Auditing – Lecture 4

Part II. Audit process by phase: Phase I. Client acceptance

Content

- Objectives of audit – objectives + setting of objectives
- Acceptance of client – acceptance, ability, professionals, predecessor, engagement
- Recommended reading
- Appendices: ISA 200, 210, 240, 250, 620

Objectives of conducting an audit – steps

- **Steps** to develop audit objectives:
  - Understand **objectives and responsibilities (O&R)** for the audit
  - Divide financial statements into **cycles**
  - Know **management assertions** about financial statements
  - Know **general audit objectives** for classes of transactions, accounts, and disclosures
  - Know **specific audit objectives** for classes of transactions, accounts, and disclosures
- **The responsibility for adopting sound accounting policies, maintaining adequate internal control, and making fair representations in the financial statements rests with management rather than with the auditor. In contrast, the auditor's knowledge of these matters and internal control is limited to that acquired during the audit.**

Objectives of conducting an audit – mgmt's O&R

- The **annual reports** of many public companies **include a statement about management's responsibilities and relationship with the CPA firm.** Management's responsibility for the integrity and fairness of the representations (assertions) in the financial statements carries with it the privilege of determining which presentations and disclosures it considers necessary. **If management insists on financial statement disclosure that the auditor finds unacceptable, the auditor can either issue an adverse or qualified opinion or withdraw from the engagement.**
- SOX requires the chief executive officer (CEO) and the chief financial officer (CFO) of public companies to certify the quarterly and annual financial statements submitted to the SEC. In signing those statements, **management certifies that the financial statements fully comply with the requirements of the Securities Exchange Act of 1934 and that the information contained in the financial statements fairly present, in all material respects, the financial condition and results of operations**.

Objectives of conducting an audit – auditor's O&R*

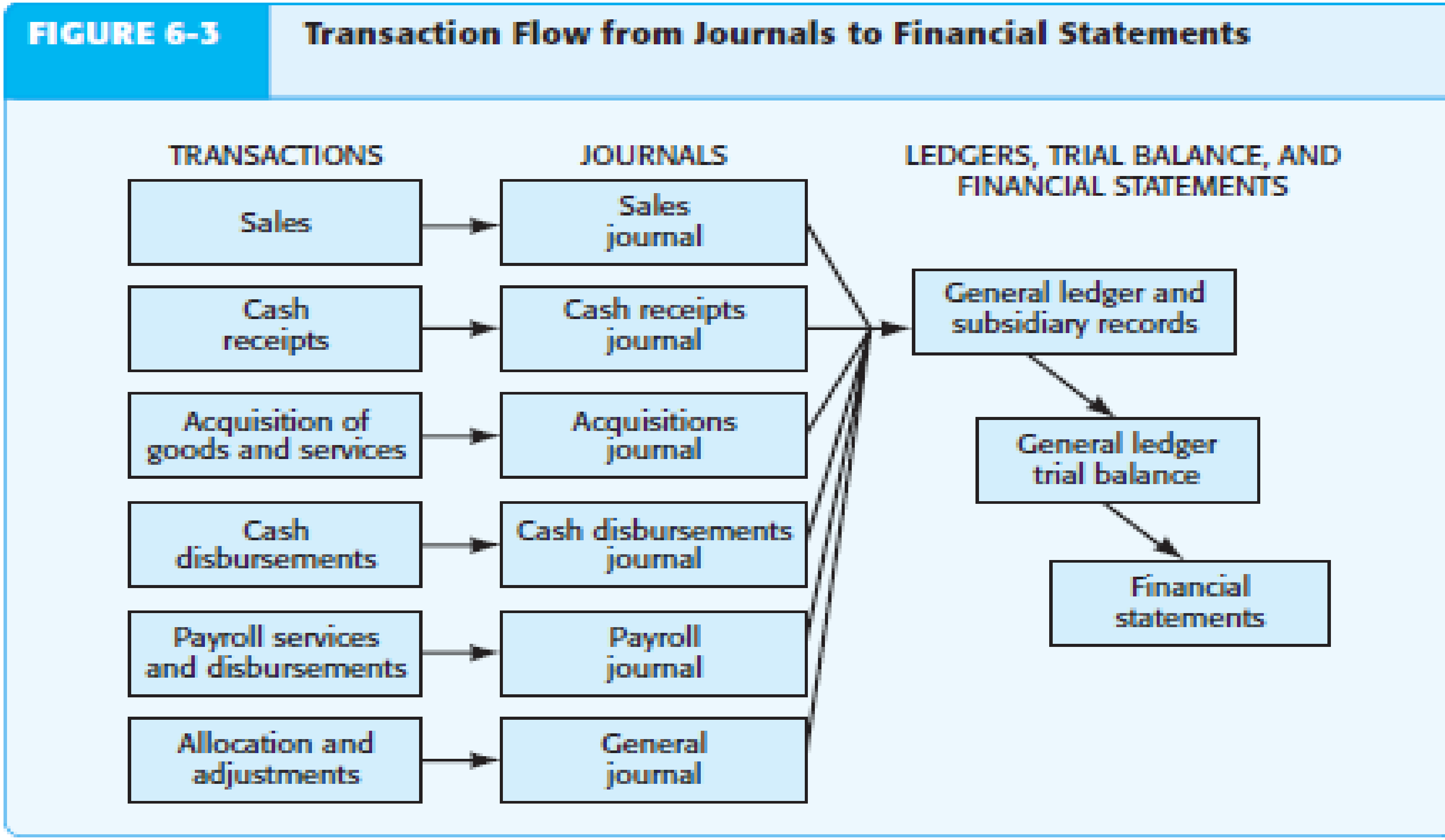
- ISA 200, 240 and 250 set the following **overall objectives of the auditor:**
  - To obtain reasonable assurance about whether **the financial statements as a whole are free from material misstatement, whether due to fraud or error**, thereby enabling the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
  - To **report on the financial statements**, and communicate as required by auditing standards, in accordance with the auditor's findings.

* See Appendix: ISA 200, 240, 250

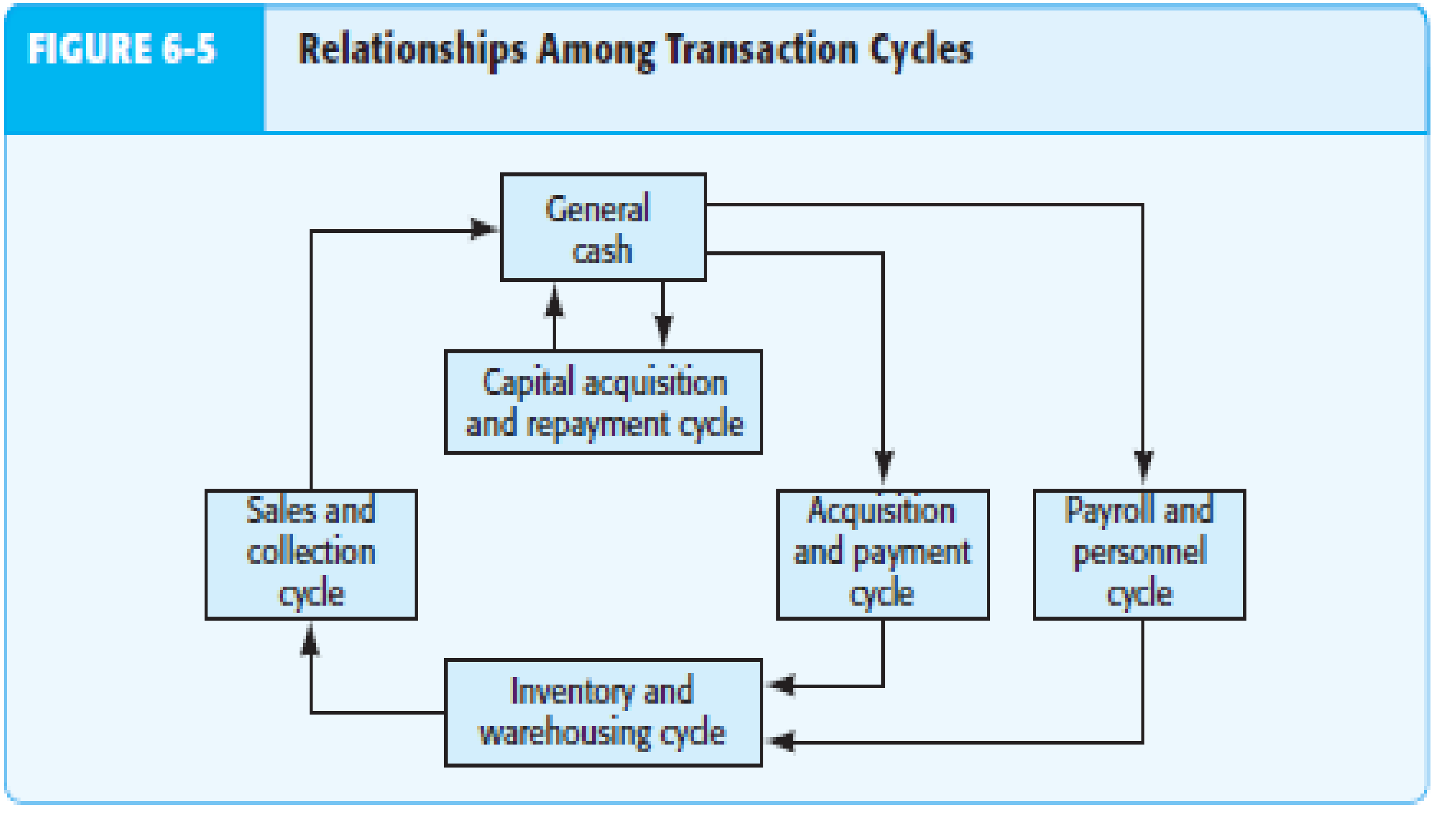
Objectives of conducting an audit – fin statements cycles

- Audits are performed by **dividing the financial statements into smaller segments or components**. The division makes the audit more manageable and aids in the assignment of tasks to different members of the audit team. **Each segment is audited separately but not on a completely independent basis.** After the audit of each segment is completed, including interrelationships with other segments, the results are combined. A conclusion can then be reached about the financial statements taken as a whole.
- **A common way to divide an audit is to keep closely related types (or classes) of transactions and account balances in the same segment**. This is called the **cycle approach**. For example, sales, sales returns, cash receipts, and charge-offs of uncollectible accounts are the four classes of transactions that cause accounts receivable to increase and decrease. Therefore, they are all parts of the sales and collection cycle. Similarly, payroll transactions and accrued payroll are parts of the payroll and personnel cycle.

Objectives of conducting an audit – fin statements cycles



Objectives of conducting an audit – fin statements cycles



Objectives of conducting an audit – setting of objectives

- There are transaction-, balance-, presentation- and disclosure-related audit objectives:
  - **Transaction-related audit objectives** - **are closely related to management's assertions about classes of transactions**. There is a difference between general transaction-related audit objectives and specific transaction-related audit objectives for each class of transactions. The six general transaction-related audit objectives discussed here are applicable to every class of transactions and are stated in broad terms. Specific transaction-related audit objectives are also applied to each class of transactions but are stated in terms tailored to a specific class of transactions, such as sales transactions. **General transaction-related audit objectives:**
    - **Occurrence** – recorded transactions exist
    - **Completeness** – existing transactions are recorded
    - **Accuracy** – recorded transactions are stated at the correct amounts

Objectives of conducting an audit – setting of objectives

- **Posting and summarization** – recorded transactions are properly included in the master files and are correctly summarized
- **Classification** – transactions included in the client's journals are properly classified
- **Timing** – transactions are recorded on the correct dates

- **Balance-related audit objectives** – are similar to the transaction-related audit objectives just discussed. They also **follow from management assertions and they provide a framework to help the auditor accumulate sufficient appropriate evidence related to account balances.** There are also both general and specific balance-related audit objectives. The major difference between balance-related and transaction-related audit objectives is that balance-related audit objectives are applied to account balances. **General balance-related audit objectives are the following:**

Objectives of conducting an audit – setting of objectives

- **Existence** – amounts included exist
- **Completeness** – existing amounts are included
- **Accuracy** – amounts included are stated at the correct amounts
- **Classification** – amounts included in the client’s listing are properly classified
- **Cutoff** – transactions near the balance sheet date are recorded in the proper period
- **Detail Tie-In** – details in the account balance agree with related master file amounts
- **Realizable Value** – assets are included at the amounts estimated to be realized
- **Rights and Obligations** - in addition to existing, most assets must be owned before it is acceptable to include them in the financial statements. Similarly, liabilities must belong to the entity.

Objectives of conducting an audit – setting of objectives

- **The presentation and disclosure-related audit objectives are identical to the management assertions for presentation and disclosure discussed previously**. The same concepts that apply to balance-related audit objectives apply equally to presentation and disclosure audit objectives.

Acceptance of client - sources of information

- The **client acceptance phase** of the audit has **two objectives**:
  - **examination of the proposed client** to determine if there is any reason to reject the engagement - acceptance of the client;
  - **convincing the client to hire the auditor** - acceptance by the client.
- **The procedures to acceptance of the client** are: acquiring knowledge of the client's business; examination the audit firm's ethical requirements and technical competence; possible use of other professionals (including outside specialist) in the audit; communication with the predecessor auditor; preparation of client proposal; assignment of staff and the submission of the terms of the engagement in the form of an audit engagement letter.
- **Sources of information for examination** of the proposed client:
  - **Publicly available information** - media and government databases, client, industry, and government websites
  - **Audit firm experience** – prior workpapers, client financials

Acceptance of client - discussion

- **Information from client** - client press releases, minutes important meetings, government correspondence, people associated with entity, internal audit personnel, employees, management

- **Discussions with client's management and staff** is important to evaluate governance, internal controls and possible risks. These discussions might include such subjects as:
    - changes in management, organizational structure, and activities of the client;
    - current government regulations affecting the client;
    - current business developments affecting the client such as social, technical and economic factors;
    - current or impending financial difficulties or accounting problems;
    - susceptibility of the entity's financial statements to material misstatement due to error or fraud;
    - existence of related parties

Acceptance of client – new client

- Before accepting **a new client** an audit firm will do **a thorough investigation to determine if the client is acceptable and if the auditor can meet the ethical requirements** of independence, specific competence, etc.
- Other sources of information for investigation of new client include interviews with local lawyers, other CPAs, banks and other businesses, although many of them, depending on local circumstances, might be bound by obligations of confidentiality. Sometimes the auditor may hire a professional investigator or use its forensic accounting department to obtain information about the reputation and background of the key members of management. If there has not been a previous auditor, more extensive investigation may be undertaken.

Acceptance of client – continuing client

- Many auditing firms evaluate **existing clients** every year. In addition to the research discussed above, the auditor will **consider any previous conflicts over scope of the audit, type of opinion and fees, pending litigation between the audit firm and client, and management integrity.** These four factors strongly influence whether the relationship will continue. For continuing engagements, the auditor would **update and re-evaluate information** gathered from the prior years' working papers. The auditor should also perform procedures designed to **identify significant changes** that have taken place since the last audit.
- The auditor may also choose **not to continue conducting audits for a client because he feels excessive risk** is involved. For example, there may be regulatory conflict between a governmental agency and a client which could result in financial failure of the client and perhaps ultimately lawsuits against the auditor. It may be that the auditor feels that the industry (such as financial services) offers more risk than is acceptable to the specific auditor.

Ability to meet ethical requirements

- In order to be involved into assurance engagement firstly the CPA firm should be ability to meet ethical requirements **– independence and competence.**
- The auditor will ensure that the members of the auditor team as well as the entire audit firm meet the relevant independence requirements . This will require **procedures to check personal financial investments of partners and employees and the business relationships with the potential audit client.** He should review the **non-audit services** his audit firm are providing or have recently been providing to this potential client. IFAC's Code of Ethics for Professional Accountants in a commentary on fees suggests **independence is jeopardized if fees due from a client for professional services remain unpaid for an extended period of time.** There is a threat to independence if a substantial part of what is owed is not paid before the issue of the report of the auditor for the following year.

Ability to meet ethical requirements

- The issue of **specific competence** needs specific consideration in the light of client evaluation in the previous step of the engagement process. On the basis of the specific circumstances of the client and its industry, the auditor should determine **if the necessary expertise regarding the industry, specific US GAAP/IFRS issues, or certain non-audit skills are available to the audit team**. Consideration of whether the firm has the **competencies and resources to undertake a new engagement** includes reviewing existing partner and staff competencies, for:
  - knowledge of relevant industries or subject matters;
  - experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge in an effective manner;
  - understanding and practical experience of similar engagements;
  - appropriate technical knowledge, including relevant information technology knowledge

Cooperation with other professionals – an auditor*

- Part of the search for background information includes considering **if another auditor will be required to audit a component of the business** such as a division in another country. If another auditor is auditing part of the financial statements, the auditor should consider the impact of using the work of another auditor on the combined financial statements.
- The purpose of ISA 600 and 620 - the standards about the work of other professionals - is to establish standards and provide guidance when an auditor, acting as a group auditor, decides to use the work of a related auditor or other auditor in the audit of group financial statements. A **related auditor** is an auditor from the group auditor's firm, a network firm, or other firm operating under common quality control policies and procedures. Any auditor who is not the group auditor or a related auditor is an "**other auditor**."

See Appendix: ISA 620

Cooperation with other professionals – an auditor

- When the group auditor concludes **that the work of the related auditor or other auditor cannot be used and the group auditor has not been able to perform sufficient additional procedures, the group auditor should express a qualified opinion because there is a limitation in the scope of the audit.** In some countries, like the Netherlands, the group auditor may only refer to the use made of other auditors to motivate a qualified, disclaimer of adverse audit opinion. This is to emphasize the undivided responsibility of the group auditor. In other countries (e.g. the USA) it is possible to assume divided responsibility, which is expressed by referring in the audit opinion to the fact that the financial statements include numbers that have been audited by another auditor, without affecting the unqualified nature of the opinion.

Cooperation with other professionals – an expert*

- **The auditor's education and experience enable him to be knowledgeable about business matters in general, but he is not expected to have the expertise of a person trained for another profession such as an engineer**. If the auditor requires special expertise, the auditor should consider **hiring an expert to assist in gathering the necessary evidence.** ISA 620 defines **an expert** as **a person or firm possessing special skill, knowledge, and experience in a particular field other than accounting and auditing.** Situations where an auditor might use an expert are valuations of certain types of assets (land and building, works of art, precious stones, etc.); determination of physical condition of assets; actuarial valuation; value of contracts in progress; specific IT expertise (e.g. in the audit of a telecommunications company); and legal opinions.

See Appendix: ISA 620

Cooperation with other professionals – an expert

- If an expert's work is to be used as audit evidence, **the auditor should determine the expert's skills and competence** by considering professional certifications, experience and reputation. **The expert's objectivity should be evaluated**. Objectivity is impaired when the expert is employed by the client or related in some manner to the client. The auditor should obtain sufficient appropriate audit evidence that the scope of the expert's work is adequate for the purposes of the audit.
- **When issuing an unqualified and unmodified auditor's report, the auditor should not refer to the work of the expert**. Such a reference might be misunderstood to be a qualification of the auditor's opinion or division of responsibility.
- If, as a result of the work of an expert, **the auditor decides to issue a modified auditor's report,** in some circumstances when explaining the nature of the modification it may be appropriate **to refer to the expert by name and the extent of his involvement.** This disclosure requires the permission of the expert.

Communication with predecessor

- If there is **an existing auditor**, the IFAC Code and AICPA Code require **the new auditor to communicate directly with the predecessor auditor.** In cases when a new auditor will replace an existing auditor, the code of ethics advises the new, proposed auditor **to communicate with the existing accountant**. The extent to which an existing accountant can discuss the affairs of the client with the proposed accountant will depend on **receipt of the client's permission and the legal or ethical** requirements relating to this disclosure. The **purpose of this communication is to determine whether there are technical or ethical facts, or circumstances the new auditor should be aware of, prior to accepting the audit**. This requirement is an important measure to prevent "opinion shopping," or to notify the new auditor of the circumstances under which the predecessor auditor has ended the relationship with the client.

Engagement proposal*

- After the auditor has determined that the client is acceptable from a risk and ethics perspective, and has concluded that the ethical requirements regarding the specific client engagement can be met, then, typically, significant effort is devoted **to gaining the auditee as a client, given the competitive pressure that exists in the current audit environment**. This requires a carefully prepared **engagement proposal**. Aspects of the procedures for the engagement proposal may be found in ISA 210 - the auditor and the client should have a mutual understanding of the nature of the audit services to be performed, the timing of those services, the expected fees, audit team, audit approach, audit quality, use of client's internal auditors, and the transition needs.
  - **The continuing client proposal** will differ between firms, but generally it discusses the following: a review of how the auditing firm can add value, both to the company in general and to those directly responsible for the engagement of the auditor, for example the Audit Committee; plans for further improvement in value added including discussion of present

See Appendix: ISA 210

Engagement proposal

regulatory trends, audit scope, and any recent changes in the company that may affect the audit; a description of the audit team and any changes in the audit team from the previous year; a detailed fee proposal.

- **A proposal to audit a new client** is very important to audit firms because new clients are the primary growth engine for firms. A proposal to a large, solid client may be very complex, requiring many hours of staff time to prepare, especially if it is a competitive situation. The general proposal may begin with a description of client business sectors, technology, financial strengths and divisions. The client's objectives as the basis of the audit strategy could be outlined. It may point out audit requirements relating to securities exchange, environmental, governmental and other regulations, including items in the company's policies that go beyond existing statutory requirements. Strengths of the audit firm may be stated by emphasizing report quality, continuity of audit teams, worldwide service, cost effectiveness of audits, and audit firm's quality standards.

Engagement letter

- It is in the interests of both client and auditor that the auditor sends **an engagement letter**, preferably **before the commencement of the engagement**, to help in **avoiding misunderstandings with respect to the engagement. An engagement letter** is an **agreement between the accounting firm and the client for the conduct of the audit and related services**. An auditor's engagement letter documents and confirms his **acceptance of the appointment**, **the objective and scope of the audit**, the **extent of auditor responsibilities** to the client, and the **form of any reports**.
- **The engagement letter may affect legal responsibilities to the client**. In litigation, the auditor may use an engagement letter as a **contract stating its scope, responsibilities, and limitations**. The letter describes the **auditor's purpose**, that the audit entails **study of internal control**, the **time schedule of the engagement, and fees**.
- **Contents of the engagement letter** - the form and content of the audit engagement letter may vary for each client, but they should generally include reference to:

Engagement letter

- the **objective** of the audit of financial information;
- **management's responsibility** for the financial information as described in ISA 200;
- the applicable **financial reporting framework**;
- the **scope of the audit**, including reference to applicable legislation such as related to fraud (ISA 240) or money laundering, regulations or pronouncements of professional bodies to which the auditor adheres;
- the **form of any reports** or other **communication** of results of the engagement,
- the **fact that** because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, **there is an unavoidable risk that even some material misstatement may remain undiscovered**;
- **unrestricted access to whatever records, documentation and other information** requested in connection with the audit.

Recommended reading

- Arens et al. (2015) – chosen chapters will be uploaded to IS
  - Ch. 6 (whole)
- Hayes et al. (2014) – chosen chapters will be uploaded to IS
  - Ch. 5 (whole)
- ISA 200, 240, 250, 600, 620, 210.

Appendix: ISA 200 – O&R

- **Scope:**
  - ISA 200 deals with the **independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with ISAs**.
  - ISAs are written in the context of an audit of financial statements.
  - An audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit.
  - The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
- **Objectives:**
  - To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to

Appendix: ISA 200 – O&R

- express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

- **Requirements:**
  - Compliance with ethical requirement relating to audit of financial statement.
  - Auditor shall exercise professional judgment in planning and performing audit of financial statement.
  - Auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.
  - In case of departure from ISA auditor shall perform alternative audit procedures to achieve the aim of that requirement.
  - If objective of ISA cannot be achieved auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor to modify the auditor's opinion or withdraw from the engagement.

Appendix: ISA 240 – O&R

- **Scope:**
  - ISA 240 deals with **auditor's responsibilities relating to fraud in an audit of financial statements.**
  - Identifying and assessing the risks of material misstatement due to fraud.
- **Objective**:
  - To identify and assess the risks of material misstatement of the financial statements due to fraud.
  - To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses.
  - To respond appropriately to fraud or suspected fraud identified during the audit.
- **Requirements (general):**
  - The auditor shall maintain professional skepticism throughout the audit.

Appendix: ISA 240 – O&R

- Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.
- Make inquiries of management about:
  - Management assessment of risk of that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
  - Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist.
  - Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.

Appendix: ISA 240 – O&R

  - Management's communication, if any, to employees regarding its views on business practices and ethical behavior.
  - Management, internal audit and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present.
- When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue

Appendix: ISA 240 – O&R

recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

- Auditor shall design and perform procedure that are responsive to assessed risk.
- Auditor shall perform following procedure due to risk of Management override of control;
  - Test the appropriateness of journal entries, for end of period and throughout period and inquire about any unusual transaction.
  - Review accounting estimates for biases by evaluation and retrospective review.
  - For significant transaction outside the normal course of business, evaluate the business rationale.

- **Requirements (specific):**
  - Evaluation of audit evidence
    - Evaluate the result of analytical procedure that are performed at the end of audit for consistency with assessed risk

Appendix: ISA 240 – O&R

  - Evaluate identified misstatement weather material or not, if its indicative of fraud or not.
  - If the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor shall evaluate the implications for the audit
- Auditor is unable to continue the engagement
  - Determine the professional and legal responsibilities
  - Determine its appropriate to withdraw or not
  - If withdraw: discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Appendix: ISA 240 – O&R

- Written representations – the auditor shall obtain written representations from management and, where appropriate, those charged with governance that:
  - They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;
  - They have disclosed to the auditor the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud
  - They have disclosed to the auditor their knowledge of fraud, or suspected fraud, affecting the entity and its financial statements.
- Communications to management and with those charged with governance:
  - If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management.

Appendix: ISA 250 – O&R

- **Scope:**
  - ISA 250 deals with the **auditor's responsibility to consider laws and regulations in an audit of financial statements.**
  - ISA 250 does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.
- **Objectives:**
  - To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;
  - To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
  - To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.

Appendix: ISA 250 – O&R

- **Requirements (general):**
  - Auditor shall obtain understanding of legal and regulatory framework applicable to the entity and how entity is complying with it.
  - Audit shall obtain sufficient and appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.
  - Auditor shall perform following procedure to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements;
  - Auditor shall remain alert for instances of non-compliance.
  - Obtain written representation on all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

Appendix: ISA 250 – O&R

- **Requirements (specific):**
  - Audit procedures when non-compliance is identified or suspected:
    - If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain an understanding of the nature of the act and the circumstances in which it has occurred and further information to evaluate the possible effect on the financial statements.
    - Seek legal advice if sufficient information not made available on material non-compliance, which auditor suspects.
    - If information cannot be obtained consider impact on opinion.
    - Consider the impact of non-compliance on auditor's risk assessment and the reliability of written representations, and take appropriate action.
  - Reporting of identified or suspected non-compliance:

Appendix: ISA 250 – O&R

- Communicate to those charges d with governance, unless they themselves are involved.
- If management and those charged with governance are involved consider reporting to next level of authority like audit committee.
- Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice
- If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, express a qualified opinion or an adverse opinion on the financial statements.

Appendix: ISA 250 – O&R

- If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope.
- If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's.

Appendix: ISA 620 – work of others

- **Scope** - ISA 620 deals with the **auditor's responsibilities relating to the work of an individual or organization in a field of expertise other than accounting or auditing**, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.
- **Objectives:**
  - To determine whether to use the work of an auditor's expert; and
  - If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes.
- **Requirements:**
  - Determining the need for an auditor's expert
    - If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.

Appendix: ISA 620 – work of others

- Nature, timing and extent of audit procedures - In determining the nature, timing and extent of those procedures, the auditor shall consider matters including;
  - The nature of the matter to which that expert's work relates;
  - The risks of material misstatement in the matter to which that expert's work relates;
  - The significance of that expert's work in the context of the audit;
  - The auditor's knowledge of and experience with previous work performed by that expert; and
  - Whether that expert is subject to the auditor's firm's quality control policies and procedures.
- Competence, capabilities and objectivity of the auditor's expert - the auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the

Appendix: ISA 620 – work of others

auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

- Obtaining an understanding of the field of expertise of the auditor's expert - the auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:
  - Determine the nature, scope and objectives of that expert's work for the auditor's purposes; and
  - Evaluate the adequacy of that work for the auditor's purposes.
- Agreement with the auditor's expert - the auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert:
  - The nature, scope and objectives of that expert's work;

Appendix: ISA 620 – work of others

  - The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and
  - The need for the auditor's expert to observe confidentiality requirements.
- Evaluating the adequacy of the auditor's expert's work - The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:
  - The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
  - If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
  - If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

Appendix: ISA 620 – work of others

- If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall: agree with that expert on the nature and extent of further work to be performed by that expert; or perform additional audit procedures appropriate to the circumstances.

- Reference to the auditor's expert in the auditor's report - The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the auditor's opinion.
- If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion.

Appendix: ISA 210 - proposal

- **Scope:**
  - **establishing certain preconditions for an audit.**
  - establishing responsibility which rests with management and, where appropriate, those charged with governance.
- **Objective** - to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed:
  - Establishing whether the preconditions for an audit are present; and
  - Confirming that there is a common understanding between auditor and management and where appropriate those charged with governance.
- **Requirements (general):**
  - Financial reporting framework to be applied in the preparation of the financial statements shall be acceptable.
  - Management acknowledges and understands its responsibility:
    - For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

Appendix: ISA 210 - proposal

- For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- To provide auditor with access of all information, additional information and unrestricted access to person in company for audit.

- If limitation on the scope of audit prior to acceptance of audit that will result in disclaiming opinion don’t accept engagement unless required by law.
- Agree the terms of audit engagement with management or those charges with governance and Engagement letter shall at least include:
  - The objective and scope of the audit of the financial statements;
  - The responsibilities of the auditor;
  - The responsibilities of management;
  - Identification of the applicable financial reporting

Appendix: ISA 210 - proposal

framework for the preparation of the financial statements; and

- Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

- If above components of engagement letter in law and regulation, engagement letter not necessary.
- On recurring audit assess the change in circumstances and need to revise engagement letter.
- There must be reasonable justification for change in engagement letter, after it has been agreed.
- If change not agreeable with management, Withdraw and consider the legal or contractual obligation.

- **Requirements (particular):**
  - Financial Reporting Standards Supplemented by Law or Regulation - if the auditor considers the conflict between law and standards, he needs to make additional disclosure or

Appendix: ISA 210 - proposal

change description of applicable financial reporting framework.

- Financial Reporting Framework Prescribed by Law or Regulation - Other Matters Affecting Acceptance –
  - Financial reporting frame unacceptable but required by law accept engagement if: management agree to provide additional disclosures; add emphasis of matter paragraph in audit report; don’t add true and fair like statement unless required and allowed by law.
  - If above conditions are not meet and audit required by law, evaluate effect of misleading information and include reference to that in the engagement letter.