audit plan is the formulation of the general strategy for the audit, which sets the direction for the audit, describes the expected scope and conduct of the audit and provides guidance for the development of the audit program.

An audit plan typically contains:

- knowledge of the business
- preliminary analytical review
- risk assessment
- materiality
- audit approach
- independence
- budget and staffing
- timetable and deadlines

An audit program is a set of instruction to the audit team that sets out the audit procedures the auditors intend to adopt and may include references to other matters such as the audit objectives, timing, sample size and the basis of selection for each area. It also serves as a means to control and record the proper execution of the work.

The overall audit plan and the audit program should be revised as necessary during the course of the audit.

Exam focus point
Audit strategy VS audit plan/The importance of audit planning 文字理论题
Audit risk掌握定义，案例分析题必考
Control environment/Control procedures 文字理论题

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Audit strategy

audit plan

Knowledge of the business (KOB)

Audit risk

Inherent risk

Control risk

Detection risk

Control environment

3A: Awareness, attitude and action

Control procedures

PAPAMOSS:

Physical

Authorization and approval

Personnel

Arithmetical and accounting

Management

Organization

Supervision

Segregation of duties

2. 必做习题

(1) Quiz:

- Audit Planning: Quiz 1-5
- Identifying and Assessing Risk: Quiz 1-5
- Audit Materiality: Quiz 1-5

(2) Constructed Response Revision Questions:

Audit Planning and Risk Assessment:

- Sycamore Science
- Hurling Co
- Prancer Construction
- Darjeeling Co
- Peony Co
- Harlem Co
- Scarlet Co
- Hart Co

Chapter 7 Fraud, laws and regulations

审计法律规范是由国家制定或认可的，由国家强制力保证实施的调整各种审计监督关系的行为规则. 通过学习本章节，你会了解到三个国际审计准则：欺诈舞弊、错报以及审计财务报表法律法规等相关内容。

Learning outcomes

- Discuss the effect of fraud and misstatements on the audit strategy and extent of audit work.
- Discuss the responsibilities of internal and external auditors for the prevention and detection of fraud and error.
- Explain the auditor's responsibility to consider laws and regulations.

1. Fraud and error (ISA 240(R))

In order to maintain confidence in the profession it is important for the auditors and the directors to understand their role in the prevention and detection of fraud.

ISA240 (R)The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statement gives the definition

1.1 Definitions

Fraud -'An intentional act ' act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage

Error - 'An unintentional mistakes 'and could include accidental misapplication of accounting policies, oversights or misinterpretation of the facts.

1.2 Types of fraud

There are two types of fraud:

- Fraudulent financial reporting - deliberately misstating the accounts to make the company look better/worse than it actually is
- Misappropriation of assets - the theft of the company's assets such as cash or inventory.

1.3 Management Responsibilities

- **Primary** responsibility for **prevention** AND **detection** of fraud and error lies with management and those charged with governance.
- Through safeguarding the company's assets and implementing and operating an adequate accounting and internal control system.
- The directors should be aware of the potential for fraud and this should

feature as an element of the risk assessment and corporate governance procedures.

- The audit committee should review these procedures to ensure that they are in place and working effectively. This will normally be done in conjunction with the internal auditors

1.4 Internal auditor responsibilities

- To assess the likelihood of fraud, or if a fraud has been discovered,
- To assess its consequences and
- To make recommendations for prevention in the future.

1.5 External auditor responsibilities

- ISA240 (redrafted) makes it clear who has the main responsibility for the prevention and detection of fraud:' The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management'
- ISA240 (redrafted) also goes on to state, however, that:' An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the F/S as a whole are free from material misstatement, whether caused by fraud or error'.
- Hence, both the entity itself and the auditors have responsibilities for fraud and error.
- **Primary** responsibility for **prevention** AND **detection** of fraud and error lies with management and those charged with governance and the auditor has a **secondary responsibility.**
- ISA240 (redrafted) further requires that:' the auditor is responsible for maintaining an attitude of **professional skepticism** throughout the audit.'
- By definition then, the external auditor is responsible for detecting any material fraud that may have occurred as this will lead to a material misstatement.
- However, they have no specific responsibility with regard to immaterial fraud. As with immaterial errors, if they identify them they will be reported to those charged with governance, but there is no duty to identify them.
- In order to have a chance of detecting fraud the auditor must maintain an attitude of professional skepticism when performing their work which involves keeping an open mind to the possibility of fraud occurring.
- If their work confirms that, or is unable to conclude whether, the F/S are materially misstated as a result of fraud, the auditors need to consider the implications for their audit.

1.6 Reporting of fraud

The external auditors needs to careful of their duty of confidentiality to their client, therefore before reporting to any external party, it is advisable to seek **legal advice** unless there is a legal requirement to report.

If fraud is identified the auditor should report it to:

- The audit committee, if one exists, or
- To the highest level of management, or
- The shareholders if the fraud is being committed by the highest level of management and no audit committee is in place.

Consider the implication of the Audit report

A modified audit opinion will be given if the external auditors:

- Conclude that a suspected or actual fraud or error has a material effect on the financial statements and they disagree with the accounting treatment or with the extent or lack of disclosure in the financial statements
- Are unable to determine whether a fraud or error has occurred due to a limitation in the scope of their work

To third parties

- In certain exceptional circumstances external auditors are not bound by their duty of confidentiality and have the right or duty to report matters to a proper authority e.g. Minister of Finance. External auditors need to use their professional judgment to determine whether their misgivings justify them in carrying the matter further or are too insubstantial to deserve reporting. They would normally take legal advice before making a disclosure.

Withdrawal from the engagement

The external auditor may conclude, having taken legal advice, that withdrawal from the engagement is necessary when the entity does not take the remedial action regarding fraud that the external auditor considers necessary in the circumstances.

2.Misstatement

2.1 ISA 450 *Evaluation of Misstatements Identified During the Audit* considers what a misstatement is and deals with the auditor's responsibility in relation to misstatements.

It identifies a misstatement as being: A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

It also then defines uncorrected misstatements as: Misstatements that the auditor has accumulated during the audit and that have not been corrected.

2.2 There are three categories of misstatements:

(i)Factual misstatements are misstatements about which there is no doubt.

(ii)Judgemental misstatements are differences arising from the judgements of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate.

(iii)Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.

2.3 The auditor has a responsibility to accumulate misstatements which arise over the course of the audit unless they are very small amounts.

Identified misstatements should be considered during the course of the audit to assess whether the audit strategy and plan should be revised.

The auditor should determine whether uncorrected misstatements are material in aggregate or individually.

All misstatements should be communicated to those charged with governance on a timely basis and request that they make necessary amendments. If this request is refused then the auditor should consider the potential impact on their audit report.

A written representation should be requested from management to confirm that unadjusted misstatements are immaterial.

3. ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements

Under ***ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements***, management have a responsibility to ensure that the operations of the company are conducted in accordance with the provisions of laws and regulations. This includes compliance with laws and regulations that determine amounts and disclosures in financial statements, including tax liabilities and charges.

Auditors are not responsible for preventing non-compliance with laws and regulations, and cannot be expected to detect non-compliance with all laws and regulations. They have a responsibility to obtain reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

EA responsibility differs in relation to the two different categories of laws and regulations identified below:

– Laws and regulations which have a **DIRECT** effect on the determination of material amounts and disclosures in financial statements. Here the auditor is responsible for obtaining sufficient appropriate audit evidence regarding compliance.

– Laws and regulations which **DO NOT HAVE A DIRECT EFFECT** on the determination of material amounts and disclosures in financial statements, but may impact the entity's ability to continue to trade. Here the auditor's responsibility is limited to specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements. This includes inquiring with management whether the entity is in compliance with such laws and regulations, and inspecting correspondence with relevant licensing or regulatory authorities.

EA also has a responsibility to remain alert, by maintaining **professional scepticism**, to the possibility that other audit procedures may bring instances of identified or suspected non-compliance with laws and regulations.

Exam focus point **ISA240 (R) The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statement gives the definition/ ISA 450 Evaluation of Misstatements Identified During the Audit/ ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements 注意选择题和文字题。**

以下内容可以帮助你进行本章复习及自测

1. 重点词汇

Fraud

Error

Misstatement

Laws and Regulations

Factual misstatements

Judgemental misstatements

Projected misstatements

2. 必做习题

(1) Quiz:

Fraud, Law and Regulations: Quiz 1-5