Summary of ISAs for ACCA F8 Students
The Essential Knowledge
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Overview

• ISA 200 – 265
  – Basic concepts/issues affecting whole audit
• ISA 300 – 330
  – Planning / Controls Assessment
• ISA 402 – 580
  – Evidence and Completion
• ISA 600 – 620
  – Reliance on work of others
Overview 2

• ISA 700 – 720
  – Audit report issues
SSA 200 - 265

- ISA 200 – Objectives & Conduct of audit
- ISA 210 – Engagement Letters
- *ISA 220 – Quality Control ... is not on F8 😊*
- ISA 230 – Documenting the Audit
- ISA 240 – Fraud
- ISA 250 – Laws & Regs at clients
- ISA 260 – Communicating with TCWG
- ISA 265 – Reporting Significant Deficiencies in Internal Controls to TCWG
ISA 200

• Lots of technical terms to learn
  • Reasonable Assurance
    – High, but not perfect level of assurance
  • Material
    – Something that could affect users’ decisions on FS
  • Sufficient Appropriate Evidence
    – Sufficient = enough, and depends on risk, judgment, quality of evidence collected
    – Appropriate = relevant to assertions, reliable (e.g. from a 3rd Party is better than from directors)
ISA 200 continued

- Professional Judgment
  - Use your training and experience, and consult colleagues

- Professional Skepticism
  - Questioning mind, be critical and do not assume client is right

- Misstatement
  - Mistake caused by error, or deliberate fraud

- Audit Risk
  - Risk of material misstatements, and auditor fails to detect
  - Assess risk, and respond to them (with audit work)
ISA 200 continued

• Audits are not perfect – LIMITATIONS
  • Heavy use of judgment
  • IAS often offers choice of accounting treatments
  • Directors have incentive to lie to auditors
  • Auditors cannot check everything
  • Fraud, Related Party Transactions hard to identify

• In other words, REASONABLE assurance, not TOTAL!
ISA 200 continued

• For an audit to take place, there are PRECONDITIONS:
  – Company using an acceptable FR framework
  – Directors accept responsibilities for:
    • To prepare FS under this FR framework
    • To maintain suitable IC Systems to protect FS
    • To provide auditors with all evidence
ISA 200 continued

• Audit Standards – structure
  • Objective/Aim
  • Required actions by auditor
  • Guidance
  • Introduction
  • Examples
  • Definitions
  • Help for audits of smaller companies
ISA 210 – Terms of Engagement

• Only accept audit engagement if:
  • Preconditions in place (see ISA 200)
  • Terms understood by auditor and management

• To ensure understanding of term ...

ENGAGEMENT LETTER 😊
ISA 210 – Engagement Letter

- The terms of the audit assignment (contract)
  - Responsibilities of auditor and management
  - Which FR framework, and which audit standards
  - Limitations of an audit
  - Explanation of audit process
  - Explanation of communication with TCWG, and when
  - Whether experts, client’s Internal Audit to help
  - Fees
  - Any liability restriction
ISA 230 - Documentation

• Document everything, to show ISAs followed
  • Helps in planning and review of work
  • Helps in future quality control checks of audit files
    – An experienced auditor should be able to understand work done, conclusions reached

• Amount of documentation will depend on size, complexity of client, risk, nature of work done etc.
ISA 230 continued

• All working papers should say:
  • WHAT work was done, and WHY
  • WHO did it, and WHO reviewed it
  • WHEN the work, and review, were done
  • HOW was work done
  • CONCLUSIONS reached
  • How JUDGMENT was used, if relevant

• May STANDARDISE working papers
  • Helps quality, junior staff, review
  • May result in too “mechanical” approach, no judgment
ISA 230 continued

• CURRENT AUDIT FILE
  • All working papers for current year audit
  • Whole process from draft FS to final FS

• PERMANENT AUDIT FILE
  • Working papers of use in future year audits
    – Organisation structure / info on company history
    – Long term documents (leases, grants, loans)
    – Control System description
ISA 240 - Fraud

• Definition of fraud
  • Stealing assets of company
  • Fraudulent financial reporting (deliberate misstatements or omissions in FS)

• Responsibility to prevent and detect...
  – MANAGEMENT and Those Charged with Governance (TCWG)

• Auditor responsibility
  • To assess risks of fraud (ISA 315) and respond (ISA 330)
ISA 240 continued

• To Assess Risks of Fraud
  • Be aware of those who have MOTIVE + OPPORTUNITY
  • Discuss Fraud in audit planning meeting
  • Assess Internal Controls re. fraud

• Audit Work/Response re Fraud Risks
  • Maintain prof skepticism
  • Ask client’s Internal Audit and TCWG for info
  • Check all journal entries, and estimates for bias
  • Get a Mgmnt representation (ISA 580) – all fraud suspicions reported to auditors
ISA 250 – Laws + Regs at Clients

• Auditor responsibilities
  • Understand relevant laws and regs of client
    – Enquire of mgmnt / client’s legal advisers
    – Inspect Board Minutes for discussion of breaches / new rules
  • To tell mgmnt / TCWG of any breaches of laws by company
  • To report to external regulator / police as necessary
  • Consider effect on FS
    – Provision for fines/penalties
    – Accrual for legal costs
    – Serious breach – potential Going Concern
ISA 260 – Communicating with TCWG

• WHY?
  • As part of process to understand client
  • To agree audit / client responsibilities
  • Discuss ethical threats and proposed safeguards
  • Agree audit plan
  • Discuss audit findings at completion stage
  • Inform TCWG of any misstatements not corrected by mgmnt
  • Explain proposed audit report
  • Difficulties experienced during audit
ISA 265 – Mgmnt Letter to TCWG

• Communicating significant deficiencies in ICS
  • Controls not working properly
  • Controls missing completely

• Deficiencies / Consequences / Recommendations for Improvement

• Covering Letter
  • Only those problems found in normal audit process so not comprehensive list of problems company has
  • Only for use by mgmnt – no 3rd Party use of Letter
ISA 300 - 330

• ISA 300 – Planning
• ISA 315 – Understanding Entity & Environment (to identify audit risks)
• ISA 320 – Materiality
• ISA 330 – Responding to Risks
ISA 300 – Audit Planning

• Why Plan
  • Time allocated to important areas of FS
  • To identify likely problems as soon as possible
  • Efficiency of audit process
  • To allow a review at the completion phase
  • To identify need for experts / specialist staff

• Strategy v Detailed Plan
  • Strategy is overview, Plan is risk assessment / response
ISA 300 – Strategy v Plan

• STRATEGY
  • What FR they use / reporting requirements (e.g. listed)
  • Timetable for audit
  • Client-relevant info from prior years / since last year
  • Interim Audit pre y/e? Stocktake to attend?
  • Resources needed (experts, 2nd partner for review?)

• DETAILED AUDIT PLAN
  • When to do risk assessment (Interim Audit?) and WHO and HOW
  • What audit work to do in RESPONSE to these risks, and WHO will do it (and WHEN!)
ISA 315 – Identifying Risk

• Understand Client and its Environment
  • Enquire of management
  • Analytical Procs (to see how figures inter-relate)
  • Inspect operations / website / mgmnt accounts
  • Last year’s audit papers

• Info Required
  • Industry laws and regulations
  • Directors
  • Plans and accounting policies
  • Business model, key customers, suppliers, regulators
ISA 315 – Risk Assessment (continued)

• 5 Elements of IC System
  • Control Environment
    – Mgmnt style, attitude, org. structure, ethics, HR policies, training of staff
  • Control Procedures/Activities
    – CARCAP, from class notes!!
  • Info System
    – How transactions initiated, processed and recorded
  • Risk Assessment
  • Monitoring (by Internal Audit)
ISA 315 – Audit Risk

- Risk of material misstatement (FS Risk) and substantive tests fail to detect them (D Risk)
- Audit Risk = FS Risk x Detection Risk
- FS Risk = Inherent Risk x Control Risk
- IR and CR – overall FS (e.g. Going Concern Threats, poor Control Environment)
- IR and CR – specific ASSERTIONS (see next slide)
ISA 315 - Assertions

• INCOME STATEMENT
  • Completeness
  • Occurrence
  • Cut-Off
  • Classification
  • Accurate Value
ISA 315 - Assertions

• BALANCE SHEET / ST of FIN POSITION
  • C ompleteness
  • O wnership (”Rights & Obligations”)
  • V aluation
  • E xistence

• DISCLOSURE NOTES
  • C ompleteness
  • O ccurrence
  • V alues correctly disclosed
  • U nderstandable / clearly presented and explained
ISA 315 – Controls

• Limitations
  • Human error
  • Collusion
  • Mgmt override them

• Computer Controls
  • General (passwords, back-ups, security, anti-virus)
  • Application (range limits, sequence checks)
ISA 320 - Materiality

An item is material if it could affect the decisions of users of the FS

• By SIZE (Quantitative)
  • 0.5%-1% Revenue
  • 1%-2% Assets
  • 5%-10% Profit

• By NATURE (Qualitative)
  • E.g. director pay
Materiality affects
  • Assessment of importance of FS risks
  • Sample sizes

Performance Materiality
  • Smaller than Materiality, to recognise that during audit process smaller misstatements will add up!

End of audit
  • Aggregate all misstatements to assess overall effect
ISA 330 – Responding to Risks

• By doing AUDIT TESTS!
  • Control Tests (did controls operate throughout year)
  • Substantive Tests- using tests (AEIOU) to get evidence (DADA3) to verify assertions (COVED) about balances and disclosures

• If CONTROLS good, reduce Sub Tests

• Other responses to risks
  • Increase prof skepticism
  • Increase seniority of audit team staff
ISA 402 – 450

• ISA 402 – Service Organisations
• ISA 450 – Evaluating Misstatements
ISA 402 – Service Organisations

• Companies outsource some things
• If this thing relates to numbers in the FS, may be hard for auditor to get evidence
• To get evidence about controls:
  • Get written report from the service provider’s own external auditors
    – Just a description of the IC Systems (Type 1 Report)
    – Opinion on effectiveness of the IC Systems (Type 2 Report)
ISA 450 – Evaluating Misstatements

• This standard applies Materiality (ISA 320) to the misstatements found during the audit.
  • Record ALL misstatements found (unless trivial)
  • Ask mgmnt to correct them, or explain why not
  • For misstatements they will not correct:
    – Add up to assess if combined effect is material
    – Get Mgmnt Rep to confirm they are not correcting them purely due to immateriality
ISA 500 - 580

- ISA 500 – Evidence
- ISA 501 – Evidence: Specific Items
- ISA 505 – External Confirmations
- ISA 510 – Initial Audits: Opening Balances ... not on F8 😊
- ISA 520 – Analytical Procedures
- ISA 530 – Sampling
- ISA 540 – Audit of Estimates
- ISA 550 – Audit of Related Parties ... not on F8 😊
- ISA 560 – Subsequent Events
- ISA 570 – Going Concern
- ISA 580 – Written Representations
ISA 500 – Audit Evidence

• Sufficient Appropriate Evidence:
  • Sufficient = quantity, depends on risk, quality of evidence
  • Appropriate = Relevant and Reliable
    – Relevant = to an assertion
    – Reliable = 3rd Party, auditor-obtained, original documents are better than client-provided and oral
ISA 500 – Audit Evidence

• Types of audit test:
  – **Analytical Procedures**
    • Comparing current year with last year, Industry etc.
  – **Enquiry and Confirmation**
    • Ask questions and get written replies
  – **Inspection** (of documents, of assets)
  – **Observation** (of controls happening)
  – Recalc **U** lation
ISA 501 – Evidence (Specific Items)

• Inventory
  – Attend client stocktakes
    • Liaise with Internal Audit if multi-location
    • May need to use experts (e.g. to assess WIP)
    • If count not y/e, attempt roll-back or roll-forward
    • At final audit, check stocktake list to final stock list
  – Legal Claims against company
    • Confirmation from client’s lawyers on details
    • Written Rep from mgmmt / Board minutes on whether they plan to fight it or settle out of court
ISA 505 – External Confirmations

• Positive confirmations
  • Must reply, either to confirm/dispute balance or to fill in a balance

• Negative confirmations
  • Reply needed only if disagreeing with balance

• If mgmnt do not want auditor to contact a customer
  • Report it to Audit Committee
  • Get alternative evidence about this balance
ISA 520 – Analytical Procedures

• Used at:
  • PLANNING (ISA 315 covers this)
  • As a SUBSTANTIVE test (part of AEIOU)
  • At COMPLETION phase

• Method
  • Compare auditor EXPECTATION with DRAFT FS
  • If expectation uses predicted relationships, and is close to draft figure, may be enough evidence in itself
  • Use prior year, Industry, budgets, ratios etc.

• Completion Stage
  • To take account of figures (and expectations) changing during audit
ISA 530 - Sampling

• Aim = REPRESENTATIVE sample
  • Sample has same characteristics as population
  • Then can EXTRAPOLATE results from sample to population overall
  • Use statistical sampling (RANDOM + probability theory)
ISA 530 - Sampling

• Lots of terms to know:
  • SAMPLING UNIT – item being tested (e.g. an invoice)
  • STRATIFICATION – break population into sub-populations (e.g. by value, or by age)
  • SAMPLING RISK – risk sample is not representative
  • NON-SAMPLING RISK – risk audit staff mess up test
  • ANOMALY – error that is clearly a one-off (rare!!)
  • TOLERABLE MISSTATEMENT – maximum error acceptable in a sample (based on Perf Materiality)
ISA 530 - Sampling

• SAMPLE SELECTION METHODS
  • Random (best method)
  • Value-Weighted (random, where sampling unit is each individual $)
  • Block (not good – simple, as it picks a “block” of transactions or balances, unlikely to be representative)
  • Haphazard (audit staff manual attempt to be random, hard to avoid bias though)
ISA 540 – Audit of Estimates

• Estimates include:
  • Uncertain future events
  • Valuation of items (e.g. assets)

• If estimate does not turn into actual, this does NOT mean the estimate was bad at that time!

• Issues
  – How management measures them
  – The models used (if relevant)
  – Expert used / Assumptions used / level of uncertainty
ISA 540 – Audit of Estimates

• Audit work on estimates
  • Prior year v actual (to assess their methods)
  • Post y/e latest events
  • Assess mgmnt’s estimation methods
  • Auditor expectation v the estimate
  • Assumptions used by mgmnt – realistic?
  • Get a Written Rep confirming best estimate
  • Audit the expert (if one used)! (ISA 620)
ISA 560 – Subsequent Events

• The audit of IAS 10 matters (EARP / PBSE)
  • PBSE are events between y/e and date FS signed
  • Give evidence of company’s position at y/e, then ADJUSTING
  • Do not give such evidence, then NON-ADJUSTING
  • If non-adjusting, could be so significant to need DISCLOSURE
SSA 560 – Subsequent Events

• The problem is this – sometimes the event that happens BEFORE FS are signed is not discovered until AFTER FS are signed.

• But if the event was before FS were signed, it is an IAS 10 EARP and may be adjustable, or disclosable.
ISA 560 – Subsequent Events

• Auditor audits as normal (active duty) up to date audit report is signed (after FS signed).

• After that date, duty becomes “passive”.
  • If a EARP is DISCOVERED after FS and Audit Report signed (but event OCCURRED before FS signed), assess if it is:
    – Adjustable
    – Non-adjustable, but disclosable
  • Ask Board if they plan to correct the FS (they should do)
ISA 560 – Subsequent Events

• If directors change the FS:
  – Check the correction done properly
  – Check they changed nothing else!
  – The IAS 10 applicable date has now moved forward to the later date the new revised FS are signed – so audit the gap
  – Sign new audit report, with Emphasis of Matter to explain that the FS were revised, and the initial audit report can be ignored

• If directors refuse to change FS:
  – Get legal advice
  – Speak at AGM
  – Consider resignation
ISA 570 – Going Concern

• Auditor must:
  • Assess if Going Concern basis of preparation is correct
  • Assess any disclosures of GC threats

• FRS 1
  • FS normally prepared under GC assumption
  • This means company expected to continue for > 1 year
  • If not, use alternative basis of preparation
  • Disclose any significant GC threats in a FS Note
ISA 570 – Going Concern

• Indicators of GC problems
  • Net liabilities
  • Loans need to be repaid soon (or other big outflows)
  • Suppliers denying credit
  • Loss of key staff / products / markets
  • Legal claims / regulatory investigations
  • New competitors
  • Losses / poor cash position
  • Ratio analysis looks bad
ISA 570 – Going Concern

• Audit Work
  • Review forecasts (and whether assumptions realistic)
  • Mgmnt Accounts since y/e for latest results
  • Loan agreements
  • Board Minutes
  • Get a Written Representation
  • Recent orders received
  • Correspondence with bank
  • Availability of cash / assets to sell (or use for secured loan)
ISA 570 – Going Concern

• If not a GC, but they used GC basis of prep:
  • Adverse Opinion

• If a GC, but there are threats not disclosed:
  • “Except for” qualified opinion, or Adverse, depending on the nature of the missing disclosure

• If a GC, with threats, which ARE disclosed in FS:
  • Unmodified opinion, plus Emphasis of Matter paragraph
ISA 580 – Written Representations

• Confirmations from management of:
  • Responsibility for FS and IC System
  • All evidence given to auditors
  • To support other evidence
    – Specific matters (e.g. a legal case)
    – Going Concern
    – All fraud issues told to auditors
    – All contingent liabilities disclosed
    – That any uncorrected misstatements are immaterial
    – All estimates are best estimate
ISA 600 - 620

• *ISA 600 - Audit of Group FS* ... not on F8
• ISA 610 – Reliance on work of internal audit
• ISA 620 – Reliance on auditor’s expert
ISA 610 – Using work of Internal Audit

• If client has Internal Audit, its work may be relied upon by External Audit
  • External auditor retains responsibility in full for audit opinion
  • Only rely if IA work relevant, properly planned and documented etc.
• Assess IA
  – Independent?
  – Competent / qualified staff?
  – Work done with due professional care
ISA 610 – Using the work of Internal Audit

• Other considerations:
  • Communicate with IA to help assess risk of material misstatement in FS at planning
  • For judgment areas of FS, and high risk areas, do not rely much on IA work, EA should do it themselves
  • Do not use IA to help with 3rd Party confirmations
  • Communicate plans to rely on IA to TCWG (ISA 260)
  • Where relying on IA work, reperform some first to ensure it is reliable
ISA 620 – Reliance on Experts

- Auditor may use an expert to help audit
- If hire OWN expert, not client’s, easier to:
  - Get independence
  - Control their work
- Consider:
  - Independence
  - Competence
  - Experience
ISA 700 - 720

• ISA 700 – Audit Reports
• ISA 705 – Modified Opinions
• ISA 706 – Emphasis of Matter & Other Matter
• ISA 710 – Comparative figures ... not on F8 😊
• ISA 720 – Other Information
ISA 700 – Auditor’s Report

• Content required:
  • Title (including word “Independent”)
  • Introduction (listing the FS audited)
  • Responsibilities (of management and auditor)
  • Description / Basis
    – How work done
    – Whether sufficient appropriate evidence obtained
  • Opinion
    – Whether FS are true and fair
  • Report on Other Legal Matters
    – Those matters required by your specific government
ISA 705 – Modified Opinions

• 4 Modified Opinions
  • Qualified “Except for” material misstatement
  • Qualified “Except for” lack of evidence
  • Adverse opinion (“not a true and fair view”)
  • Disclaimer (“we do not give an opinion”)

• Adverse and Disclaimer if pervasive:
  • Pervasive = affects many balances, or a single balance / disclosure in a fundamental way
ISA 705 – Modified Opinions

• Above Opinion
  • “Basis for qualified / adverse / disclaimer of opinion”
    – Describes why opinion being modified
    – E.g. the IAS being breached and financial effect
    – E.g. the missing evidence and reason it is missing

• When modifying, inform TCWG (see ISA 260)
ISA 706 – E of M and OM Paragraphs

• Additional communication to shareholders, on matters that are audit related.
• However, **no effect on audit opinion**
• Emphasis of Matter
  • Where something in **FS** needs to be highlighted
  • Extra paragraph under Opinion
  • Refer to the FS Note being highlighted
  • Make clear opinion not modified
• Other Matter
  • Same as E of M, except the matter to be highlighted is **NOT** in FS, and is **INCORRECT** (eg error in Chairman Statement)
ISA 706 – E of M and OM paragraphs

• Emphasis of Matter examples:
  • Audit Report revised and reissued (as per ISA 560) *(note, this example very unlikely in exam)*
  • Major Going Concern threat disclosed correctly in FS

• Other Matter example:
  • Inconsistency in “Other Information” (ISA 720)
ISA 710 - Comparatives

- Relates to prior year figures in current year FS
  - Make sure b/f = c/f from last year
  - Ensure consistent accounting policies with last year

- Audit Report issues
  - Prior year modified opinion unresolved, means comparatives are / might be wrong – so report it!
  - Can modify opinion if this year you find a mistake in last year’s figures
ISA 720 – Other Information

• Credibility of audited FS may be undermined...
• ...by inconsistent info within the Other Info
  – Read the Other Information pre-audit report
  – If problem, tell TCWG
  – May need to get legal advice
  – Other Matter paragraph
  – May need to resign