SAICA FREQUENTLY ASKED QUESTIONS

Application of the requirements of the International Standards on Auditing in relation to matters arising from monitoring findings and other in-practice challenges

Please note:

- Every effort has been made to ensure that the information in this document is complete and accurate. Nevertheless, information is given purely as guidance with respect to the subject matter and SAICA will have no responsibility to any person for any claim of any nature whatsoever which may arise out of or related to the contents of this document.

- The information provided in this document does not constitute legal advice and should be read in that context.

- Where the document suggests a particular view, such a view is based on SAICA's interpretation at that point in time, of the relevant laws, regulations, standards, codes and related pronouncements. Although SAICA has consulted with the Independent Regulatory Board for Auditors (IRBA) and the Assurance Guidance Committee (AGC) of SAICA, it is possible that a different view may ultimately be followed in practice.

- This document has not been subject to any formal process of the IRBA or SAICA and merely outlines the outcome of the engagements between the IRBA and the AGC.

- This is a live document that is subject to change and is non-authoritative.

- This document does not impose requirements on auditors beyond those included in the International Standards on Auditing (ISAs) and does not change the auditor's responsibility to comply with all ISAs relevant to the audit and with each requirement of an ISA (unless, in the circumstances of the audit, an entire ISA is not relevant, or a requirement is not relevant because it is conditional and the condition concerned does not exist)..

- Although specific references to the ISAs have been included in this document, the auditor is still required to have an understanding of the entire text of the ISAs to assess whether or not any particular FAQ is relevant to an engagement, and if so, to enable the auditor to apply all the requirements of the particular ISAs properly.

- The concepts of professional scepticism and professional judgement should be applied in all the scenarios described in the FAQs. The different approaches presented are not necessarily the only acceptable approaches. The auditor must obtain sufficient appropriate audit evidence in the circumstances of a particular audit in accordance with the requirements of the ISAs relevant to the audit.

- The auditor is required to prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's conclusions and report, and evidence that the audit was planned and performed in accordance with the ISAs and applicable legal and regulatory requirements. Auditors are alerted to pay specific attention to the documentation requirements in accordance with ISA 230, *Audit documentation*, and all other ISAs relevant to the audit.

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1. Risk assessment at assertion level

When identifying and assessing risks of material misstatement at the assertion level, is the auditor required to perform the risk assessment per individual assertion for classes of transactions, account balances and disclosures?

Further context to the problem / challenge / uncertainty

There is uncertainty whether the assessment of risks of material misstatement 'at the assertion level' means that the assessment has to be performed per individual assertion for classes of transactions, account balances and disclosures. Monitoring findings have also indicated instances where this was not done.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- ISA 315 (Revised), Para. 25, A122 – A131

Application of the requirements of the ISAs

ISA 315 (Revised).25 requires the auditor to identify and assess the risks of material misstatement at:

(a) The financial statement level; and (Ref: Para. A122 – A125)
(b) The assertion level for classes of transactions, account balances, and disclosures, (Ref: Para. A126 – A131)

to provide a basis for designing and performing further audit procedures.

Although ISA 315 (Revised).25 only makes reference to the "assertion level" in general, the application and other explanatory material contained in ISA 315 (Revised).A128 provides clarity in stating that all aspects contained in ISA 315 (Revised).A129 (a) – (b), being the individual assertions, must be covered, as follows:

"The auditor may use the assertions as described in paragraph A129 (a) – (b) below or may express them differently provided all aspects described below have been covered. For example, the auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances and related disclosures."

Conclusion

When identifying and assessing risks of material misstatement at assertion level each individual assertion must be considered. The assertions applied by the auditor may be those contained in ISA

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315 (Revised).A129 (a) – (b) or other assertions in accordance with the firm's audit methodology, provided that all the aspects contained in ISA 315 (Revised) are covered.

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2. The presumption of risks of fraud in revenue recognition

When identifying and assessing risks of material misstatement due to fraud in revenue recognition, does the significant risk presumption in terms of ISA 240.26 relate to all assertions and what are the implications for the auditor's documentation if the presumption is to be rebutted in the circumstances of a particular engagement?

Further context to the problem / challenge / uncertainty

Revenue for an entity may include different types of revenue or revenue transactions, and there are individual assertions that underlie each of these types of revenue or revenue transactions.

There is uncertainty whether the practitioner, having identified and assessed risks of material misstatement of revenue, can conclude that the significant risk presumption is not applicable for a type of revenue or class of revenue transactions as a whole. Furthermore, considering individual assertions for a particular type of revenue or class of revenue transactions, there is uncertainty whether the documentation requirement relating to the rebuttal of the significant risk presumption applies to each individual assertion.

Monitoring findings have indicated instances where practitioners do not properly document the reasons for their assessment of risks of material misstatement due to fraud at the assertion level, including the rebuttal of the significant risk presumption.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- ISA 230, Para. 8
- ISA 240, Para. 25
- ISA 240, Para. 26, A28 – A30
- ISA 240, Para. 47
- ISA 315 (Revised), Para. 25, A122 – A131

Application of the requirements of the ISAs

ISA 240.25 requires the auditor, inter alia, in accordance with ISA 315 (Revised), to identify and assess the risks of material misstatement due to fraud at the assertion level for classes of transactions, account balances and disclosures. Based on FAQ 1 in this document, it is concluded that this risk assessment must be performed per assertion.

In relation to revenue recognition, ISA 240.26 continues to require the following: "When identifying and assessing the risks of material misstatements due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks."

Therefore, the auditor would in the normal course of identifying and assessing risks of material misstatement in accordance with the requirements of ISA 315 (Revised) and ISA 240 take cognisance of the presumption in ISA 240.26 and evaluate which types of revenue, revenue transactions or assertions give rise to risks of fraud and, therefore, represent significant risks.

ISA 240.A28 states that material misstatements due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenue, but may also result from an understatement of revenue. Overstatement could relate to all assertions relating to particular revenue transactions, excluding completeness and understatement could relate to all assertions relating to particular revenue transactions, excluding occurrence. Therefore the risk of fraud could relate to one, some or all assertions pertaining to certain types of revenue or revenue transactions.

By way of illustration, the auditor may have identified risk factors relating to a motivation for management to overstate a certain type of revenue linked to profit targets and performance measurement applicable to management. The auditor has determined that there are risks relating to fictitious transactions and pre-invoicing. In these circumstances the auditor, in accordance with ISA 240.26, evaluates that the occurrence assertion and cut-off assertion give rise to risks of material misstatement due to fraud and are therefore significant risks. Therefore, for this type of revenue (revenue stream) at the specific client, the significant risk presumption has not been rebutted, since it applies to the occurrence and cut-off assertions. Had no assertions been identified as significant risks, the auditor would be required to rebut the presumption for the particular type of revenue (revenue stream).

To further clarify the illustration above, the auditor is required to pay particular attention to the following matters relating to the application of the requirements of the ISAs in the circumstances:

- For the type of revenue (revenue stream) in this scenario, the auditor is required to perform an assessment of risks of material misstatement at the assertion level for each individual assertion (as would normally be the case – also refer to FAQ 1 in this document). Referring to the assertions in ISA 315 (Revised).A129(a), the risk assessment will relate to, *and will be documented* for the following assertions: Occurrence, completeness, accuracy, cut-off, classification and presentation.
- In the normal course of performing the risk assessment, the auditor has identified risk factors that give rise to risks of material misstatement due to fraud in relation to the occurrence and cut-off assertions and, therefore, these two assertions have also specifically been identified and assessed as significant risks (*the identification and assessment of which are clearly indicated and documented as part of the risk assessment*).

- ISA 230.8(c) requires the preparation of audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit to understand, amongst other things, the significant professional judgements made in reaching conclusions. The auditor's judgements relating to revenue recognition in this scenario will be supported by the auditor's risk assessment at assertion level, documented in sufficient detail to enable an experienced auditor to understand such judgements and the conclusions reached.

ISA 240.A30 provides an example of when the presumption can be rebutted per type of revenue or class of revenue transactions as a whole, namely: "there is a single type of simple revenue transaction, for example leasehold revenue from a single unit rental property".

ISA 240.47 requires that if the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion be included in the audit documentation.

Conclusion

ISA 240.26 refers to "types of revenue", "revenue transactions" <u>or</u> "assertions" and is therefore not prescriptive that the significant risk presumption must be rebutted per assertion. It would however not be appropriate for the auditor to consider revenue for an entity in total/ overall when the entity's revenue comprises different types of revenue (revenue streams) or revenue transactions.

When identifying and assessing risks of material misstatement due to fraud, the auditor could conclude, based on the understanding obtained, that the risk of fraud is not applicable to a type of revenue (revenue stream) or class of revenue transactions, and document the reasons for the rebuttal.

If none of the assertions are considered to be significant risks in the circumstances (i.e. no risks of material misstatement due to fraud have been identified in relation to any of the assertions), the auditor has to document why the significant risk presumption does not apply (i.e. rebut the presumption) to revenue recognition related to the type of revenue (revenue stream) or class of revenue transactions concerned (or to revenue overall, if the entity's revenue does not comprise different types of revenue (revenue streams) or revenue transactions). The auditor's judgements relating to revenue recognition will be supported by the auditor's risk assessment at assertion level, documented in sufficient detail to enable an experienced auditor to understand such judgements and the conclusions reached.

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3. Substantive procedures for each material class of transactions, account balance and disclosure (i.e. for each material financial statement item)

At what level should materiality be applied in identifying material classes of transactions, account balances and disclosures when designing and performing substantive procedures?

Further context to the problem / challenge / uncertainty

The ISAs require the auditor to design and perform substantive procedures for *each material* class of transactions, account balance and disclosure (ISA 330.18). There is uncertainty about the level at which materiality should be applied when testing items, for example, whether it is appropriate to apply materiality to the level at which the items are presented in the financial statements; to each individual account or item that is presented in a lead schedule that ultimately makes up the item presented in the financial statements; or to each individual transaction or event included in the general ledger.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- Glossary of Terms: Financial statements; Population
- ISA 200, Para. 11
- ISA 230, Para. 8
- ISA 330, Para. 18, A42 - A47
- ISA 500, Para. 10, A52 – A56
- ISA 530, Para. 1 – 2, A4 – A9, Appendix 1

Application of the requirements of the ISAs

The Glossary of Terms defines *Financial statements* as "A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with a financial reporting framework …" A complete set of International Financial Reporting Standards (IFRS) compliant financial statements per IAS 1.10 comprise:

- A statement of financial position;
- A statement of profit or loss and other comprehensive income;
- A statement of changes in equity;
- A statement of cash flows; and
- Notes.

IAS 1.54 and .82 contain requirements of the <u>line items</u> which the statement of financial position and statement of profit or loss and comprehensive income must consist of and how these line items should be presented. The term "line items" are similar to the terms "financial statement items" and "classes of transactions, account balances and disclosures", used throughout the ISAs, and are interpreted to have the same meaning.

To determine at what level materiality should be applied in identifying material classes of transactions, account balances and disclosures / material financial statement items / line items, it is relevant to consider the definition of a "population" and the different means of selecting items for testing.

The Glossary of Terms defines *Population* as "The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions". *Stratification* is defined as "The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value)."

ISA 500.10 requires the auditor to "determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure" (for example, when designing tests of details). The application material in ISA 500.A52 indicates that the means available to the auditor for selecting items for testing are the following:

- Selecting all items;
- Selecting specific items; and
- Audit sampling.

ISA 500.A52 continues to state that the application of *any one or combination* of these means may be appropriate. The auditor shall also take cognisance of ISA 500.A55 that emphasises, in relation to selecting specific items for testing, that the results of audit procedures applied to items selected in this way cannot be projected to the entire population; accordingly, selective examination of specific items does not provide audit evidence concerning the remainder of the population. Accordingly, the auditor has to consider and document in accordance with the requirements of ISA 230.8 whether and, if so, what further work is required in relation to the remainder of the population in order to reduce the risk of material misstatement to an acceptable low level.

The same definition of a *Population* should apply equally to all of the means of selecting items for testing in terms of representing the entire set of data from which the auditor will select items for testing.

Line items or individual financial statement items may be found in the separate statements that make up the financial statements <u>and</u> in the notes that form an integral part of the financial statements. In terms of the auditor obtaining reasonable assurance about the financial statements as a whole (ISA 200.11) (i.e. the complete set of financial statements), it would be appropriate for the auditor to use the notes (where applicable) to determine the relevant populations for purposes of selecting items for testing. For example, the auditor uses the note relating to Property, plant and equipment (PPE) which is further broken down into its different classes, rather than the single figure on the face of the statement of financial position to determine means of selecting items for testing.

If each class of PPE is a population, such population can be further stratified to more effectively test the population. The strata can, for example, be based on the value of the items making up the population or on identified characteristics that represent risks of material misstatement. ISA 530 Appendix 1 provides additional guidance relating to stratification.

Conclusion

"Classes of transactions, account balances and disclosures" are interpreted as the line items making up, or the individual financial statement items presented in the separate statements and the notes in a complete set of financial statements.

Materiality in terms of testing each material financial statement item should be applied at the level of the individual financial statement items as presented in the separate statements and in the notes. Based on the discussion in the above paragraphs, there is no requirement in the ISAs to test:

- Each individually material account or item that is presented in a schedule that ultimately makes up the item presented in the financial statements; or
- Each individually material transaction or event included in the general ledger (excluding journal entries and other adjustments in certain instances, as discussed in FAQ 4 in this document).

Notwithstanding the above, the auditor must ensure an appropriate response to identified and assessed risks of material misstatement at the assertion level, and is required to exercise professional scepticism and professional judgement in determining the nature and extent of the audit procedures to be performed in order to obtain sufficient appropriate audit evidence in the circumstances.

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4. Testing of journal entries and other adjustments

To what extent is the auditor required to test journal entries and other adjustments, taking into account that the risk of management override of controls is present in all entities, and that it is a risk of material misstatement due to fraud and thus a significant risk?

Further context to the problem / challenge / uncertainty

Journal entries and other adjustments are intrinsically linked to the auditor's consideration of the risks of material misstatement due to fraud in management override of controls as addressed in ISA 240. There is uncertainty about whether all material journal entries and other adjustments made as part of the financial statement closing process should be tested; the extent of testing required in relation to journal entries and other adjustments made as part of the closing process that are not material and whether there is a requirement to test journal entries and other adjustments made throughout the reporting period.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- ISA 230, Para. 8
- ISA 240, Para. 44
- ISA 240, Para. 31, 32(a), 33, A41 – A44
- ISA 315 (Revised), Para. 18, A93 – A94
- ISA 315 (Revised), Para. 29
- ISA 330, Para. 20, A52

Application of the requirements of the ISAs

In terms of ISA 240.31, "Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur; it is a risk of material misstatement due to fraud and thus a significant risk". One of the ways management override may occur is through the processing of journal entries.

Owing to the significant risk presumption above, in terms of ISA 315 (Revised).29, the auditor is required to obtain an understanding of the entity's controls, including control activities, relevant to the risk. This would relate to the entity's information system and business processes surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments (refer to ISA 315 (Revised).18, A93 – A94 for further information in this regard).

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In designing and performing audit procedures to test journal entries and other adjustments, the following requirements of the ISAs are particularly relevant:

ISA 240.32(a): "Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:

(i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
(ii) Select journal entries and other adjustments made at the end of a reporting period; and
(iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A41 – A44)".

ISA 330.20: "The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

(a) Agreeing or reconciling the financial statements with the underlying accounting records; and
(b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: A52)".

ISA 330.20(b) makes reference to material journal entries and other adjustments made *during the course of preparing the financial statements.* Since the heading of the introductory sentence to ISA 330.20 refers to *the financial statement closing process*, it is clear that the requirements relate to matters that the auditor should focus on at the end of the reporting period when the accounting records are closed off and balanced.

In considering and applying the requirements of the ISAs, it is important to draw the distinction as highlighted above. Reference will be made here to "End of reporting period/ Financial statement closing process journal entries and adjustments", which incorporates journal entries and other adjustments made at *the end of a reporting period*. Journal entries and other adjustments made *throughout the reporting period* are referred to as "Other journal entries and adjustments".

Conclusion

In the context that management override of controls is a risk of material misstatement due to fraud and thus a significant risk, ISA 240 requires the auditor to design and perform certain audit procedures pertaining to, amongst other matters, journal entries and other adjustments, as well as to determine whether any other procedures in addition to those specifically referred to may be required in the circumstances of a particular audit (refer to ISA 240.31 – 33).

Testing of End of reporting period/ Financial statement closing process journal entries and adjustments

Both ISA 240.32(a)(ii) and ISA 330.20(b) refer to End of reporting period/ Financial statement closing process journal entries and adjustments and therefore need to be read together in understanding the requirements relating to the testing of these journal entries and adjustments.

Irrespective of the auditor's assessment of the risk of management override of controls, the auditor shall make a selection of journal entries and adjustments made at the end of a reporting period. The auditor, therefore, ensures that all these journal entries and adjustments are identified to make up a complete population, and then proceeds as follows:

- Examine *material* End of reporting period/ Financial statement closing process journal entries and adjustments by designing and performing appropriate substantive procedures. There is no requirement contained in the ISAs for the auditor to test all material journal entries but the auditor's testing shall include the examination of material End of reporting period/ Financial statement closing process journal entries. In terms of ISA 330.A52 and ISA 240.A44, the auditor is permitted to exercise professional judgement in determining the nature and extent of testing of journal entries and adjustments made at this time, taking into account the nature and complexity of the entity's financial reporting process and the related risks of material misstatement; the consideration of which shall be documented in accordance with the requirements of ISA 230.8 and ISA 240.44 (as applicable); and

- In addition to material journal entries and adjustments, the auditor exercises professional judgement to decide which non-material journal entries and adjustments may need to be tested; the consideration of which shall be documented in accordance with the requirements of ISA 230.8 and ISA 240.44 (as applicable). The auditor exercises professional judgement in determining the nature, timing and extent of testing performed on journal entries and other adjustments. ISA 240.A43 provides guidance on the matters that are of relevance when identifying and selecting journal entries and adjustments for testing and determining the appropriate method of examining the underlying support for the items selected.

Testing of Other journal entries and adjustments

In terms of ISA 240.32(a)(iii) the auditor shall consider the need to test journal entries and other adjustments throughout the period. This consideration shall be documented in terms of ISA 230.8 and ISA 240.44 (as applicable). Again, the auditor exercises professional judgement in determining the nature, timing and extent of testing to be performed on journal entries and other adjustments. There is, however, no requirement contained in the ISAs for the auditor to specifically examine material Other journal entries and adjustments, as there is for material End of reporting period/ Financial statement closing process journal entries and adjustments. In response to the risk of fraud, the auditor applies the guidance in ISA 240.A43 with respect to the matters that are of relevance when identifying and selecting Other journal entries and adjustments for testing and determining the appropriate method of examining the underlying support for the items selected.

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5. Opening balances – Recurring engagements

What audit work should the auditor perform in relation to opening balances in a recurring engagement?

Further context to the problem / challenge / uncertainty

There is uncertainty around the procedures that have to be performed on the closing balances that are carried forward as opening balances in the current period for a recurring audit and whether the procedures in ISA 510 are applicable to a recurring engagement. It is important to note that this question only relates to the auditor's work effort in terms of confirming that those balances that existed at the beginning of the period represent the closing balances of the prior period, and does not deal with the current period work effort in testing the closing balance that is made up, cumulatively, of items from the current period and previous periods.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- ISA 510, Para. 4(a)
- ISA 710, Para. 1 and 7
- General risk assessment and response procedures in ISA 315 (Revised) and ISA 330
- Special consideration requirements in ISA 240

Application of the requirements of the ISAs

ISA 510 deals with the auditor's responsibilities relating to opening balances in an initial audit engagement. ISA 510.4(a) defines an initial engagement as "an engagement in which either the financial statements for the prior period were not audited, or the financial statements for the prior period were audited by a predecessor auditor".

Although ISA 710 deals with the auditor's responsibilities relating to comparative information in an audit of financial statements, the scope of ISA 710 also confirms that the requirements relating to opening balances, as contained in ISA 510 are applicable, in addition to those contained in ISA 710, when the financial statements of the prior period have been audited by a predecessor auditor or were not audited. Therefore, ISA 710 applies to initial engagements and recurring engagements, and is relevant in terms of how those prior period balances, reflected as corresponding figures in the current period financial statements, have been carried forward in the current period.

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Conclusion

The ISAs do not contain specific requirements and guidance on testing closing balances that are carried over as opening balances in the current year for a recurring engagement.

In the absence of specific requirements and guidance with respect to recurring engagements, the auditor applies the general risk assessment and risk response requirements in ISA 315 (Revised) and ISA 330, together with special considerations requirements contained in ISA 240, with respect to the consideration of fraud in an audit of financial statements. The auditor needs to ensure that proper identification and assessment of risks of material misstatement at the financial statements level and at the assertion level are performed and that further procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement are designed and performed.

For additional practical context, it would be prudent to ensure that the auditor's procedures relating to opening balances at least cover the following key aspects (subject to a proper risk assessment and risk response, as discussed above):

- Whether opening retained income and other reserves in the general ledger agrees to closing retained income and other reserves as per the prior period's financial statements.
- Agreement between the comparative information as included in the current period's financial statements and the information in the prior period's financial statements. Also refer to the auditor's responsibilities with respect to comparative information in ISA 710.
- The composition of balances, totals and disclosures (i.e. their composite elements in terms of items / categories of items or ledger accounts or similar) in the current period and their composition at the end of the previous period, and any changes or discrepancies in relation thereto. This information may be reflected in lead schedules of the current and prior periods.
- The effect of any changes in accounting policies, prior period errors and/or reclassifications in the current period (also refer to ISA 710.7 – 9).
- The results of current period audit procedures on balances and disclosures that may raise issues or questions relating to those balances or disclosures in the prior period and how they have been rolled forward or brought forward to the current period.

The auditor would evaluate any differences or discrepancies relating to opening balances and consider the appropriate response required. The nature and extent of the audit procedures to be performed are ultimately determined by the auditor in applying professional judgment in response to the assessed risks of material misstatement.

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6. Approval of Financial Statements by the entity, the dating and signing of the auditor's report and the related documentation thereof

(a) How does the auditor assess whether the "act of approval" of the financial statements[1] has taken place?

(b) What are the requirements with respect to the dating and signing of the auditor's report that signifies that the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion?

(c) What should the auditor include in the audit file to ensure that the audit documentation is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the results of the audit procedures performed and audit evidence obtained in respect of the approved financial statements and final versions of the entity's financial statements?

(d) What is the auditor's responsibility in relation to published Annual Financial Statements[2]?

Further context to the problem / challenge / uncertainty

<u>Note</u>: *These matters are relevant to all situations where financial statements are required to be approved by law or regulation, or in terms of an entity's founding documents or a deed, agreement, resolution or similar document. Furthermore, the dating and signing of the auditor's report is applicable where the auditor has been engaged to perform an audit of financial statements, whether it is a mandatory audit or a voluntary audit, and irrespective of the nature and form of the audited entity.* ***For purposes of this FAQ,*** *the matters concerned have been framed in the context of the audit of a company's annual financial statements in accordance with the Companies Act, No. 71 of 2008 (the Companies Act). Users may also find this FAQ, if adapted as necessary, useful when dealing with these matters in different circumstances.*

Monitoring findings in relation to completed engagements have identified instances where the auditor did not prepare audit documentation that was sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the results of the auditing procedures performed and audit evidence obtained in respect of the approved and final versions of the company's financial statements. In certain instances there has been uncertainty about whether the final version of the financial statements have been included in the audit file. Monitoring findings have also identified instances where it is unclear whether the final version of the auditor's report has been included in the audit file.

[1] In line with the terminology contained in the ISAs, when outlining the auditor's responsibilities applicable in this FAQ, reference is made to the term "financial statements".

[2] In line with the terminology contained in section 30 of the Companies Act, when referring to the requirements of the Companies Act and the publication of results of the entity in this FAQ, reference is made to the term "Annual Financial Statements".

Specific references in the ISAs, the Companies Act, the Auditing Profession Act and the IRBA Code of Professional Conduct for Registered Auditors

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific questions presented here (but are not intended to be exhaustive):

- ISA 230, Para. 8-11, A4
- ISA 560, Para. 5(b), 10,14, A2
- ISA 700 (Revised), Para. 20, 46,47,49, A18, A62, A64,A65,A67, A68
- Companies Act, sections 30(1); 30(3)(a); and 30(3)(c)
- Audit Profession Act, section 41(8)
- IRBA Code of Professional Conduct for Registered Auditors, section 150.6[3]

Application of the requirements of the ISAs, the Companies Act, the Auditing Profession Act and the IRBA Code of Professional Conduct for Registered Auditors

a. Act of approval of financial statements

Specific requirements relating to the individual/(s) or body/(ies) that are responsible for the preparation of the financial statements and the necessary approval process are included in relevant laws and regulations, founding documents, deeds, agreements, resolutions or similar documents. In the case of a company, these requirements are contained in the Companies Act.

The Companies Act requires a company to prepare annual financial statements (AFS) (section 30(1)), which must include an auditor's report if the AFS are audited (section 30(3)(a)). Furthermore, the AFS, whether audited or not, must be approved by the board and signed by an authorised director (section 30(3)(c)). These provisions of the Companies Act are unalterable provisions, as defined. Therefore, a company is required to comply with these provisions and cannot remove or diminish these provisions through its Memorandum of Incorporation (MOI). The MOI may, however impose on the company more onerous requirements.

The ISAs require that the auditor's report be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements. This includes evidence that:

(a) All the statements and disclosures that comprise the financial statements have been prepared; and

[3] The IRBA is in the process of revising and restructuring the IRBA Code of Professional Conduct for Registered Auditors, which will, when approved and issued, be effective for periods beginning on or after 15 June 2019. In terms of the proposed Revised IRBA Code of Professional Conduct, the applicable reference is R115.6 SA.

(b) Those with the recognised authority have asserted that they have taken responsibility for those financial statements (ISA 700 (Revised).49).

Since the auditor's opinion is provided on the financial statements and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements and disclosures that comprise the financial statements have been prepared and that management has accepted responsibility for them (ISA 700 (Revised).A67).

The application and other explanatory material of ISA 560 and ISA 700 (Revised) recognise that in some jurisdictions, law or regulation identifies the individuals or bodies that are responsible for concluding that all the statements and disclosures that comprise the financial statements have been prepared, and specifies the necessary approval process. In such cases, evidence is obtained of that approval before dating the auditor's report on the financial statements. (ISA 560.A2; ISA 700 (Revised).A68).

In the case of a company in South Africa, the law or regulation that identifies the individuals or bodies that are responsible for concluding that all the statements and disclosures that comprise the AFS have been prepared and that specifies the necessary approval process, is the Companies Act (refer to section 30(3)(c) as described above). In essence, the act of approval of the AFS requires the completion of two steps, namely (1) the board of directors must approve the AFS and (2) the AFS must be signed by a director who has been authorised by the board to do so. If any of these steps are not completed, the act of approval has not occurred.

b. Dating and signing of the auditor's report

The *date of the approval* of the financial statements is defined in ISA 560.5(b) as "The date on which all the statements that comprise the financial statements, including the related notes, have been prepared and those with the recognised authority have asserted that they have taken responsibility for those statements".

Once the AFS are approved by the board of directors and signed by an authorised director, the auditor is able to date and sign the auditor's report on the financial statements.

ISA 700 (Revised) contains the following requirements specific to the auditor's report:

- The auditor's report shall be in writing (ISA 700 (Revised).20). A written report encompasses reports issued in hard copy and those using electronic medium (ISA 700 (Revised).A18);
- ISA 700 (Revised).46 requires the name of the engagement partner to be included in the auditor's report of financial statements of listed entities. Laws, regulation or national auditing standards may require that the auditor's report include the name of the engagement partner responsible for audits other than those financial statements of listed entities, as well include additional information beyond the engagement partner's name to further identify the engagement partner (ISA 700 (Revised). A62).
- The auditor's report shall be signed (ISA 700 (Revised).47). The application and other explanatory material of ISA 700 (Revised) expands on this in stating that in some cases, law or regulation may allow for the use of electronic signatures in the auditor's report (ISA 700 (Revised).A65).

The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction. In addition to the auditor's signature, in certain jurisdictions, the auditor may be required to declare in the auditor's report, the auditor's professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognised by the appropriate licensing authority in that jurisdiction (ISA 700 (Revised). A64).

In South Africa, section 41(8) of the Auditing Profession Act, No. 26 of 2005 determines that a registered auditor is not prevented from signing the firm name or title under which the registered auditor practises. Therefore, the auditor would be able to sign the auditor's report in his/her personal name or in the name of the firm or both.

In addition to the requirements of ISA 700 (Revised), the signing conventions for reports or certificates as contained in paragraph 150.6 of the IRBA Code of Professional Conduct for Registered Auditors[4] is a regulatory requirement applicable in South Africa. The signing convention states that the individual registered auditor responsible for the audit shall, when signing any audit report reflect the following:

(a) The individual registered auditor's full name;
(b) If not a sole proprietor, the capacity in which they are signing, namely 'partner' or 'director';
(c) The designation 'Registered Auditor' underneath their name; and
(d) If not set out on the firm's letterhead, the name of the registered auditor's firm.

c. Audit Documentation

Sufficient appropriate audit evidence of the approval process and the final set of financial statements signed by the authorised director has to be obtained and the auditor must prepare and retain sufficient audit documentation in this regard, in accordance with the requirements of ISA 230. Such documentation could include a copy of minutes of meetings or a working paper that documents the auditor's inspection of the minutes of meetings and a clearly marked "final version" of the financial statements on which the auditor has performed procedures as part of the audit completion process.

It is encouraged that the auditor's documentation be clear in terms of identifying the final signed version of the auditor's report that has been issued by the auditor and audit firm in relation to the approved audited AFS of the company concerned.

In finalising the contents of the audit file, it should be noted that the auditor is not required to include superseded drafts of financial statements in the audit documentation (ISA 230. A4). It is encouraged that superseded documentation be removed from the file as this can complicate the monitoring reviews of the audit file. If this is not possible, the version control in relation to the various sets of financial statement included in the audit file becomes an important consideration in ensuring that the audit documentation is sufficient in respect of the final version of the company's financial statements.

[4] The IRBA is in the process of revising and restructuring the IRBA Code of Professional Conduct for Registered Auditors, which will be effective for periods beginning on or after 15 June 2019. In terms of the Revised IRBA Code of Professional Conduct, the applicable reference is R115.6 SA.

d. Auditor's responsibility in relation to published AFS

With the move towards a paperless environment, entities are choosing to include the AFS on their website or making use of other electronic means to communicate with stakeholders. This gives rise to an increased risk that the incorrect version of the AFS are published and this is not identified and addressed by the auditor. Although the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report and when the financial statements have been issued (ISA 560.10, 14), from a risk management point of view, it would be prudent for firms to develop internal policies and procedures to mitigate the risk of the incorrect version of the financial statements or auditor's report being published. However, if after the financial statements have been issued, the auditor becomes aware of a fact that, if it was known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor has a responsibility to take action, as required by paragraph 14 of ISA 560.

Conclusion

The Companies Act contains two components relating to the approval of the AFS namely, their approval by the board and the signing thereof by an authorised director. The auditor is required to obtain sufficient appropriate audit evidence of the approval process of the financial statements and ensure that this is clearly documented. The audit documentation must be sufficiently clear to mitigate the risk that an experienced auditor, having no previous connection with the audit, is unable to identify the final and approved version of the company's financial statements and the final signed version of the auditor's report in the audit file.

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7. When information to be used as audit evidence involves the work of experts

What does an "expert" mean in the context of a management's expert and an auditor's expert; what is the difference between these experts; and what do the ISAs require of the auditor in an audit engagement when information to be used as audit evidence involves the work of experts?

Further context to the problem / challenge / uncertainty

There is uncertainty about the meaning of a management's expert and an auditor's expert, the differences between these experts and the differing levels of work effort to be applied by the auditor in complying with the requirements of the ISAs when information to be used as audit evidence involves the work of these experts. Such uncertainty could result in the non-application or the application of requirements of the incorrect ISAs, which could result in deficiencies in audit documentation or a lack of sufficient appropriate audit evidence to support the auditor's opinion on the financial statements.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

In general
- ISA 200, Para. 7, 15, 16
- ISA 230, Para. 8 - 11
- ISA 500, Para. 5(d), 7, 9, A26 - A33 and A49 - A51
- ISA 620, Para. 6(a), 6(b), A1, A11, A12 and A29

When a management's expert is applicable
- ISA 500, Para. 8, A34 – A48

When an auditor's expert is applicable
- ISA 220, Para. 7(d)
- ISA 620

When expertise in accounting or auditing is applicable
- ISQC 1, Para. 34, A36 – A40
- ISA 220, Para. 18, A21 – A22

Application of the requirements of the ISAs

General

It is important to first determine what an expert is in the context of the ISAs. ISA 620.6(b) defines expertise as: skills, knowledge and experience in a particular field.

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Expertise in the context of a management's expert and an auditor's expert relates to expertise in a field other than accounting or auditing, as indicated in the definitions below and as covered by the relevant requirements of ISA 500 and ISA 620, respectively. If the auditor consults on matters that require expertise in the field of accounting or auditing, the auditor refers to the relevant requirements and application material pertaining to *consultation* in ISQC 1 and ISA 220. This is addressed in the sub-section "Expertise in the field of accounting or auditing", below.

- ISA 500.5(d) defines a management's expert as an individual or organisation possessing expertise <u>in a field other than accounting or auditing</u>, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

- ISA 620.6(a) defines an auditor's expert as an individual or organisation possessing expertise <u>in a field other than accounting or auditing</u>, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.

The ISAs require that the auditor exercise professional scepticism and professional judgement throughout the planning and performance of the audit, and recognise that circumstances may exist that cause the financial statements to be materially misstated (ISA 200.7, 15, 16). Planning and performing the audit with professional scepticism and exercising professional judgement is particularly important when considering the work of experts. This work often relates to significant matters that are integral to the audit and involve subjectivity, uncertainty and complex judgements, and there is therefore a higher risk of material misstatement.

<u>Examples of expertise that could be applicable to either an auditor's expert or a management's expert</u>

Paragraph A1 of ISA 620 includes the following examples of expertise in a field other than accounting or auditing:

- The valuation of complex financial instruments, land and buildings, plant and machinery, jewellery, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired;
- The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans;
- The estimation of oil and gas reserves;
- The valuation of environmental liabilities, and site clean-up costs;
- The interpretation of contracts, laws and regulations; and
- The analysis of complex or unusual tax compliance issues.

Although these examples are included in the context of an auditor's expert, they can also be applied by the auditor when identifying a management's expert and using the work thereof.

<u>Difference between a management's expert and an auditor's expert</u>

Based on the above-mentioned definitions, a key difference between a management's expert and an auditor's expert, is that the auditor's expert is employed or engaged by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence on management's assertions; whereas a management's expert is employed or engaged by the entity (i.e. the auditee) to assist them in preparing financial information to be included in the financial statements.

In the management's expert scenario, the auditor will be presented with evidence of a valuation of land and buildings, for example, that management did not prepare themselves; i.e. they used the work of an expert to assist the entity in calculating amounts that are included in the financial statements. Apart from performing any other audit procedures that would be required in the circumstances to obtain sufficient appropriate audit evidence, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes, also test the reliability of the work of the expert by performing the procedures contained in ISA 500.8.

The auditor may also decide to use his / her own expert (an auditor's expert) to determine the value of land and buildings in assisting the auditor to obtain sufficient appropriate audit evidence. In this case ISA 620 will have to be applied.

Different scenarios may arise in practice, for example:

- the entity uses a management's expert and the auditor uses the work of that management expert without using an auditor's expert;
- the entity uses a management's expert and the auditor deems it necessary to also engage an auditor's expert; or
- management does not use a management's expert, but the auditor decides it is necessary to use an auditor's expert.

An auditor who is not an expert in a particular field other than accounting or auditing may nevertheless be able to obtain sufficient understanding of that field in order to perform the audit without an auditor's expert. This understanding may be obtained through, for example:

- Experience in auditing entities that require such expertise in the preparation of their financial statements.
- Education or professional development in the particular field. This may include formal courses, or discussions with individuals possessing expertise in the relevant field for the purpose of enhancing the auditor's own capacity to deal with matters in that field. Such discussion differs from consultation with an auditor's expert regarding a specific set of circumstances encountered on the engagement where that expert is given all the relevant facts that will enable the expert to provide informed advice about the particular matter.
- Discussions with auditors who have performed similar engagements (ISA 620.A7).

<u>Difference between internal experts and external experts</u>

In the section above, when explaining the difference between a management's expert and an auditor's expert, reference is made to the fact that both of these experts can either be employed or engaged by management or the auditor, as the case may be.

An auditor's expert may be either an auditor's internal expert, or an auditor's external expert (ISA 620.6(a) (extract)). ISA 620 explains the difference between an auditor's internal expert and auditor's external expert as follows:

- An auditor's internal expert may be a partner or staff, including temporary staff, of the auditor's firm, and therefore subject to the quality control policies and procedures of that firm in accordance with ISQC 1 or national requirements that are at least as demanding. An auditor's internal expert may also be a partner or staff, including temporary staff, of a network firm, which may share common quality control policies and procedures with the auditor's own firm (ISA 620.A11).
- An auditor's external expert is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with ISQC 1 (ISA 620.A12 (extract)).

Although ISA 500 does not specifically address a management's internal expert and a management's external expert, the application and other explanatory material indicates that the entity may *employ or engage* experts in the applicable fields to obtain the needed expertise to prepare the financial statements (ISA 500.A34 (extract)). Therefore, the reference to a management's expert includes both an internal expert and an external expert.

Examples of management's internal experts include those employees that have been employed by the entity for the expertise that they possess and such expertise is unrelated to accounting or auditing. The management's internal expert has no involvement in the preparation of the financial statements as such, but the work performed by these employees assist the entity in preparing the financial statements. Examples of management's internal experts include:

- Engineers or quantity surveyors in the employment of a construction entity who estimate the contractual costs relating to construction contracts;
- Engineers in the employment of a mining entity who estimate the environmental liabilities and other site clean-up costs; and
- Actuaries in the employment of an insurance company who estimate the value of liabilities that are used in preparing the financial statements.

When experts such as those mentioned above are not employed by the entity, but rather engaged from outside of the entity so that their work in the particular field can be used by the entity in preparing the financial statements, they are management's external experts.

<u>Requirements when using the work of a management's expert</u>

When information to be used as audit evidence has been prepared using the work of a management's expert, the requirements in paragraph 8 of ISA 500 apply as follows:

The auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

(a) Evaluate the competence, capabilities and objectivity of that expert;
(b) Obtain an understanding of the work of that expert; and
(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Paragraphs A34 to A48 of ISA 500 provide guidance on how to achieve the above-mentioned requirements.

Furthermore, it should be noted that there may be instances where the auditor has made an appropriate determination that the use of certain information does not involve using the work of a management's expert, but that such information nevertheless represent information from a source independent of the entity. This could potentially occur in relation to any particular financial statement item, depending on the circumstances of the entity. For example, where revenue related transaction information that is obtained from an entity's (i.e. the audit client's) customer includes information provided by an individual or organisation that possess expertise in a field other than accounting or auditing.

In such instances, the information concerned, if used as audit evidence, would then still be subject to paragraph 7 of ISA 500, which requires the auditor to consider the relevance and reliability of the information to be used as audit evidence. ISA 500, paragraphs A26-A33 provide guidance on how to achieve this requirement. In addition, referring to the example provided, such information may be subsumed into the entity's information system in relation to revenue (i.e. part of the relevant business process for revenue transactions). ISA 500, paragraphs 9 and A49-A51 address using information produced by the entity as audit evidence.

<u>Requirements when using the work of an auditor's expert</u>

When the auditor uses the services of an auditor's expert, irrespective of whether the expert is an internal expert or an external expert, the auditor is required to apply ISA 620 in its entirety.

Some additional guidance to note includes the following:

- ISA 220.7(d) defines an engagement team as all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external expert engaged by the firm or a network firm. Therefore, when an auditor's external expert is used, he/she/the organisation does not form part of the engagement team.
- Subject to any agreement to the contrary, the working papers of an external expert belong to the external expert and do not form part of the audit documentation. The auditor may, in terms of an agreement, have access to, and retention of these working papers (ISA 620.A29).
- The auditor's internal expert is a member of the engagement team and therefore the expert's working papers form part of the audit documentation.

<u>Documentation</u>

Neither ISA 500 nor ISA 620 contain specific documentation requirements. The auditor has to refer to the general documentation requirements in ISA 230. ISA 230.8 to 11 are of particular importance to management's experts and auditor's experts.

The documentation must be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

(a) The nature, timing and extent of audit procedures performed to comply with the ISAs;
(b) The results of the audit procedures performed and the audit evidence obtained; and
(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

The auditor shall document discussions of significant matters with management and those charged with governance, and others (this includes discussions with experts), including the nature of the significant matters discussed and when and with whom the discussions took place (ISA 230.10).

If the auditor identified information that is inconsistent with the auditor's final conclusions regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency (ISA 230.11).

Expertise in the field of accounting or auditing

When expertise in the field of accounting or auditing is involved, the auditor's considerations are not around *experts* as defined and described in the previous sections, but rather on *consultation* as addressed in ISQC 1 (paragraphs 34 and A36-A40) and ISA 220 (paragraphs 18 and A21-A22).

The engagement partner has to ensure that the engagement team consulted on difficult or contentious matters in terms of the firm's ISQC 1 policies and procedures regarding Engagement Performance – Consultation. In terms of ISA 220.18 the engagement partner shall:

(a) take responsibility for the engagement team undertaking appropriate consultation;
(b) be satisfied that appropriate consultation has taken place within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;
(c) be satisfied that the nature, scope and conclusions of the consultation are agreed with the party consulted; and
(d) Determine that the conclusions resulting from the consultation have been implemented. In instances where there is a difference of opinion and the conclusions resulting from the consultation have not been implemented, the engagement partner has to make sure that the firm's difference of opinion policies and procedures have been followed which are required to be established in term of ISQC 1.43-44.

Conclusion

An expert in the context of a management's expert and auditor's expert relate to expertise in a field other than accounting or auditing.

If an expert in accounting and auditing is used in a particular engagement, the requirements in ISA 500 and ISA 620 in respect of management's experts and auditor's experts, respectively, are not applicable. The firm's ISQC 1 policies and procedures regarding Engagement Performance – Consulting and ISA 220.18 regarding Consultation are applicable in respect of difficult or contentious matters.

The auditor is required to apply ISA 500.8 and A34-A48 when management used a management's expert to assist the entity in preparing the financial statements and the auditor intends to use the work of the management’s expert to contribute to sufficient appropriate audit evidence in the circumstances. ISA 620 in its entirety is applicable when the auditor decides to use the work of an auditor’s expert in obtaining sufficient appropriate audit evidence in the circumstances.

The documentation requirements in ISA 230 are applicable and auditors should ensure that their considerations regarding experts are sufficiently and appropriately documented in the audit file.

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8. Using the work of other auditors

What is "another auditor" or "other auditors" and what is required of the auditor when using the work of another auditor or other auditors in an audit engagement?

Further context to the problem / challenge / uncertainty

There is uncertainty about what "another auditor" or "other auditors" mean and what is required of the auditor when using their work in an audit engagement. The meaning of another auditor or other auditor further serves to clarify the uncertainties about whether the auditor is using the work of an auditor's expert or "another auditor"/ "other auditors". Refer to FAQ 7 which addresses the former in more detail. Such uncertainty could result in the non-application or the application of requirements of the incorrect ISAs, which could result in deficiencies in audit documentation or a lack of sufficient appropriate audit evidence to support the auditor's opinion on the financial statements.

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- ISA 402, Para. 8(d), A19
- ISA 600, Para. 2, 9(b)

Application of the requirements of the ISAs

The terms "another auditor" or "other auditors" are not defined in the ISAs, but are used in a number of instances throughout the ISAs, as follows:

Another auditor:

- ISA 402.12(d); 15 (b); 16(c); A11; A15; A19; A26(b); A27; A28; A30; A32; A37;
- ISA 501.A16;
- ISA 510, Appendix: Illustrations of Auditor's Reports with Modified Opinions, Illustration 1 and 2, Other matter paragraph;
- ISA 600.2;
- ISA 706 (Revised). Appendix 3: Illustration of an Independent Auditor's Report that Includes a Key Audit Matters Section, an Emphasis of Matter Paragraph, and an Other Matter Paragraph, Other matter paragraph;
- ISA 710. Appendix: Illustrations of Independent Auditors' Reports, Illustration 3, Other matter paragraph; and
- ISA 810 (Revised). 24.

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Other auditors:

- ISA 210.A26;
- ISA 240. 8a (b), A5a;
- ISA 250 (Revised).9(b); A8; A26
- ISA 300.A8; Appendix: Considerations in Establishing the Overall Audit Strategy, Characterises of the Engagement;
- ISA 501.A3;
- ISA 600.2;
- ISA 620.A15; and
- ISA 810 (Revised). A24.

There is no specific ISA that applies to the scenario where the auditor uses the work of another auditor or other auditors. Instead, the following terms are defined and referred to in the ISAs and if the auditor uses these practitioners to perform work on his/ her behalf or uses the work they have already performed, the requirements and guidance of the ISA concerned have to be applied.

- ISA 402.8(d) "service auditor" – An auditor who, at the request of the service organisation, provides an assurance report on the controls of a service organisation.
- ISA 600.9(b) "component auditor" – An auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit.
- Defined in the Glossary of Terms and used in ISA 610 "internal auditors" – Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

ISA 402.A19 and ISA 600.2 state that ISA 600 could be useful when the auditor uses other auditors and under these circumstances the requirements of the standard (ISA 600) would have to be appropriately adapted.

Although ISA 600 includes requirements that address using the work of component auditors in audits of group financial statements, the principles contained in the following paragraphs, adapted as necessary in the circumstances, may be relevant in providing the auditor with guidance on additional procedures that can be performed in ensuring that sufficient appropriate audit evidence is obtained when using the work of another auditor or other auditors in other instances:

- ISA 600.19 - 20, Understanding the Component Auditor;
- ISA 600. 24, Responding to Assessed Risk
- ISA 600.40; 41, Communication with the Component Auditor;
- ISA 600.44; 45, Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained; and
- ISA 600.50, Documentation.

Conclusion

The requirements of ISA 600 may be adapted as necessary when the work of another auditor or other auditors is used. Although there is no specific ISA that applies to the scenario where the auditor uses the work of another auditor or other auditors, it is prudent for the auditor to perform additional

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procedures as he/she considers necessary and appropriate in the interest of ensuring that sufficient appropriate audit evidence has been obtained. The nature, timing and extent of such procedures will involve the application of the auditor's professional judgement, taking into account the specific client and engagement circumstances.

The documentation requirements in ISA 230 are applicable and auditors should ensure that their considerations regarding the work of another auditor or other auditors are sufficiently and appropriately documented in the audit file.

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9. ISA 450, Evaluation of misstatements identified during the audit

(a) Evaluation of misstatements that are individually material

The ISAs require the auditor to determine whether uncorrected misstatements are material, individually or in aggregate. At what point does the auditor assess whether an uncorrected misstatement is individually material, and at what point is it appropriate for the auditor to consider the aggregate effect of uncorrected misstatements?

(b) Level of aggregation in assessing uncorrected misstatements

In assessing whether uncorrected misstatements are material in aggregate in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, at what level is the auditor required to aggregate individual uncorrected misstatements?

Further context to the problem / challenge / uncertainty

There is uncertainty about the point at which the auditor considers and evaluates the aggregate effect of individual uncorrected misstatements. In accordance with the requirements of ISA 450.5, the auditor accumulates all misstatements identified during the course of the audit, other than those that are clearly trivial. Does the auditor consider both the individual uncorrected misstatements and the aggregated effect of misstatements at the same time; or are individual uncorrected misstatements evaluated and assessed first, and if they are neither quantitatively or qualitatively material, then aggregate the misstatements that are individually not material to determine whether they are material in aggregate?

There is further uncertainty about the level/(s) at which misstatements are required to be aggregated in determining whether uncorrected misstatements are material. Does the auditor aggregate misstatements for:

- Classes of transactions, account balances or disclosures as summarised and aggregated on the lead sheets in the audit file;
- Individual line items as presented on the face of a statement as part of the complete set of financial statements, such as property, plant and equipment, trade and other receivables and inventory on the face of the statement of financial position;
- Sub-classifications of line items presented in the individual statements or in the notes to the financial statements, such as classes of property, plant and equipment, disaggregation of trade and other receivables and disaggregation of inventories; or
- Asset, liability or equity categories classified as either non-current or current, as applicable and presented on the face of the statement of financial position; various totals as presented on the face of the statement of profit or loss and other comprehensive income; as well as cash flows from operating activities, cash flows from investing activities and cash flows from financing activities as presented on the face of the statement of cash flows?

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The level of aggregation is dependent on the requirements of the applicable financial reporting framework (e.g. IFRS or the IFRS for SMEs) which determine how line items/financial statement items are to be categorised or grouped to present certain totals in the individual statements or in the notes to the financial statements.

In considering the above, it is important to understand the process to be followed by the auditor in the evaluation and assessment of uncorrected misstatements, recognising that this could be done in different ways depending on preferred audit techniques or methodologies. The evaluation and assessment will be appropriate if it satisfies the relevant requirements of the ISAs.

It is important to note that the auditor is also required to consider the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole (ISA 450.11(b)).

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including relevant requirements read together with the related application material. The following specific references are relevant in considering the specific questions presented here (but not intended to be exhaustive):

- ISA 240, Para 35
- ISA 450, Para 4; 8; 11 - 15; A16 - A22
- ISA 700 (Revised), Para 10, 11(b), 12

Application of the requirements of the ISAs

In forming an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (ISA 700 (Revised).10), the auditor is required to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. This conclusion shall take into account inter-alia, the auditor’s conclusion in accordance with ISA 450, whether uncorrected misstatements are material, individually or in aggregate (ISA 700 (Revised).11(b)).

In evaluating whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework, the auditor must include consideration of the qualitative aspects of the entity’s accounting practices (ISA 700 (Revised). 12).

ISA 450 requires the auditor to determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider the size (i.e. quantitative effect) and nature (i.e. qualitative effect) of misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as whole, and the particular circumstances of their occurrence (ISA 450.11 (a)).

ISA 450 defines a misstatement as “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 <u>for the item</u> to be in accordance with the applicable financial reporting framework" (ISA 450.4(a)) (emphasis added).

ISA 450 defines *uncorrected misstatements* as "Misstatements that the auditor has accumulated during the audit and that have not been corrected". (ISA 450.4(b))

<u>Accumulation of misstatements during the audit</u>

During the audit, the auditor accumulates individually identified misstatements relevant to each financial statement item, other than those that are clearly trivial, as required by ISA 450.5. The term "financial statement item" is similar to "line item/(s)" and "classes of transactions, account balances and disclosures". Refer to FAQ 3, *Substantive procedures for each material class of transaction, account balance and disclosure (i.e. for each material financial statement item)* where these terms are discussed. The conclusion includes that "Classes of transactions, account balances and disclosures" are interpreted as the line items making up, or the individual financial statement items presented in the separate statements and in the notes in a complete set of financial statements.

In the course of an audit, misstatements could be identified as a result of performing the planned or additional audit procedures as part of the auditor's response to the assessed risks of material misstatement at the assertion level for individual financial statement items. The results of such audit procedures enable the auditor to determine the total identified misstatement in a particular financial statement item, for example the total by which the item trade payables, as presented in the disclosure note, Trade and other payables, is misstated.

If the total identified misstatement equals or is less than the clearly trivial threshold, no further action is required. If the clearly trivial threshold is exceeded, the total identified misstatement relating to a particular financial statement item and its components (i.e. on or more misstatements), representative of its size and nature (cause and circumstances) are documented (ISA 450.5, 15(b)). The auditor must then report all misstatements accumulated during the audit to the appropriate level of management, and request management to make adjustments to correct those misstatements (ISA 450.8). The correction process does not form part of this FAQ.

After the process of reporting identified misstatements to management and requesting these to be corrected, the auditor would ordinarily prepare a summary of uncorrected misstatements in order to separate corrected misstatements from uncorrected misstatements and to determine whether the effect of uncorrected misstatements are material individually or in aggregate.

When individual uncorrected misstatements are transferred to the summary of uncorrected misstatements, it is common practice to indicate the rand value of the individual misstatements in terms of their debit effect and credit effect on the groups or categories in the financial statements representing the totals of various line items or financial statement items that are required to be presented in the separate statements in accordance with the requirements of the applicable financial reporting framework. **An illustration of such groups or categories is provided under subheading b., below.**

The ISAs are not prescriptive in terms of how the auditor operationalises the requirements of ISA 450 regarding the accumulation of identified individual misstatements and the evaluation of uncorrected misstatements, for example, by way of using a summary of uncorrected misstatements and its form and content. This is a matter that each firm deals with in their audit methodology, which must comply with the requirements of ISA 450. The important principle is to ensure that the effect of uncorrected misstatements is considered at the appropriate levels in accordance with the requirements of the applicable financial reporting framework relating to various line items and groups of line items presented in the separate statements and as disclosed in the notes to the financial statements. Furthermore, the auditor must comply with the specific documentation requirements contained in ISA 450.15.

Other disclosures, including qualitative disclosures will not have a debit and credit effect and can therefore not be aggregated in assessing whether misstatements of this nature are quantitatively material. Each qualitative misstatement must therefore be assessed individually. Such individual misstatements must, however, also be considered in aggregate (the impact on the financial statements as a whole) by the auditor in assessing whether they result in a misstatement that is qualitatively material. For example, depending on the misstatements identified in disclosures, the auditor may consider whether identified errors are persistent or pervasive, or whether a number of identified misstatements are relevant to the same matter and considered collectively may affect users' understanding of that matter (ISA 450.A18) (extract).

e. Evaluation of misstatements that are individually material

Once the auditor has transferred all uncorrected misstatements to the summary of uncorrected misstatements, these uncorrected misstatements are evaluated to determine whether they are individually material. Prior to evaluating the effect of uncorrected misstatements, the auditor is required to reassess materiality to confirm whether it remains appropriate (ISA 450.10); effectively determining final materiality.

The auditor then evaluates whether the uncorrected misstatements in relation to a particular class of transactions, account balance or disclosure is material or not (ISA 450.11(a)), thereby concluding on whether each individual financial statement item is free from material misstatement. For example, Trade payables is an individual line item that is disclosed in the note "Trade and other payables" to the financial statements; therefore, the auditor is considering whether any related uncorrected misstatements have a material effect on the individual line item, Trade payables (the net effect of relevant misstatements in Trade payables).

The auditor should also take cognisance of the following application material in ISA 450.A19 in relation to the off-setting of misstatements: "If an individual misstatement is judged to be material, it is unlikely that it can be offset by other misstatements. For example, if revenue is materially misstated, the financial statements as whole will be materially misstated even if the effect of the misstatement on earnings is completely offset by an equivalent misstatement of expenses. It may be appropriate to offset misstatements within the same account balance or class of transactions; however, the risk that further undetected misstatements may exist is considered before concluding that offsetting even immaterial misstatements is appropriate".

Line items or individual financial statement items may be found in the separate statements that make up the financial statements as well as in the notes that form an integral part of the financial statements. In terms of the auditor evaluating identified individual misstatements, it would be appropriate for the auditor to accumulate misstatements in the various line items and groups of line items that are required by the applicable financial reporting framework to be presented in the separate statements and disclosed in the notes to the financial statements.

Illustration of line items / financial statement items

- Line items presented in the separate statements

  Statement of financial position
  - Property, plant and equipment
  - Inventory
  - Trade and other receivables
  - Bank and cash
  - Trade and other payables
  - Ordinary share capital
  - Retained earnings

  Statement of profit or loss and other comprehensive income
  - Revenue
  - Cost of sales
  - Depreciation and amortisation
  - Finance income
  - Finance costs

  Statement of cash flows
  - Cash generated by operations
  - Changes in working capital
  - Property, plant and equipment - Additions to maintain operations
  - Decrease in long term loans payable

- <u>Line items disclosed in the notes to the financial statements</u>

  In the notes to the Statement of financial position
  - Classes of property, plant and equipment
  - Disaggregation of inventories
  - Disaggregation of trade and other receivables
  - Disaggregation of trade and other payables

  In the notes to the Statement of profit or loss and other comprehensive income
  - Disaggregation of revenue
  - Disaggregation of cost of sales
  - Disaggregation of finance income or finance costs
  - Individual disclosable items included as part of Results from Operating activities

For the <u>quantitative</u> evaluation, the auditor compares the rand value of each uncorrected misstatement with the relevant materiality figure.

- If a specific materiality figure has been determined for the particular financial statement item, that materiality figure must be used (ISA 450.A16). Otherwise, the overall materiality figure is used.

- If the misstatement exceeds the relevant materiality figure, the misstatement is individually quantitatively material.

  There is an exception in this regard, namely in the case of classification misstatements. This involves the evaluation of qualitative considerations, such as the effect of the classification misstatement on covenants, the effect on individual line items or sub-totals, or the effect on key ratios. There may be circumstances where the auditor concludes that a classification misstatement is not material in the context of the financial statements as a whole, even though it may exceed the materiality level or levels applied in evaluating other misstatements. For example, a misclassification between balance sheet line items may not be considered material in the context of the financial statements as whole when the amount of the misclassification is small in relation to the size of the related balance sheet line items and the misclassification does not affect the income statement or any key ratios (ISA 450.A20).

  This evaluation should be supported by the auditors understanding of the entity and the risk assessment performed during the planning and performance of the audit. The exercise of professional scepticism, professional judgement and any other relevant considerations must be clearly documented to enable an experienced auditor to understand these considerations made in reaching the conclusion. The auditor should therefore exercise caution in evaluating and assessing whether a classification misstatement is material or not.

- If the misstatement does not exceed the relevant materiality figure, the misstatement is not quantitatively material, however the auditor would continue to consider whether the misstatement is qualitatively material.

For purposes of evaluating whether uncorrected misstatements are qualitatively material, ISA 450 provides guidance on a number of matters and factors that may be relevant in the circumstances, as indicated below. It would be prudent to incorporate these into a firm's audit methodology and working papers in order to ensure that audit teams give due consideration not only to the quantitative effect of uncorrected misstatements, but also whether they may be qualitatively material.

- When considering the implications of uncorrected misstatements in classes of transactions, account balances and disclosures, the auditor exercises professional scepticism in accordance with ISA 200 (ISA 450.A22).

- Each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosure(s), as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement(s) in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgement (ISA 450.A17). Paragraph A17 of ISA 450 contains examples of where such misstatements may be material.

- In determining whether uncorrected misstatements are qualitatively material, consideration is given to the individual misstatement or when taken in combination with other misstatements. For example the auditor may consider whether identified errors are persistent or pervasive, or a number of identified misstatements are relevant to the same matter and in considering these collectively, may affect the users' understanding of that matter (ISA 450.A18).
- Furthermore, the circumstances related to some uncorrected misstatements may cause the auditor to evaluate these as material even if they are lower than the materiality for the financial statements as a whole (ISA 450.A21). Paragraph A21 of ISA 450 includes a list of circumstances that may affect the evaluation.

- ISA 240, paragraph 35 explains that when there is an indication that a misstatement may be as a result of fraud, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements (ISA 450.A22).

Once the auditor is satisfied that each individual uncorrected misstatement is neither quantitatively or qualitatively material, the auditor can commence with the process of evaluating and assessing whether they are material in aggregate.

f. Level of aggregation in assessing uncorrected misstatements

The auditor considers whether individual uncorrected misstatements are material in aggregate, both quantitatively and qualitatively.

From a quantitative perspective, aggregation refers to determining the cumulative quantitative effect of the uncorrected misstatements on the totals of different groups or categories of line items or financial statement items as presented and disclosed in the financial statements. The information needs of the users are paramount in assessing whether the financial statements present fairly, in all material respects. The manner in which information is collated, summarised and presented is a key consideration in assessing whether the financial statements as a whole "present fairly, in all material respects" in that the financial statements is the means used to present information to the users and these encapsulate certain messages that are conveyed, such as relationships between items, trends and totals used for calculating ratios.

The requirements of the applicable financial reporting framework determines which individual items need to be presented and disclosed in the separate statements and in the notes, as well as how these are to be categorised or grouped in order to present certain totals in the financial statements. Therefore, uncorrected misstatements that have been evaluated and assessed as being individually not material quantitatively and qualitatively are aggregated and further assessed.

Illustration of groups or categories of line items / financial statement items which represent the levels for aggregation of uncorrected misstatements (i.e. considering the aggregate effect)

Statement of financial position
- Current assets
- Non-current assets

- Total assets
- Current liabilities
- Non-current liabilities
- Total liabilities
- Equity

Statement of profit or loss and other comprehensive income
- Gross profit
- Total income (if applicable)
- Total expenses (if applicable)
- Results from operating activities
- Profit or loss for the year
- Other comprehensive income for the year
- Total comprehensive income for the year

Statement of cash flows
- Cash flows from operating activities
- Cash flows from investing activities
- Cash flows from financing activities

When determining the aggregate effect of individual uncorrected misstatements that are not material, these are offset in determining the net effect on the total of a particular group or category (such as those indicated above). This offsetting must not be confused with offsetting in evaluating and assessing individual uncorrected misstatements where ISA 450 paragraph A19 is of relevance. This is addressed under subsection a. above.

If the net effect of misstatements in relation to any of the above-mentioned totals (groups or categories) exceed the overall materiality figure, the aggregate effect of those misstatements is quantitatively material and, therefore, material to the financial statements as a whole. For example, if Accounts Receivable is overstated by an amount that is individually not material and Inventory is overstated by an amount that is individually not material and the total of these two overstatements are quantitatively material, then Current assets will be materially misstated. If however the total was not quantitatively material and Property Plant and Equipment was also overstated by an amount that is individually not material, the auditor would consider the total of these three overstatements. If the total of these three amounts are quantitatively material, then Total assets would be materially misstated.

If the aggregate effect does not exceed the overall materiality figure, the misstatements are not quantitatively material, but in line with the assessment of individual identified misstatements (refer to subsection a. above), the auditor continues to evaluate relevant qualitative factors to make a final determination on whether the uncorrected misstatements are material.

ISA 240, paragraph 35 requires the auditor to evaluate whether identified misstatements are indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognising that an instance of fraud is unlikely to be an isolated occurrence.

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Conclusion

Only once the auditor is satisfied that each individual uncorrected misstatement is neither quantitatively or qualitatively material, can the auditor commence with the evaluation and assessment of the aggregate effect of uncorrected misstatements.

Although the auditor first evaluates individual misstatements, there is a level of accumulation of identified misstatements that takes place for items that are required by the applicable financial reporting framework to be presented in the separate statements and disclosed in the notes to the financial statements, as follows, in order to determine whether each such individual item is free from material misstatement:

- Individual line items as presented on the face of a statement as part of the complete set of financial statements, such as property, plant and equipment, trade and other receivables and inventory on the face of the statement of financial position; and
- Sub-classifications of line items presented in the individual statements or in the notes to the financial statements, such as classes of property, plant and equipment, disaggregation of trade and receivables and disaggregation of inventories.

The process involved and relevant considerations are discussed in subsection a. of this FAQ.

There are various levels in the aggregation process where the net effect of individual uncorrected misstatements that are not material are considered. This is dependent on the requirements of the applicable financial reporting framework which determine how line items/financial statement items are to be categorised or grouped to present certain totals in the financial statements. Such totals represent the levels of aggregation to be applied.

The process involved and relevant considerations are discussed in subsection b. of this FAQ.

Uncorrected misstatements at individual and aggregate level are evaluated against quantitative and qualitative materiality determined in accordance with ISA 320 (ISA 450.10).

The auditor is reminded about the responsibility to communicate with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report (ISA 450.12). Such communication shall include the effects of uncorrected misstatements related to prior periods (ISA 450.13).

The auditor is further reminded about the responsibly to obtain written representation from management, and where appropriate those charged with governance indicating whether they believe that the effects of uncorrected misstatements are immaterial, individually and in aggregate to the financial statements as a whole. A summary of such items must be included or attached to the written representation (ISA 450.14).

Auditors should ensure that their evaluation of misstatements for an audit engagement is sufficiently and appropriately documented in the audit file, taking cognisance of the specific documentation requirements in ISA 450, paragraph 15. In particular, the audit documentation is required to include the auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

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10. Testing the completeness assertion from an appropriate source

With information systems relevant to financial reporting evolving, questions are being raised around whether the use of system-generated information (accounting system, financial reporting system or related sub system) is an appropriate source that will result in relevant information to be used as audit evidence in performing tests of details for understatement of a particular class of transactions, account balance or disclosure, in response to the identified risks of material misstatements (RoMM) relating to the completeness assertion?

Further context to the problem / challenge / uncertainty

Testing for understatement of a particular class of transaction, account balance or disclosure and the identification of a source that is appropriate continues to be a challenging area for the auditor. The challenges in this area are further exacerbated by continuous changes in the environment in which an audit is performed. Over the years, information systems have evolved from manual processes to, in many instances, fully automated processes, resulting in manual sources of information becoming redundant. The auditor is therefore challenged when identifying an appropriate source that will result in relevant information used to test for understatement in response to the identified RoMM.

An example of a deficiency identified through regulatory inspections and monitoring activities in relation to this challenge is that there is no documented audit evidence in the audit file to verify the appropriateness of the system-generated source from which a sample was selected and used for the purposes of testing for understatement (for example, revenue).

Specific references in the ISAs

The auditor has to comply with all ISAs relevant to the audit, including all relevant requirements read together with the related application material. The following specific references are relevant in considering the specific question presented here (but are not intended to be exhaustive):

- Preface to the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements (Preface to the International Standards), Para. 16
- Glossary of Terms - *Information system relevant to financial reporting*
- ISA 200, Para. 16
- ISA 230, Para. 8
- ISA 315 (Revised), Para 18; A129
- ISA 330, Para. A45
- ISA 500, Para. 7; 9;10; A27; A52
- ISA 530, Para. A5

Application of the requirements of the ISAs

The Glossary of Terms defines an *information system relevant to financial reporting* as a component of internal control that includes the financial reporting system, and consists of the procedures and records 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.

ISA 500.7 states that when designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence. The focus of this FAQ is on the relevance of information to be used as audit evidence, in that, if the auditor does not identify an appropriate source for testing the completeness assertion, the audit procedure may not give rise to relevant information to be used as audit evidence.

ISA 500.A27 specifically expands on the relevance of information to be used as audit evidence and indicates that relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, when appropriate, the assertion under consideration and that the relevance of information to be used as audit evidence may be affected by the direction of testing. The application material uses the example of testing accounts payable and states that when testing for understatement, testing the recorded amounts would not be relevant but testing information such as subsequent disbursements, unpaid invoices, supplier's statements and unmatched receiving reports may be relevant.

The *completeness* assertion is described as: "all transactions and events; 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 (ISA 315 (Revised)." A129 (a) (ii); (b) (iii)). ISA 330.A45 explains that the nature of the risk and assertion is relevant to the design of tests of details and states that tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.

The auditor is therefore tasked with identifying what should have been recorded in the financial statements and to use this as the source in the design of tests of details to obtain relevant information to be used as audit evidence in response to the identified RoMM related to the completeness assertion.

In accordance with the requirements of ISA 315 (Revised), the auditor must obtain an understanding of the entity and its environment, including the entity's internal controls. This includes an understanding of the information system, including the related business processes, relevant to financial reporting (ISA 315 (Revised).18).

The ISAs remain principles based and therefore do not dictate what an appropriate source is. In accordance with the Preface to the International Standards, as well as ISA 200.16, the auditor is required to exercise their professional judgement in identifying an appropriate source, which will give rise to relevant information to be used as audit evidence in testing for understatement.

The auditor may conclude that the use of system-generated information is an appropriate source in gathering relevant information that can be used as audit evidence in testing for understatement. Information systems may comprise a number of different yet integrated elements that provide for reporting on various matters. This may, for example include a module relating to the management of inventory that is linked to the inventory and payables general ledger, as well as the revenue and receivables general ledger. Although any information generated from such a module is *system generated*, this may relate to the initiation of the transaction, account balance or disclosure. Such information may therefore provide the auditor with an appropriate source for selecting items to test in gathering relevant information to be used as audit evidence in relation to the completeness assertion.

The purpose of the test of detail must be at the forefront of the auditor's mind at all times. Once the auditor has identified an appropriate source for selecting items for testing, the auditor must then ensure that the item selected for testing is ultimately recorded in the financial statements.

ISA 500.10 requires the auditor to determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure. The application material in ISA 500.A52 indicates that the means available to the auditor for selecting items for testing are:

- Selecting all items;
- Selecting specific items; and
- Audit sampling.

The auditor is reminded that when performing audit sampling, the auditor needs to perform audit procedures to obtain evidence that the population from which the audit sample is drawn is complete (ISA 530.A5).

The auditor is reminded of the documentation requirements contained in ISA 230.8 which states that the auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;
(b) The results of the audit procedures performed, and the audit evidence obtained; and
(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

To design tests of details that result in the auditor gathering relevant information to be used as audit evidence, the auditor needs to demonstrate, through documentation, an understanding of the information system relevant to financial reporting, such that an experienced auditor will understand why the chosen source is considered appropriate in selecting items to test in gathering relevant information to be used as audit evidence in responding to identified RoMM relating to the completeness assertion.

Conclusion

Although the auditing environment continues to evolve, the basic principles of auditing remain. The auditor is required to consider and document the relevance and reliability of information to be used as audit evidence. The focus of this FAQ is on the relevance of such information.

The auditor is required to obtain an understanding of the entity and its environment, including the information systems and, based on such an understanding, apply their professional judgement in identifying an appropriate source in gathering relevant information that can be used as audit evidence for tests of details performed in response to identified RoMM relating to the completeness assertion. This source may either be manual information or system-generated information, depending on the unique business process relevant to financial reporting that the entity under audit has implemented.

The ISAs recognise that the information system of the entity is wider than only relating to financial reporting. The understanding obtained by the auditor and the professional judgement applied in identifying an appropriate source in gathering relevant information that can be used as audit evidence must be sufficiently documented to enable an experienced auditor to understand why the chosen source is considered appropriate in gathering relevant information that can be used as audit evidence.

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