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An introduction to International Standards on Auditing

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Agenda

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Introduction to ISAs

International Standards on Auditing

International Standards on Auditing (ISA) are professional standards for the performance of financial audit of financial information. These standards are issued by International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

Why do we need ISAs?

The IAASB works to establish:

- High quality audits
- Uniformity of practice by professional accountants globally
- Strengthening public confidence in the global auditing profession
- Serving the public interest

PwC compliance with ISAs

The PwC Audit is designed to comply with all provisions of the International Standards on Auditing (ISAs). It is the intent of the PwC leadership to have full compliance with ISAs on all engagements around the world.

As new standards are issued by the IAASB, we would perform a detailed mapping of the standard to current PwC Audit and our policies and guidance are subsequently aligned with the new standard as necessary.

In addition, we establish policies and procedures that interpret how ISA requirements are to be applied on a PwC Audit.

ISAs at the 'Planning and Mobilisation' stage

ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with ISAs

ISA 200: Audit objectives

ISA 200 states that there are 2 overall objectives of the independent auditor:

1. 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 on whether the financial statements are prepared, in all **material** respects, in accordance with the applicable **financial reporting framework**.
2. To report on the financial statements and communicate as required by ISAs in accordance with the auditor's findings.

ISA 200: Audit objectives

ISA 200 contains separate requirements:

- The auditor shall comply with relevant **ethical requirements** including those pertaining to independence, related to financial statements audit engagements.
- The auditor shall plan and perform an audit with **professional scepticism**, recognising that circumstances may exist which cause the financial statements to be materially misstated.
- The auditor shall exercise **professional judgement** in planning and performing an audit of financial statements.
- To obtain reasonable assurance, the auditor shall obtain **sufficient appropriate audit evidence** to reduce audit risk to an **acceptably low level** and thereby enable the auditor to draw **reasonable conclusions** on which to base the auditor's opinion.

ISA 210: Agreeing the terms of audit engagements

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The objective of the auditor is to **accept** or **continue** an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- Establishing whether the **preconditions for an audit** are present; and
- Confirming that there is a **common understanding** between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

ISA 210: Agreeing the terms of audit engagements

In order to establish whether the preconditions for an audit are present, the auditor shall:

- Determine whether the financial reporting framework to be applied in the preparation of the financial statements is **acceptable**.
- Obtain the **agreement of management** that it 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
  - 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
  - To provide the auditor with *access to all information* required by the auditor to reach an opinion on the financial statements.

ISA 220: Quality control for an audit of financial statements

ISA 220: Quality control for an audit of financial statements

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- The audit complies with professional standards and applicable legal and regulatory requirements
- The auditor's report issued is appropriate in the circumstances

The ISA should be read in conjunction with **ISQC1** which applies a firm-wide perspective to quality control.

Under ISQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

a. The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and

b. Reports issued by the firm or engagement partners are appropriate in the circumstances

ISA 230: Audit Documentation

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ISA 230 defines audit documentation (referred to as 'working papers') as:

'The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached'.

The **main objectives** of audit documentation are to provide:

- A *sufficient and appropriate* record of the basis for the auditors' report
- Evidence that the audit was *planned and performed in accordance with ISAs*, and applicable legal and regulatory requirements.

ISA 230: Audit Documentation

Requirements for the auditor:

- Document audit evidence to support the audit opinion and demonstrate compliance with ISAs in a *timely manner*
- Prepare sufficiently *detailed working papers* to provide an in-depth understanding of the audit
- Document *planning, nature, timing and extent* of audit procedures performed including results and conclusions thereon
- Ensure *confidentiality, safe custody* and *appropriate retention* of work papers.
- In the case where departing from ISAs is unavoidable, one must document how *alternative procedures performed* achieve our audit objective.

ISA 300: Planning an audit of financial statements

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When does audit planning take place?

Planning should **not** be seen as a discrete and separate part of the overall audit.

The audit plan may be revised as the audit progresses and should not be viewed as being fixed in place once the formal planning phase has ended.

For instance, a significant event may take place once the audit is in progress, requiring drastic changes to the audit plan.

ISA 300: Planning an audit of financial statements

ISA 300 contains a requirement that the auditor shall undertake the following activities at the beginning of the current audit engagement:

- Performing procedures regarding the *continuance of the client* relationship and the specific audit engagement.
- Evaluating *compliance with relevant ethical requirements*, including independence.
- Establishing an understanding of the *terms of the engagement*.

ISA 315: Identifying and assessing the risks of material misstatement through understanding the entity and its environment

ISA 315: Understanding the entity and its environment

As per ISA 315, our understanding of the entity and its environment should cover the following main areas:

- *Industry, regulatory and other external factors* including the applicable financial reporting framework
- *Nature* of the entity
- Entity's selection and application of *accounting standards*
- Objectives, strategies and related *business risks*
- Measurement and review of entity's *financial performance*

The above should be sufficiently detailed to identify and assess the risks of material misstatement in the financial statements.

ISAs at the 'Audit Evidence' Stage

ISA 250: Consideration of laws and regulations in an audit of financial statements

ISA 250: Laws and regulations

The objectives of the auditor according to paragraph 10 in ISA 250 are:

- to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations that have a *direct effect on the determination of material amounts and disclosures* in the financial statements
- to perform *specified audit procedures to help identify non-compliance* with other laws and regulations that may have a material effect on the financial statements
- to *respond appropriately* to non-compliance or suspected non-compliance identified during the audit.

ISA 250: Laws and regulations

a) For those laws that have a **direct impact** on the financial statements, the auditor will be concerned about gathering sufficient and appropriate audit evidence that the entity has complied with such laws and regulations. E.g payroll compliance with tax legislation.

There is thus a risk that the entity could be fined for non-compliance and the fines could be material, either in isolation or when aggregated with other misstatements.

b) For those laws and regulations that have an **indirect effect** on the financial statements, the auditor will undertake procedures with the objective of identifying *non-compliance* with such laws and regulations

- Compliance with the terms of an operating license
- Compliance with regulatory solvency requirements (FS)
- Compliance with environmental regulations

ISA 250: Laws and regulations

What if the auditor finds instances of non-compliance?

Where the auditor discovers non-compliance with laws and regulations, the auditor must

i) notify those charged with governance

However, care must be taken by the auditor because:

ii) if the auditor suspects that those charged with governance are involved, the auditor must then communicate with the *next highest level of authority*, which may include the audit committee.

iii) If a higher level of authority does not exist, the auditor will then consider the need to *obtain legal advice*.

The auditor must also consider whether the non-compliance has a *material effect on the financial statements* and, in turn, the impact the non-compliance will have on their *audit report*.

ISA 330: The auditor's responses to assessed risks

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The main objective of ISA 330 is to give guidance on **how auditors should obtain sufficient appropriate evidence** regarding the assessed risks of material misstatement by *designing and implementing appropriate responses to those risks.*

This ISA is largely connected to ISA315 where of central importance is the recognition that assessing risk is at the core of the audit process.

ISA 330 requires that:

The auditor shall design and perform *further audit procedures* whose nature, timing, and extent are *based upon and are responsive to the assessed risks* of material misstatement at the assertion level.'

ISA 330: The auditor's responses to assessed risks

Substantive Procedures and Tests of Control

- **Test of Control:** An audit procedure designed to evaluate the *operating effectiveness of controls* in preventing, or detecting and correcting, material misstatements at the assertion level.
- **Substantive Procedure:** An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise both Tests of Detail and Substantive Analytical pocedures.

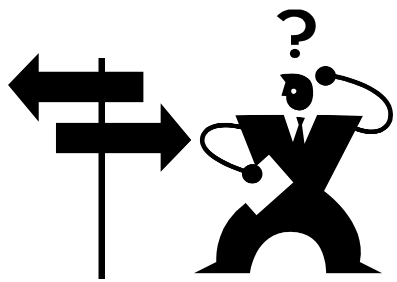
ISA 330 requires that, irrespective of the assessed risks of material misstatement, the auditor shall design and perform *substantive procedures* for each **material** class of transactions, account balance and disclosure.

ISA 240: The auditors' responsibilities in relation to fraud in an audit of financial statements

Characteristics of Fraud

Misstatement

Intentional



Unintentional

Fraud

Error

Responsibilities in relation to fraud

The primary responsibility for the prevention and detection of fraud rests with both **those charged with governance of the entity** and **management.**

ISA 240

"In planning and performing an audit to reduce the risk to an acceptably low level, the auditor should consider the risks of material misstatements in the financial statements due to fraud"

An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, **whether caused by fraud or error.**

ISAs at the 'Completion' stage

ISA 260: Communication with those charged with governance

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The role of communication

This ISA focuses primarily on communications from the auditor to those charged with governance. Nevertheless, **effective two-way communication** is important in assisting:

- The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a **constructive working relationship.** This relationship is developed while *maintaining the auditor's independence and objectivity;*
- The auditor in **obtaining information relevant to the audit** from those charged with governance (*e.g understanding the entity and its environment*)
- Those charged with governance in fulfilling their responsibility to **oversee the financial reporting process**, thereby *reducing the risks of material misstatement* of the financial statements.

ISA 520: Analytical Procedures

ISA 520: Analytical Procedures

Analytical procedures are applied in the following instances:

- **Preliminary analytical review** – to obtain an understanding of the business and its environment *(e.g comparison of financial performance) ref. ISA315*

- **Substantive analytical procedures** – used as substantive procedures when the auditor considers that the use of analytical procedures can be more efficient and effective than tests of details.

- **Final analytical review** at the end of the audit to assess whether results are consistent with the auditors' understanding of the entity

ISA 560: Subsequent Events

ISA 560: Subsequent Events

The overall objective is to ensure that the auditor performs audit procedures that are designed to obtain sufficient appropriate audit evidence to give reasonable assurance that all events up to the (expected) date of the auditor's report have been identified, properly accounted for and disclosed within the financial statements.

For the purpose of ISA 560, subsequent events are those that occur between the reporting date and the date of approval of the financial statements and the signing of the audit report.

ISA 570: Going Concern

The Going Concern assumption

Under the going concern assumption, an entity is viewed as continuing in business for the **foreseeable future**. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

Management responsibilities in relation to the going concern assumption

International Accounting Standard (IAS) 1 requires *management* to make an assessment of an entity's ability to continue as a going concern.

The detailed requirements regarding management's responsibility to assess the entity's ability to continue as a going concern and related financial statement disclosures may also be set out in law or regulation (such as the Maltese Companies Act (Cap.386)).

Management's assessment of the entity's ability to continue as a going concern involves **making a judgement**, at a particular point in time, about inherently uncertain future outcomes of events or conditions.

Auditor responsibilities in relation to the going concern assumption

The auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.

This responsibility exists even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

Thank you…

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