Royal Audit Authority

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FINANCIAL AUDIT MANUAL

JULY 2019

REPORTING ON ECONOMY, EFFICIENCY & EFFECTIVENESS IN THE USE OF PUBLIC RESOURCE

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Vision

"A credible Supreme Audit Institution that promotes value for money and good governance in public operations and contributes towards achieving the societal aspirations of Gross National Happiness".

Mission

"RAA is an independent constitutional body which contributes to accountability, transparency, and effective service delivery. In the service of Tsa-Wa-Sum (the King, Country and People), we audit without fear, favour, or prejudice and provide timely, reliable, and quality audit services to assist effective decision making in the public sector".

Foreword

The Royal Audit Authority (RAA) was signatory to XXth INCOSAI held at Johannesburg, South Africa in 2010 that endorsed the introduction of International Standards of Supreme Audit Institutions (ISSAIs) as the common language for public sector auditing. As a stepping stone towards implementing ISSAIs as authoritative standards, the RAA volunteered to undertake Supreme Audit Institution Performance Management Framework (SAI PMF) in 2014, a global tool for assessment and monitoring the performance of Supreme Audit Institutions (SAIs) to identify its performances and identify capacity development needs.

The SAI PFM report issued in May 2015 provided a wide range of insights about the performance of RAA and needs for capacity development. It also provided critical inputs for formulation of RAA's Strategic Plan 2015-2020.

Driven by the objectives of improving quality, credibility and professionalism, the RAA signed Statement of Commitment (SoC) with the IDI in April 2016 for ISSAIs implementation. The implementation began from June 2016 with the financial support of the World Bank.

Thus, this Manual has been developed based on practical experience gained from **ISSAIs** implementation and is a culmination of efforts and inputs of Financial Audit mentors, pilot audit team and field auditors. Unlike in the past, the Manual is further supported by **step -by-step guidance notes** on how to apply the processes and tools in the context of Financial Audits. It is written with simple language followed by *illustrations* and Audit Working Papers Templates.

This Manual replaces Financial Audit Manual 2010, which stands withdrawn as on the date of availability of this revised Manual. It is expected to help RAA conducts audits of high quality and ensure harmonization of practices through a common frame of reference.
Lastly, we would like to acknowledge the World Bank for supporting the ISSAIs implementation.

July 2019

(Tshering Kezang)
Auditor General of Bhutan

ACRONYMS & ABBREVIATIONS

AG	:	Auditor General
ATR	:	Action Taken Report
AWP	:	Audit Working Paper
CAATs	:	Computer Assisted Audit Techniques
COTABD	:	Classes of Transactions, Accounts Balance and Disclosures
DPA	:	Department of Public Accounts
DSA	:	Daily Subsistence Allowance
D&I	:	Design and Implementation
ECB	:	Election Commission of Bhutan
FRF	:	Financial Reporting Framework
FRR	:	Financial Rules and Regulations
IDI	:	INTOSAI Development Initiative
IFRS	:	International Financial Reporting Standards
IPSAS	:	International Public Sector Accounting Standards
ISAs	:	International Standards on Auditing
ISQC	:	International Standard on Quality Control
ISSAI	:	International Standards of Supreme Audit Institution
KAM	:	Key Audit Matters
LC	:	Letter of Credit
MoF	:	Ministry of Finance
MUS	:	Monetary Unit Sampling
PLC	:	Project Letter of Credit
PMF	:	Performance Measurement Framework
PN	:	Practice Note
RAA	:	Royal Audit Authority
ROMM	:	Risk of Material Misstatement
RQAD	:	Research and Quality Assurance Division
SAI	:	Supreme Audit Institution
TMD	:	Treasury Management Division
QA	:	Quality Assurance

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Acknowledgement

The ISSAIs Financial Audit Manual was revised and finalized by the following resource persons based on rich experience and knowledge gained from ISSAIs based audits. We thank our Financial Audit mentors and resource persons who provided insight and technical expertise in developing this Manual.

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We thank the following Financial Audit Mentors for providing regular guidance and comments that greatly helped in improving this Manual.

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We would also like to express our gratitude to IDI, especially Mr. Karma Tenzin, Senior Capacity Manager for continued support and guidance in shaping this Manual. This successful collaboration is a true manifestation of the valued partnership between the RAA and the IDI.

Chapter 1: Introduction to Financial Audit and ISSAIs

Background

Financial audit is an independent examination of an organization's financial statements and underlying accounting records by an auditor engaged to express an opinion on the financial statements prepared by the agencies. The very premise of an audit is to enhance the degree of confidence of intended users of the financial statements, which is achieved by the expression of auditors' opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable Financial Reporting Framework (FRF).

The implementation of International Standards of Supreme Audit Institutions (ISSAIs) by Supreme Audit Institution, Bhutan was initiated under Implementation Initiative 3i Programme - Phase II after signing the Statement of Commitment with INTOSAI Development Initiative (IDI) on 28 April 2016 in Oslo, Norway. The ISSAIs as a professional auditing standards and guideline is essential for enhancing the credibility, quality and professionalism of public sector auditing.

Importance of audit in the public sector

The main purpose of public sector auditing is to uphold and promote public accountability between public entities and democratically elected bodies. According to **ISSAI 12** "Value and Benefits of SAIs - Making a Difference to the Lives of Citizens", SAIs should carry out audits to ensure that governments and public entities account for their stewardship over and use of public resources and for the transparency of government operations; and ultimately to contribute to maintaining a country's financial discipline.

ISSAI 100.18 states, "In general, public-sector auditing can be described as a systematic process of objectively obtaining and evaluating evidence to determine whether information or actual conditions conform to established criteria. Public-sector auditing is essential as it provides legislative and oversight bodies, those charged with governance and the general public with information and independent and objective assessments concerning the stewardship and performance of government policies, programmes or operations."

Financial accountability is about sound (legal and regular) financial management; the fairness with which the entity has reported its financial position, results, and use of resources; and the compliance of that reporting with the applicable FRF.

Financial auditing in the public sector is commonly acknowledged as a control mechanism of the state to secure financial accountability: better financial accountability mechanisms within states support the functioning of systems by conveying information to parliaments or the equivalent about the functioning of the executive and administrative branches of the state.

Therefore, public sector auditors have an important role to play in looking at the money spent on public programmes. That role includes providing reasonable assurance that the information prepared by government properly presents the financial situation of public sector institutions, including government ministries/entities or the whole of government.

In the public sector, the cycle of accountability begins with the budget process and ends with the presentation of reports to Parliament. The published audit reports may include an opinion on the financial statements and may, as well, include audit findings on the regularity of the underlying transactions, weaknesses internal control systems, fraud, mismanagement of funds, etc.

SAI Bhutan derives its mandate from the Constitution of the Kingdom of Bhutan and the Audit Act of Bhutan 2018. Besides other Laws such as the Public Finance (Amendment) Act 2012), Companies Act of the Kingdom of Bhutan 2016, Religious Bodies Act, Civil Societies Act, and the Financial Rules and Regulations also stipulate requirements for the SAI Bhutan to conduct the Financial Audits.

Purpose of the Manual

The manual is an audit methodology that contains explanations of the ISSAI financial audit process as well as audit working paper templates that are designed to facilitate the application of ISSAIs in practice. It also:

- provide guidance to carry out ISSAI compliant financial audit; ensure that the auditors comply with professional standards and applicable legal and regulatory requirements while carrying out audit;
- promote professionalism in delivering services to audit agencies; and
- require auditors follow specific and adequate audit procedures to maintain the quality of work.

Chapter 2: Financial Audit Process

The purpose of an ISSAI financial audit is to enhance the degree of confidence of intended users in the audited financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

To be able to express an opinion, the auditor needs to gather sufficient appropriate audit evidence by designing and performing adequate audit procedures as required in the ISSAI. In doing so, the financial audit process needs to be followed as suggested in **Figure 2.1**. The audit processes are well linked to each other and should be maintained throughout the audit process, being complete only upon issuance of the audit report.

Figure 2.1: Financial Audit Process

Pre-engagement activities

The financial audit process commences with pre-engagement activities. In the context of private sector audit, the auditor conducts an assessment as to whether the audit engagement offered by a client can be accepted or not, and whether there are any professional reasons that the engagement cannot be accepted. There is also a practice of obtaining professional clearance from the previous auditor before accepting the engagement if this is applicable. Whereas, in the public sector, the SAIs are bound by their legislation, other relevant laws and regulations to conduct the financial audit of entities mandated to be audited. Therefore, the situation of not accepting the engagement will be very rare in the public sector audit, or will not exist at all. Amongst others, the purpose of conducting the pre-engagement activities is to see whether the pre-conditions for audit exist, such as acceptable financial reporting framework, whether the management understands its responsibilities, etc. The auditors also perform other specific activities, viz. assessing the ethical requirements and the competency of the team, preparation and issuance of audit engagement letter, conducting audit entry conference, etc. The completion of the pre-engagement activities needs to be reviewed and signed off by the reviewers.

The detailed processes and methodologies as to how the pre-engagement activities can be completed are given under **Chapter 3** of this Manual.

Planning an Audit

Based on the completion of pre-engagement activities, the next step is to prepare the audit plan for conducting the audit of the financial statements. ISSAIs are built upon a risk based audit approach. At this stage of the process the auditors mainly identify and assess the risks of material misstatements in the financial statements, either due to fraud or error. **ISSAI 1315** requires assessment of the risk of material misstatements through understanding the entity and its environment. Based on the risks assessment, the auditor is required to identify the controls in place that would mitigate or eliminate the risks and test the operating effectiveness of these controls. As a risk response (**ISSAI 1330**), the auditors are required to design audit procedures, e.g. test of controls and substantive tests. The audit plan needs to be reviewed and signed off by the reviewer and, as required by ISSAI, should be updated until the completion of the audit and the issuance of the audit report.

The detailed processes and methodologies for preparation and finalisation of an audit plan are highlighted under **Chapter 4** of this Manual.

Conducting an Audit

In the conducting phase, which mainly involves fieldwork, the auditors perform the audit procedures designed at the planning stage, document conclusions on audit procedures performed and gather audit evidence. The audit procedures performed by the auditors and the conclusions documented need to be reviewed and signed off by the reviewers.

The detailed processes and methodologies for performing audit procedures, documenting the conclusion, and gathering audit evidence are highlighted under **Chapter 5** of this Manual.

Completion & Review

ISSAI 1500 requires auditors to gather sufficient appropriate audit evidence to provide an audit opinion on the financial statements. The audit evidence is gathered through performing specific audit procedures, which responds to the risks identified on assertion level or financial statement level. In this phase of the audit process, the auditors evaluate the audit evidence gathered at the execution phase. The audit evidence needs to be evaluated for its sufficiency and appropriateness, which forms the basis for providing audit opinion on the financial statements and reporting on non-compliance with laws, rules and regulations.

In this phase, the audit supervisor or reviewer considers the opinion and observations prepared by the auditor, ensuring that both are adequately supported by audit evidence, and that professional judgement has been applied; Both auditors and reviewers should ensure that the audit plan was followed in conducting the audit. The work performed by auditors needs to be reviewed and signed off by the reviewers.

The detailed processes and methodologies for evaluation and review are highlighted under **Chapter 6** of this Manual.

Reporting

Based on the evaluation and review of the work done by auditors, the next step is to prepare and issue the audit report. Typically, the audit report contains the auditor's opinion on the financial statements. The opinion is based on the evidence as to whether the Financial Statements are fairly presented or presented in accordance with Financial Reporting Framework and any laws and regulation affecting their presentation. Further, there could be other reporting responsibilities as per the mandate of the SAI and these other reporting responsibilities may require the application of other auditing standards when they are beyond the scope of the financial audit ISSAIs.

The detailed processes and methodologies for preparation of audit reports are highlighted under **Chapter 7** of this Manual.

Follow-up Procedures

ISSAI 100 (Level 3) states that SAIs have a role in monitoring action taken by the audited entity in response to those matters raised in an audit report. The follow-up focuses on whether the audited entity has adequately addressed those matters, including any wider implications. In the event of non-submission or unsatisfactory Action Taken Report (ATR) by the audited entity, the SAI may take further course of action.

The follow-up procedures are considered a good practice under principle 3 of **ISSAI 20**. Unless this process (follow-up) is put in place after issuance of the audit report, the SAIs cannot gauge whether a desired impact has been created as a result of audit. Therefore, a follow-up procedures are seen to be one of the important components of the audit process.

The detailed processes and methodologies for conducting the follow-up of audit are highlighted under **Chapter 8** of this Manual.

Quality Assurance Review

ISSAI 1220 requires review of audit work performed (quality control) at different times throughout the audit process. Accordingly, it will be necessary to have a system of independent quality assurance (QA) for reviewing the work done by SAIs/Engagement Team after audit has been completed. At the audit level, the QA review process enable the Head of SAIs to reach at a conclusion as to whether the audit process has been followed and the audit of financial statements has been conducted as per the requirements of ISSAI or equivalent standards.

The QA of completed audits are carried out on a sampling basis.

In this Manual, a general idea of the need to conduct the QA review at the audit engagement level is covered under **Chapter 9**. The detailed guidance and methodologies to conduct the QA of a financial audit is covered in a separate QA Review Manual.

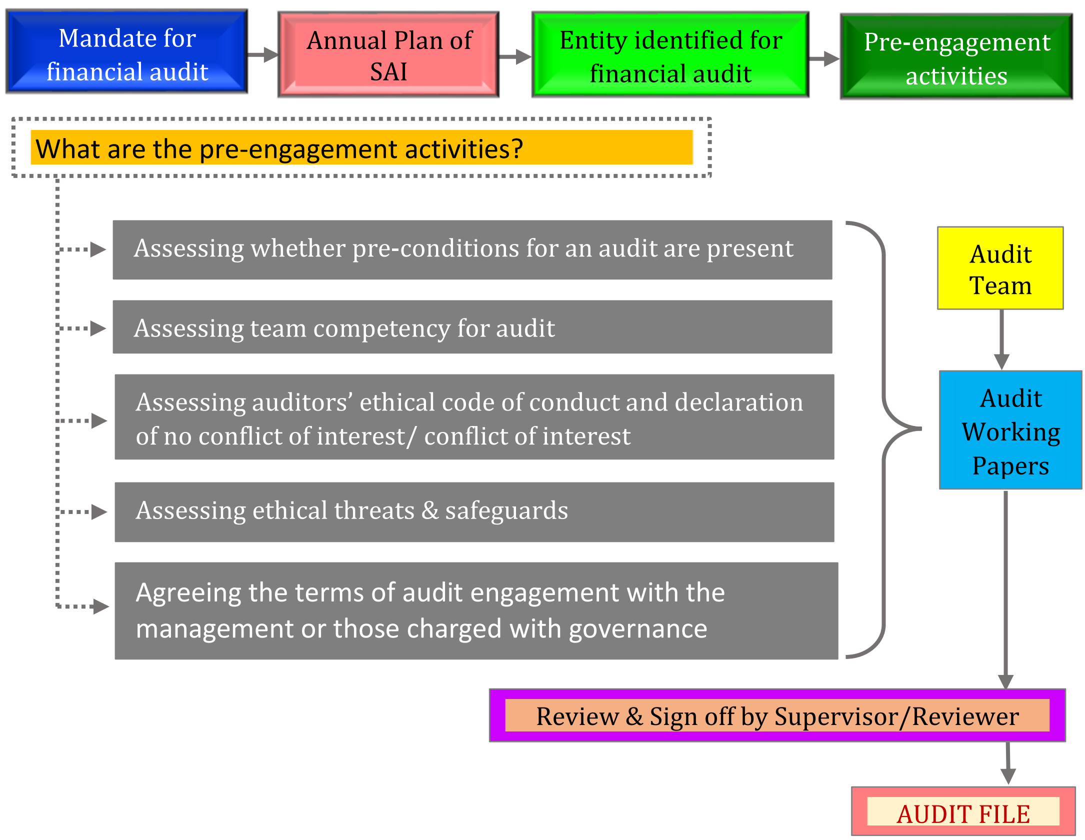
Chapter 3: Pre-engagement Activities

ISSAI 1210 prescribes the requirements related to agreeing the terms of audit engagement, an audit practice that is more in line with that observed in the private sector: auditors are required to assess certain conditions before accepting the engagement and, based on that assessment, the auditor can either accept or decline the audit engagement.

The Constitution of the Kingdom of Bhutan and Audit Act of Bhutan including other legislations mandates the SAI Bhutan to conduct audit of all public sector. In this case the SAI Bhutan do not have an option to decline or withdraw from the audit. Yet, the requirements that are appropriate in the private sector audit practice could still be applied and are relevant.

The purpose of performing preliminary engagement activities are to help ensure that the auditors have considered any events or circumstances that may adversely affect their capability to plan and perform the audit engagement as to reduce audit risk to an acceptably low level. **Figure 3.1** given below provides a snapshot of pre-engagement activities identifiable within audits conducted by SAI Bhutan.

Figure 3.1: Snapshot of pre-engagement activities



In order to ascertain if the pre-conditions for an audit are present, one of the requirements is to determine whether the financial reporting framework (FRF) used by the entity to prepare the financial statements is acceptable or not. The guidance to assess the existence of precondition of an audit is given below.

Assessing whether pre-conditions for an audit are present

3.1 This section explains the process of assessing the FRF applied by the audited entity in preparing the financial statements. In the public sector environment, the globally accepted FRF are such as International Public Sector Accounting Standards (IPSAS) and cash basis IPSAS. However, in our context the Financial Rules and Regulations is deemed acceptable FRF in accordance with **ISSAI 200:23** Fundamental Principles of financial auditing.

Definitions relevant to understanding the financial reporting framework (FRF)

3.2 **Financial statements** are a structured representation of historical financial information, which usually comprise of a Receipts & Payments statement including related schedules, that is intended, particularly in the public sector, to provide information useful for decision-making and to demonstrate the accountability of the entity for the resources entrusted to it.

3.3 **Historical financial information** is information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system about economic events, economic conditions or circumstances that occurred in a particular period, normally a financial year.

3.4 **Applicable FRF** is the financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or required by law or regulation (**ISSAI 1200:4**). There are two types of FRF, which are further explained in **ISSAI 1200:**

- **Fair presentation framework** is used to refer to a FRF that requires compliance with the requirements of the framework and:
  a) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
  b) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

- **Compliance framework** is used to refer to a FRF that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above.

3.5 To prepare financial statements, the audited entity uses either a fair presentation framework or a compliance framework. In our context the compliance framework is being applied for financial audit, since the underlying reporting framework is provided by FRR 2016, which is rule based.

In addition to preparing general-purpose financial statements, public sector entities may also prepare financial statements for other parties (such as governing bodies, the legislature or other parties that perform an oversight function) that can demand financial statements tailored to meet their specific information needs – these would be special purpose financial statements and may be prepared using special purpose reporting framework.

3.6 In Bhutan, the financial statements of governmental entities are prepared in accordance with FRR 2016 issued by the Ministry of Finance. As per **ISSAI 1210: A9**, in the absence of indications to the contrary, the FRF prescribed by law or regulation is presumed to be acceptable for general-purpose financial statements prepared by such entities.

3.7 The auditor has the responsibility to obtain a written agreement from the management where it acknowledges and understands its responsibilities for preparing the financial statements in accordance with the applicable FRF (FRR) and for establishing internal controls enabling the preparation of financial statements free from material misstatements (whether due to fraud or error) (**ISSAI 1210:6(b), A11-A12**). These terms and conditions for audit engagement are conveyed through the audit engagement letter that covers all the terms of the engagement (a sample audit engagement letter is provided as **AWP 3.7**).

3.8 The management should also be made aware of the need to provide the auditor with access to information that is relevant to the preparation of financial statements, any additional information that the auditor may require and unrestricted access to persons within the entity. The Audit Act of Bhutan 2018 and other relevant laws and regulations provides the engagement team to have unlimited access to the entity's records and information. Besides the audit engagement letter, such requirements are also specified in the Audit Intimation Letter. (a sample audit intimation letter is provided as **AWP 3.8**).

Assessing the acceptability of the FRF

3.9 The FRF is the audit criteria and the benchmark against which the subject matter (the financial statements) will be evaluated. Without an acceptable FRF the auditor will not be able to fulfil the audit objectives. But also, management needs to have acceptable criteria to use when preparing the financial statements. This is because the existence of an acceptable FRF is one of the preconditions of auditing the financial statements. Therefore, the SAI or the auditor may perform the steps implied in the following questions to see whether an applicable FRF exists and whether it is acceptable, and how the matter can be dealt with if it is not acceptable. Considering that similar entities exist across SAIs for the purpose of conducting financial audits, these steps can be performed at the SAI level rather than at the level of every audit engagement:

Step 1: Is there an applicable FRF for public sector entities?

Step 2: Is the FRF acceptable?

Step 3: Is the FRF a special-purpose or a general-purpose framework?

Step 4: Is the FRF a fair presentation framework or a compliance framework? How to report accordingly?

Step 5: What are the SAI's options if the FRF is deemed unacceptable?

Step1: Is there an applicable FRF for public sector entities?

In many cases, laws and regulations prescribe the FRF for public sector entities. The financial statements of public sector entities may be prepared on an accrual basis, a cash basis or both:

- In the first case, they may include a statement of financial position, a statement of comprehensive income, a statement of cash flows, and notes comprising a summary of significant accounting policies and other explanatory information.
- If the entity has prepared its financial statements on a cash basis, it may present a Statement of Cash Receipts, a Statement of Payments, associated notes and a comparison of budget and actual amounts. In certain environments, according to the FRF, a complete set of financial statements may also include other reports such as reports on performance and appropriation reports. However, laws and regulations may also describe a different presentation of historical financial information.

To conclude on the first step of assessing the FRF, SAIs need to identify if there is an applicable FRF for public sector entities in the SAI's environment or jurisdiction.

Step 2: Is the FRF acceptable?

The acceptability of a FRF is evaluated against the nature of the entity and the objective of its financial statements. The characteristics of an acceptable FRF are discussed under **ISSAI 200** and **ISSAI 1210** (refer to **Appendix 2** of **ISSAI 1210**). Acceptable FRFs refer **Illustration 3.1** below:

Illustration 3.1: Acceptable FRF

Characteristics	**Description**
Relevance	The information provided in the financial statements is relevant to the nature of the audited entity and the purpose of the financial statements. Relevance is subject to the entity's nature as reflected in Illustration 3.2 below. Clearly the relevance is a critical decision for the SAI and it needs to be assessed in consultation with the stakeholders.
Completeness	No transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are omitted. The purpose of the financial statements may vary from funding/investment purposes as explained in the Illustration 3.2 below to certification and approval of the annual budget. This needs to be evaluated in the context of the stakeholders' needs and accountability cycle.
Reliability	The information provided in the financial statements • reflects, where applicable, the economic substance of events and transactions and not merely their legal form; and • results in reasonably consistent evaluation, measurement, presentation and disclosure when used in similar circumstances. Reliability reflects whether the information provided is in a format that links to the accounting policies and / or financial procedures.
Neutrality	Information in the financial statements is free from bias. In other words, information provided in the financial statements does not provide an interpretation that can lead to bias toward certain results or entities.
Understandability	The information in the financial statements is clear and comprehensive and not subject to significantly diverse interpretation. This underlines that the statements are "fit for purpose" and are used and understood in the manner for which they were intended.

Acceptability of the FRF results in information provided in the financial statements that is useful to the intended users. To determine that usefulness, users themselves must be identified and their requirements understood.

In the public sector, there will typically be users of financial statements of several types of entities and for different reasons. **Illustration 3.2** presents situations within a public-sector environment. The last column lists examples of commonly used FRFs; however, their inclusion does not mean that the corresponding FRFs are acceptable. That decision must be taken by SAIs in the context of their auditing practice.

Illustration 3.2: Typical situation of a FRF in a public-sector environment

Type of Entity	Typical User	Type of Requirement	Commonly Used FRF
Ministry	Public Accounts Committee, ministries	Accountability for government expenditure and the assessment of financial management	Cash basis Modified cash basis Accrual basis
Non-revenue-generating agencies	Public Accounts Committee and responsible ministries, donor community	Accountability for funding and assessment of the performance of the entities against their mandates	Cash basis Modified cash basis Accrual basis
Revenue generating entities and corporations	Public Accounts Committee, ministries, investment authorities, banks, etc.	Assessment of return on investment and sustainability; assessment of effects of policy and regulation of the entities	Accrual-basis financial statements often aligned to a recognized reporting framework (e.g. IFRS & IPSAS)

To conclude on the third step for assessing FRF, SAIs need to identify whether the FRF in question is acceptable.

Step 3: Is the FRF a general-purpose or a special-purpose framework?

The frameworks may be categorized as either general- or special-purpose. A special-purpose framework is one designed to meet the financial information needs of specific users. A general-purpose framework is one designed to meet the needs of a wide range of users.

In some environments, special-purpose financial statements are the only financial statements prepared by the public-sector entity. It is therefore important to carefully determine whether the FRF is designed to meet the financial information needs of a wide range of users ("general-purpose framework") or the financial information needs of specific users (cf. **ISSAI 1800**).

Hence, based on **ISSAI 200** and **1200**, SAIs need to examine whether the applicable FRF is a general- or a specific-purpose framework. For example, in many cases government consolidated accounts and financial statements of public sector agencies or ministries are designed to meet the common financial information needs of a wide range of users, and the applicable reporting framework would consequently be classified as general-purpose.

When the auditor concludes that the accounting framework that is applied to prepare the financial statements to be audited is a special purpose framework, the auditor must apply **ISSAI 1800** which deals with special considerations relevant to

- the acceptance of the engagement;
- the planning and performance of that engagement; and
- forming an opinion and reporting on the financial statements.

ISSAI 1800 does not override the requirements of the other ISSAIs. Therefore, the auditor must continue to comply with all relevant requirements in other ISSAIs when applying **ISSAI 1800**.

As given in **ISSAI 200**, examples of special-purpose frameworks relevant to the public sector may include the following:

- The cash receipts and disbursements basis of accounting for cash flow information that an entity may be requested to prepare for a governing body;
- The financial reporting provisions established by an international funding organization or mechanism;
- The financial reporting provisions established by a governing body, the legislature or other parties that perform an oversight function to meet the requirements of that body; and
- The financial reporting provisions of a contract, such as a project grant.

To conclude on the second step for assessing FRF, SAIs need to conclude if the FRF in question is a general-purpose framework or a special-purpose framework.

Step 4: Is the FRF a fair presentation framework or a compliance framework? How to report accordingly?

The FRF can be either a fair presentation framework or a compliance framework. The type of framework used to prepare the financial statements affects the wording of the auditor's opinion. In case of **a fair presentation**

framework, SAIs need to evaluate whether the financial statements achieve fair presentation, including (cf. **ISSAI 1700.14**) a consideration of:

- the overall presentation, structure and content of the financial statements, and
- whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

When expressing an opinion on the financial statements prepared in accordance with the fair presentation framework, the auditor's report includes expressions such as "*the financial statements present fairly…" or "the financial statements give a true and fair view of…*".

When the financial statements are prepared in accordance with a **compliance framework**, the auditor does not express an opinion on the fairness of presentation. Instead, the auditor is required to evaluate whether the financial statements are prepared, in all material respects, in accordance with the prescribed presentation of the financial statements that may be included in a specific FRF or in applicable laws and regulations. The use of a compliance framework should not be confused with a compliance audit. The wording of the opinion will be as follows: "*Financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.*"

To conclude on the fourth step for assessing FRF:

- SAIs need to decide whether the FRF in question is a fair presentation framework or a compliance framework; and
- depending on the FRF used by an entity to prepare the financial statements, the SAI words the audit opinion accordingly.

Step 5: What are the SAI's options if the FRF is deemed unacceptable?

As explained in **ISSAI 1210.8**, if the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation, the auditor shall not accept the proposed audit engagement.

Non-acceptance of the engagement is often not possible in the SAI's environment, since SAIs are required to carry out audits according to their legal mandate. In this regard, SAIs need to explore alternative ways to deal with unacceptable FRFs.

If the auditor has determined that the FRF prescribed by law or regulation is unacceptable, **ISSAI 1210.19** requires that the auditor discuss the issue with management of the audited entity and ask it to provide **additional disclosures** to prevent the financial statements from misleading users.

Even if management prepares additional disclosures, the auditor's report on the financial statements needs to incorporate an **Emphasis of Matter** paragraph, drawing users' attention to the additional disclosures (see **Chapter 7**).

If management refuses to act upon the auditor's request to prepare additional disclosures, and the SAI cannot withdraw from the engagement as discussed above, the SAI should in accordance with **ISSAI 1210.20**; a) evaluate the effect of the misleading nature of the financial statements on the auditor's report; and b) include appropriate reference to this matter in the terms of the audit engagement.

ISSAI 1210.20 prescribes that if conditions outlined in **ISSAI 1210.19** are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor should:

- evaluate the effect of the misleading nature of the financial statements on the auditor's report; and
- include appropriate reference to this matter in the terms of the audit engagement.

Practice Note (PN) 5 to **ISSAI 1210** explains that if public sector auditors determine that the framework prescribed by law and regulation is not acceptable, the SAI can consider:

To conclude on actions in the case of an unacceptable FRF:

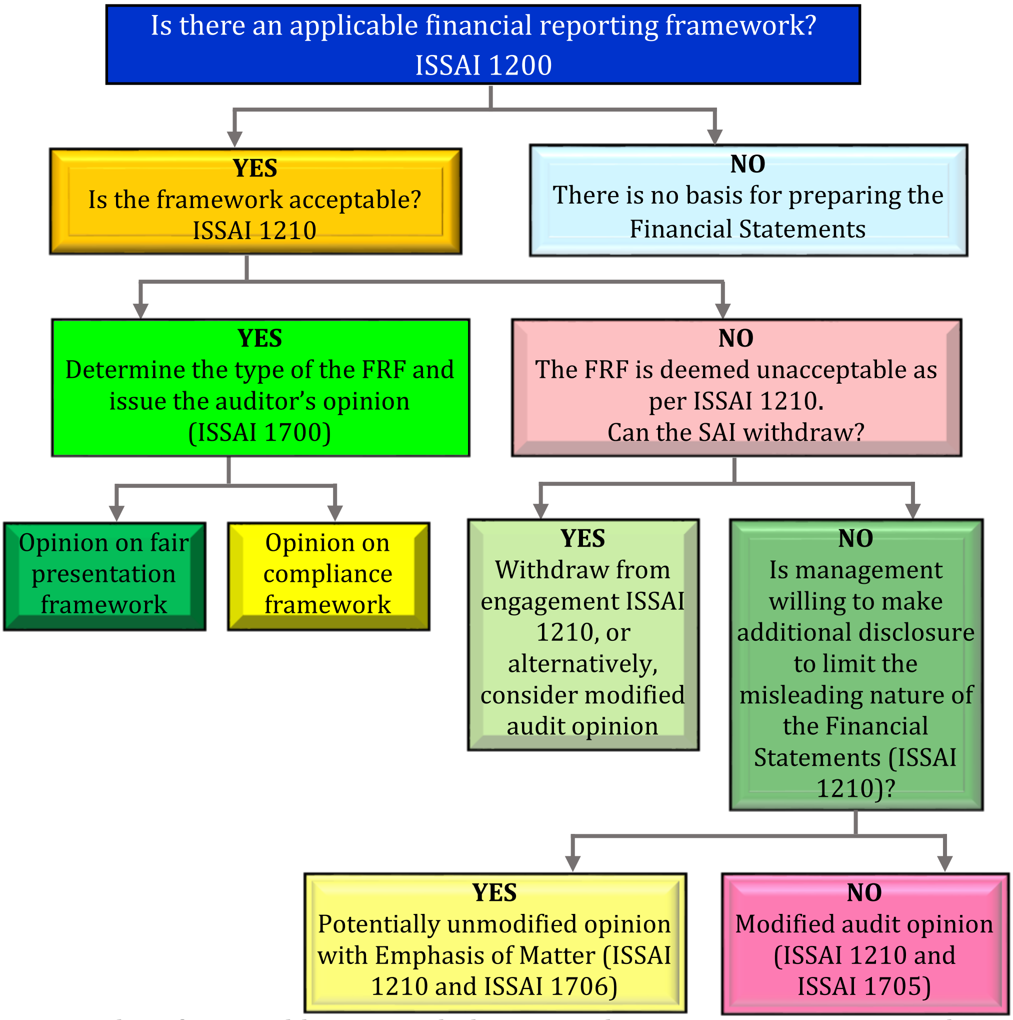
- informing the legislature; and
- influencing standard-setting by professional or regulatory organizations.

To conclude on actions in the case of an unacceptable FRF:

- The SAI needs to ask management of the audited entity to prepare additional disclosures.
- If additional disclosures are presented, then the SAI should add an Emphasis of Matter paragraph to the opinion.
- If management refuses to present additional disclosures, the SAI may consider withdrawal from the audit engagement; if withdrawal is not possible, the SAI may consider a modified auditor´s opinion (a disclaimer of opinion) explaining the misleading nature of the financial statements.
- The SAI should consider informing the legislature and standard setting bodies about the unacceptability of the FRF.

The process of assessing the FRF as explained above is summarized in the decision tree given below as **Figure 3.2**. The auditor or the assessor can document the conclusion arrived at on assessment of acceptability of the financial reporting framework using **AWP 3.1**. This working paper template also suggests recording the risks that may result in material misstatement in the financial statements which can be identified while assessing the acceptability of the financial reporting framework.

Figure 3.2: Decision Tree for determining FRF's acceptability



Examples of acceptable FRFs include IFRS and IPSAS. Accounting principles promulgated by the national accounting standards authorities are also deemed acceptable if a due process for pronouncement of the standards has been followed to consider views of wide range of stakeholders. Nevertheless, in the public sector it may also happen that those standards are supplemented by law or regulation, and then the auditor shall determine whether there are **any conflicts** between the financial reporting standards and the additional requirements (**ISSAI 1210.18, A36**). The additional requirements refer to those requirements that are prescribed by the law or regulation, in addition to the requirements of the financial reporting framework relating to preparation of financial statements. This may for example, be the case when law or regulation prescribes additional disclosures in addition to those required by the financial reporting standards (**ISSAI 1210.A36**).

In some countries, the financial statements of government entities are prepared solely according to a set of financial rules and regulations issued by parliament, the ministry of finance or the treasury department. As per **ISSAI 1210.A9**, in the absence of indications to the contrary, the FRF prescribed by law or regulation is presumed to be acceptable for general-purpose financial statements prepared by such entities. If it is not acceptable, then the steps indicated above apply.

Obtain an agreement that management understands its responsibility

3.10 As required under **ISSAI 1210:6(b)**, the auditor needs to obtain an agreement of the management that it acknowledges and understand its responsibility of preparing the financial statements in accordance with the applicable financial reporting framework, including where relevant their presentation, for internal controls for which management feels necessary to prepare the financial statements that are free from material misstatements, provide access to information and persons within the entity, and to provide additional information as required by the auditors. The auditors ensure these are included in the audit engagement letter, and explained to the management at the audit entry conference.

Other requirements

3.11 The requirements related to other pre-engagement activities are also highlighted in **ISSAI 1220** and **ISSAI 1300**, e.g. communication with the previous auditor, where there has been a change of auditors, in compliance with relevant ethical requirements. Although in our case the individual auditors are rotated amongst the audited agencies, however, since all public sector audits are being conducted by RAA, there is no need for obtaining clearance from previous auditors by the current auditors for the purpose of accepting the audit engagement.

3.12 For ensuring **quality** audit, it is important to have a competent and the **right mix of team, in terms of qualification and experience**. Ideally, it is advisable to have some auditors who have prior experience of conducting audits of a particular entity or area, since they would be familiar with the systems and procedures, which will facilitate in efficient planning and performing the audit.

It is also important to have a well-structured team whose responsibilities are clearly delegated, and that the quality review process is in place. In the context of SAI Bhutan, the audit team is usually composed of team members, a team leader and a line manager/supervisor. The audit team can use the Team Competency Matrix suggested herewith as **AWP 3.2**, to indicate and document that the audit engagement team collectively has required competencies to perform the given audit engagement. If the required competencies are not met by the engagement team including the supervisors, then respective Departmental Heads should provide necessary orientation and guidance to mitigate the gaps. For complex audits, the engagement team may hire the services of experts. However, respective supervisors will exercise due diligence on the competencies of engagement team prior to hiring services of such experts.

3.13 To ensure that the audit is conducted objectively and independently, auditors should comply with an **ethical code of conduct** (e.g. **ISSAI 30** "*Code of Ethics*")[1]. It is also essential to ensure that auditors have no conflict of interest with an entity identified for audit. A format for declaring compliance with the code of ethics is suggested herewith as **AWP 3.3**. A format suggested herewith as **AWP 3.4** may be adapted for auditors to declare No Conflict of Interest and **AWP 3.5** as declaration of existence of a conflict of interests.

3.14 Ethical threats may arise during the course of audit, such as self-review threat, self-interest threat, familiarity threat, advocacy threat, intimidation threat, etc. In this regard, the team leader or line manager/supervisor will be required to put necessary safeguards in place, so as to reduce threat to an acceptable level. A template for recording the assessment of ethical threats and safeguards is suggested herewith as **AWP 3.6**.

3.15 The next step in the pre-engagement is to agree the terms of audit engagement with the audited entity, particularly with management or, where appropriate, with those charged with governance. **ISSAI 1210:10** states: "*... the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement*". The terms of audit engagement should include, among others, the following:

- The objective and scope of the audit of financial statements;

[1] Cf. SAIS-4: Organizational Control Environment, dimension (i) "Internal Control Environment – Ethics, Integrity and Organizational Structure", of **SAIS PMF**.

- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of the applicable FRF for the preparation of the financial statements;
- Audit Entry Conference;
- Disclosure of fraud and corruption;
- Responsibility for custody and control of documents;
- Audit Exit Meeting; and
- Reference to the expected form and content of any reports to be issued by the auditor.

3.16 The engagement team may also include other terms and conditions in the audit engagement letter if deemed appropriate and necessary. An example of an audit engagement letter is provided herewith as **AWP 3.7**.

3.17 The audit engagement letter should be sent out to the management or, where appropriate, to those charged with governance and they should be asked to acknowledge agreement to these terms by signing of a copy of the engagement letter. The engagement team can also inform the management that the terms of the engagement can be discussed in the audit entry conference before being signed, as some terms may require explanation by the engagement team. The audit entry conference is convened after sending out the audit engagement letter.

3.18 Any changes to the terms of engagement, from what was initially stated in the audit engagement letter, should be documented in the form of minutes of the meeting or notes between the management and the audit engagement team.

3.19 Since the audit conducted by the SAI Bhutan are mandated by applicable laws and regulations, the probability of not agreeing to the terms of engagement by the management and those charged with governance may not arise.

Communication with management and those charged with governance

3.20 Communication with management and those charged with governance of the entity throughout the audit process is very important and facilitates the proper conduct of the audit. For some public sector entities in some jurisdictions, management may include some or all of those charged with governance.

As per **ISSAI 1260.9**, the objectives of the auditor on communication with those charged with governance are:

The engagement team needs to consider three aspects about communication:

a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;

b) To obtain from those charged with governance information relevant to the audit;

c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and

d) To promote effective two-way communication between the auditor and those charged with governance.

  - Determining appropriate persons within the entity's governance structure with whom to communicate (which could be performed at audit entry meeting-before audit commences).
  - Determining the matters that need to be communicated (i.e. auditor's responsibility, planned scope and timing of the audit, significant findings from the audit, and auditor independence).

e) To provide those charged with governance the Audit Intimation Letter defining duration of audit, name of audit engagement team and soliciting necessary support of the Management to render audit effective. As provided in **AWP 3.8.**

Establishing the communication process (the process, form, timing and adequacy of communication).

3.21 The engagement team needs to organize an **audit entry meeting** with the entity's management and those charged with its governance as a communication process. As part of the specific agenda for this meeting, the engagement team may want to discuss the terms of audit engagement mentioned in the audit engagement letter.

Chapter 4: Planning an audit

4.1 After the completion of pre-engagement activities, the engagement team needs to prepare detailed audit plan, considering the requirements of **ISSAI 1300**. These include preliminary engagement and planning activities, in addition to the overall requirements for planning an audit of financial statements. The primary objective of audit planning is to ensure that the audit is carried out efficiently and adequate resources are allocated to important audit areas. For effective audit, adequate time needs to be devoted in planning an audit.

4.2 The planning of the audit is mainly concerned with identifying and assessing the risks of material misstatements **(ISSAI 1315**) and the auditor's response to assessed risks (**ISSAI 1330**). The basic premise is that for audit to be conducted in accordance with ISSAIs, and considering the limitation of resources with increasing number of audit entities that need to be audited by the RAA in different jurisdictions, the auditors are encouraged to adopt risk-based audit approach. As such, the auditors are expected to devote considerable time in assessing the risk of material misstatements in the financial statement.

4.3 There are other ISSAIs relevant to planning an audit of financial statements, such as **ISSAI 1220** - Quality Control; **ISSAI 1240 -** Auditor's responsibilities relating to fraud; **ISSAI 1250 -** Considerations of laws and regulations and **ISSAI 1230 -** Audit documentation. Since all 37 ISAs (ISSAIs) are interlinked, some of the requirements from ISAs, other than the ones mentioned above, are relevant to planning an audit of financial statements. Therefore, while planning an audit of financial statements, the auditor needs to consider the requirements from other ISAs (ISSAIs) that are relevant to a particular audit.

4.4 While planning the audit, the engagement team should estimate the time required to complete the audit and should consider how efficiently it can use that time in the audit. The team can allocate appropriate time to those areas that were identified as posing a high risk of material misstatement in the financial statements. The engagement team can prepare a time budget for guidance, which can be revised as the audit progresses.

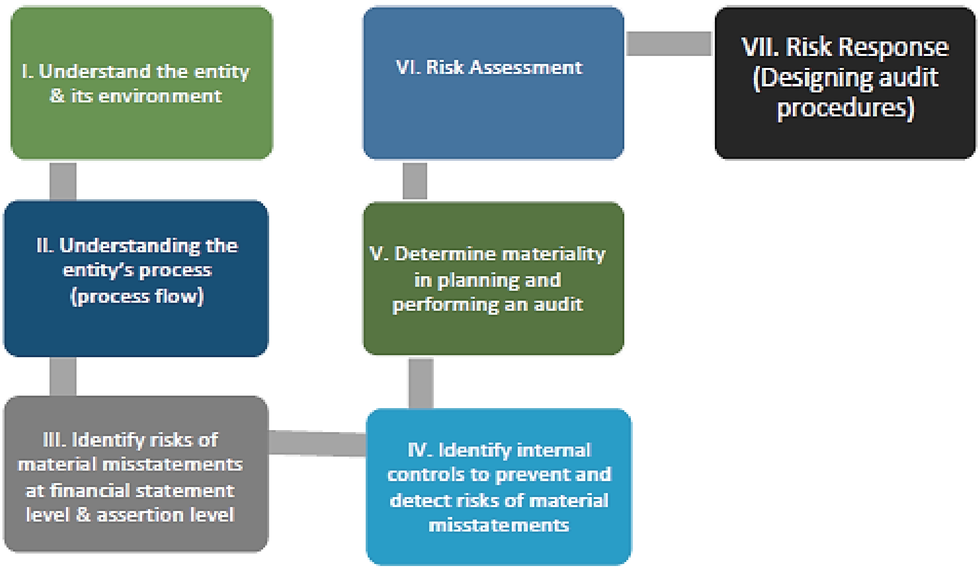
The audit time schedule also needs to fit within the financial reporting cycle of entities being audited. Typically, most SAIs would have prepared an annual plan to come into force at the beginning of the year, based on which the respective functional divisions carry out the audit.

4.5 Quite often, it may be that the audit has been scheduled but management has not yet prepared the financial statements. This will affect not only the scheduled audit but also the overall annual plan of the SAI. However, prior year financial statements can be used to plan the audit engagement where current year results are not yet known since the financial audits are typically recurring in nature. The audit plan can be updated upon receiving the current year's draft financial statements.

4.6 The auditor also needs to consider the location of the audit entity, its branches and units, etc., so that any necessary visits out of its head office can be properly planned. The audit engagement supervisor, in consultation with the team leader/audit manager, can assign audit work to the respective team members.

Figure 4.1 given below provides a snapshot of planning an audit of the audit.

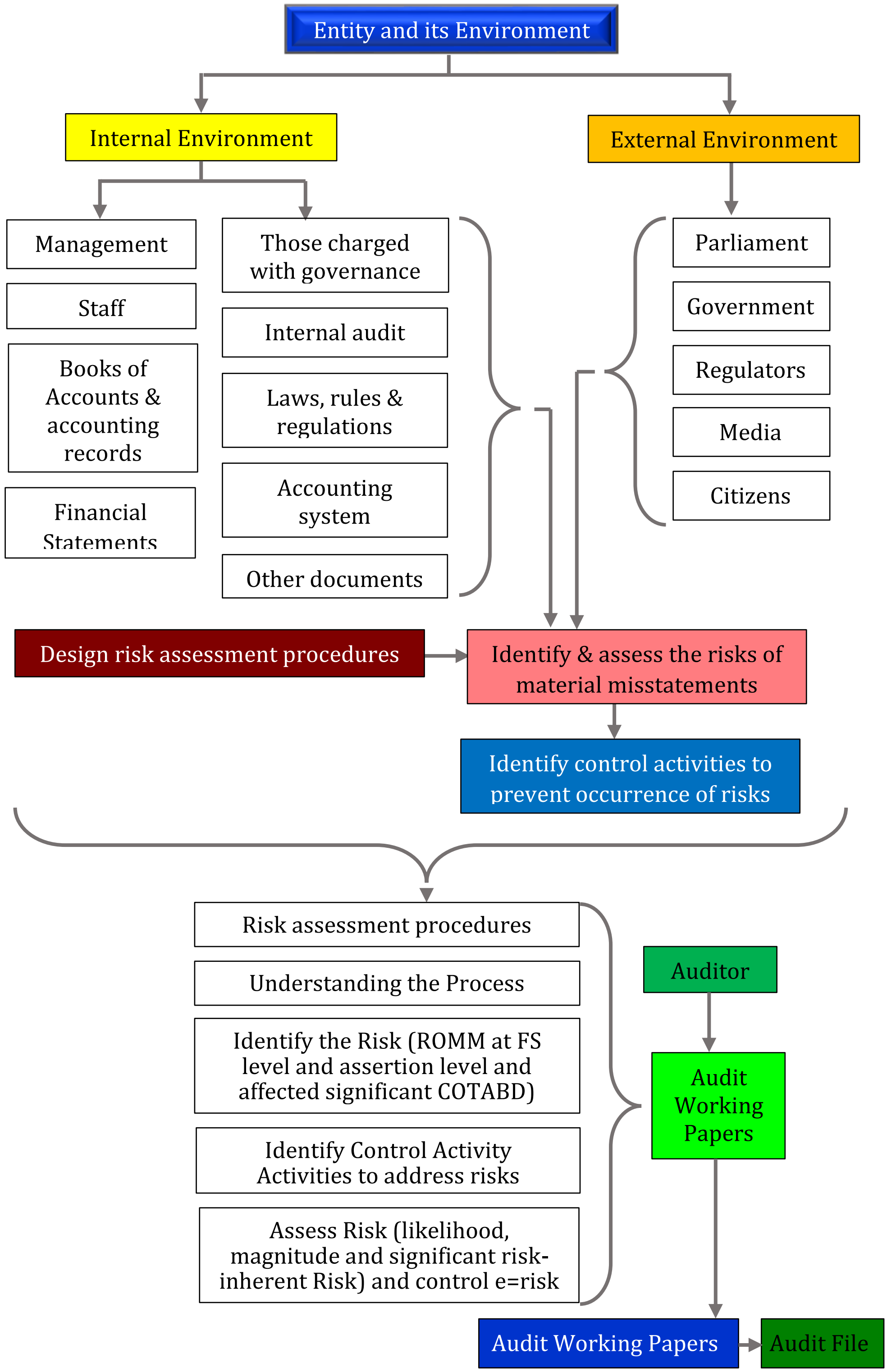
Figure 4.1: Planning process



Understanding the entity and its environment

4.7 **ISSAI 1315** broadly requires auditors to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statements and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. This particular ISSAI contains 28 broad requirements that the auditor should comply with while conducting an audit of financial statements. A snapshot of risk assessment process is depicted in **Figure 4.2**.

Figure 4.2: Snapshot of Risk assessment process



4.8 Knowledge of an entity is important, in order to conduct the audit efficiently and effectively. While auditors would be expected to have prior knowledge of entities audited over a number of years, an audit of a new entity would require more time to understand its detail operations. For entities that were audited in the past by the same auditors, any changes would need to be established and documented accordingly.

The process of understanding the entity can be broken down into two parts: 1) understanding the entity as a whole and; 2) understanding the different activities and specific business processes that have material impact on the financial statements. Understanding the entity as a whole helps the auditor to identify business risks or entity risks that may have an impact on the financial statements, whereas understanding different activities or business processes, facilitates identification of risks at an assertion level that are linked to different classes of transactions, account balances and disclosures in the financial statements.

An auditor may establish the understanding of an entity through documenting the process flow or a narrative write-up, which can then be validated by the management of an entity to ensure accuracy of the auditor's understanding of the business process and other operational affairs of an entity. An example of how the auditor can establish the understanding of an entity and its environment is given in **AWP 4.1**.

The understanding of the entity's legal framework

4.9 Auditors are required to obtain an understanding of the legal and regulatory framework within which an entity operates and to establish the existence of laws, rules and regulations relevant to the entity's operations. Most agencies are government entities, that are responsible for implementation of planned activities envisaged through annual budget approved by the Parliament. In our context, those applicable laws and regulations are in the form of environmental regulation, public finance acts, financial rules and regulation, procurement rules and regulation, employment acts, parliamentary resolutions, etc.

4.10 It is the responsibility of the management and those charged with governance to ensure that the entity's operations are conducted in accordance with the provisions of the laws and regulations, including compliance with those provisions that determine the reported amounts and disclosures in an entity's financial statements. The auditors are responsible to identify any risk related to breaches in the laws and regulations which could lead to material effects in the financial statements (**ISSAI 1250**).

4.11 As the government is composed of different sectors, viz. agriculture, forestry, finance, treasury, education, health, transport, communication, culture, foreign affairs, etc., the auditor needs to gather sector specific knowledge regarding the laws, rules and regulations applicable and relevant to different sectors and the manner in which an entity operates.

4.12 In public sector operations, especially in the government, the amounts reflected in the financial statements are based on laws enacted by the Parliament, regulations and other standing orders and circulars issued by the government, besides the applicable financial reporting framework, that provides the basis for the preparation of financial statements. These laws and regulations may have a direct effect on the determination of material amounts and disclosures in the financial statements.

The understanding of the entity's internal control

4.13 It is the responsibility of an entity to establish internal controls to prevent and detect material misstatements in the financial statements. The responsibility of the auditor is to ascertain whether those controls were designed and implemented and test the operating effectiveness of those controls. However, not all internal controls designed and implemented by the management may be relevant to an audit. **ISSAI 1315:12** requires an auditor to obtain an understanding of internal controls that are relevant to an audit. In adopting the risk-based approach to auditing, auditors are expected to identify those controls relevant to risks identified by the auditor. This is explained in detail under "*Identifying and assessing the risks of material misstatements*" section.

4.14 **ISSAI1315** requires the auditor to have an understanding of the components of internal controls, which consist of: (i) control environment (ii) the entity's risk assessment process (iii) the information system, including the related business processes, (iv) control activities and (v) monitoring of controls.

In identifying internal controls, the auditor needs to consider and establish the understanding of all five components.

Control Environment

4.15 **ISSAI 1315:A76** states that the control environment includes governance and management functions, attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance within the entity.

The control environment sets the tone of an organisation, influencing the control consciousness of its people. The standard requires the auditor to assess and evaluate whether the management and those charged with governance have created and maintained a culture of honesty and ethical behaviour in the organisation. Such an environment determines the effectiveness of other components of internal controls. Internal control activities may not function unless a culture of honesty, integrity and ethical behaviour exists in an organisation.

4.16 In the public sector environment, auditors quite often come across managers overriding controls, which may lead to the misappropriation and embezzlement of funds and abuse of power. Therefore, evaluating the control environment in assessing the risks of material misstatement due to fraud or error is very important.

The adequacy of the control environment determines the effectiveness of control activities and vice-versa. In other words, the deficiencies in the control environment undermine the effectiveness of controls that are put in place, particularly in relation to fraud. For control activities to operate effectively, there should be an effective control environment. This includes governance and management functions, attitudes, awareness and actions of those charged with governance concerning the entity's internal controls.

In public sector entities, control activities are by and large defined in the rules, regulations and standard operating procedures (SOP). The effective enforcement and adherence to these rules and regulations depends on the attitude (ethics and integrity) of the management and those charged with governance. The checklist for evaluating the control environment is in **AWP 4.2**.

The entity's risk assessment process

4.17 The entity's risk assessment process is one of the components of internal control in a modern management practice, adopted by some organisations, to manage the risks faced by the entity related to its business operation. However, this may not be a common practice adopted in public sector entities, especially in government.

4.18 In understanding the entity and its environment**, ISSAI 1315:15** requires the auditor to establish an understanding of entity's risk assessment process, which assists the auditor in identifying the risks of material misstatements. The nature, timing and extent of audit procedures to be performed depend on the entity's environment and whether a risk assessment process exists in an entity. If such process exists, the auditor should gain an understanding of it and document the results as suggested in **AWP 4.1**. The auditor's responsibility is not just to understand the entity's risk assessment process, but how the management has dealt with those risks (management's action). As part of risk assessment procedure as required by **ISSAI 1315:6 (b)** the auditors may perform analytical procedures at the financial statements level. A worksheet on overall fund reconciliation at Receipts & Payments level including the guidelines is provided as **AWP 4.7**.

4.19 If the risk assessment process does not exist, the auditor should make an enquiry of the management and also evaluate whether there is a need to have such a process in place and its impact on the preparation and presentation of financial statements. The absence of such a process, depending on the circumstances and size of the entity, may represent a significant deficiency in internal controls. The responses of the management to queries need to be documented.

The information system, including the related business processes, relevant to financial reporting, and communication

4.20 **ISSAI 1315:18** requires the auditors to obtain an understanding of the information system, including the related business processes and financial reporting. In the audit of public sector entities, the auditor, while obtaining this understanding, needs to review the procedures by which the accounting transactions are processed before presented in the financial statements.

The information system that initiates, records, processes and reports the entity's transactions is one of the key components of internal control. In order to understand the entity's information system, the auditor first needs to understand the business process, which includes the accounting transactions of an entity. The accounting transactions and generation of reports for both the government LC and PLC Accounts are mostly automated. As such, it is imperative to understand the defined accounting procedures to ensure that the accounting transactions are processed correctly.

4.21 Government entities follow cash based accounting and, therefore, the accounting system is not expected to be as complex as it is in the case of accrual based accounting. The cash based accounting system initiates and processes cash receipts and cash payments during the year.

4.22 The controls related to accounting transactions are embedded within the accounting system, and the best way of understanding the controls is to draw a process flow/narrative writes-up of an accounting transaction, and then relate to accounting process in the information system. The understanding of the information system, including the business processes, can be documented as suggested in **AWP 4.3 B**.

4.23 Pertinent information must be identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the organisation's operations. They deal not only with internally generated data, but also information about external events, activities, and conditions necessary to informed business decision making and external reporting. Effective communication also must occur in a broader sense, flowing down, across, and up the organization.

4.24 All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties.

Control activities relevant to audit

4.25 Control activities are the policies and procedures that help to ensure that the organisation's activities are carried out as required and the financial statements are free from material misstatements.

4.26 It is the responsibility of the management to institute control activities to prevent and detect errors, omissions and fraud in preparing and presenting the financial statements. The auditor's responsibility is to see whether the controls are designed, implemented and are operating effectively in relation to preparing and presenting the financial statements that are free from material misstatements.

4.27 In public sector entities, control activities are by and large defined in the rules regulations and standard operating procedures. The effective enforcement and adherence to these rules and regulations depends upon the attitude (ethics and integrity) of the management and those charged with governance. The auditor needs to obtain an understanding of those rules and regulations and other controls that are put in place by the entity.

Monitoring of control

4.28 In order to enforce the implementation of internal controls, which include the above four components, an entity is expected to have a system of monitoring, to ensure that the controls are designed, implemented and operating effectively.

4.29 Generally, the top management is responsible for monitoring the implementation of internal controls. Proper segregation of duties in the entity also ensures that the controls are implemented as intended. Adequate internal control, implementation and monitoring thereof in the financial reporting process may prevent the occurrence of risks and material misstatements will be reduced to a great extent.

4.30 The internal audit function plays an important role in monitoring the implementation of internal controls within an entity. It is a management tool, and its effectiveness depends on how independently it is placed within the entity's structure, to whom it reports and the action taken by the management and those charged with governance regarding the internal auditor's report. The effectiveness of the internal audit function should reduce the level of work to be done by the external auditors. However, not all work done by the internal audit will be relevant to an audit of financial statements.

Where an entity has an internal audit function, the auditor is required to obtain an understanding of the nature of the internal audit function, responsibilities, its organisational status and the activities performed, or to be performed. The manner in which this understanding can be obtained is suggested in **AWP 4.1 A**.

The work done by internal audit may also impact the nature and extent of audit procedures if an entity has an internal audit function whose work can be used, after a positive evaluation of the IA function as required by **ISSAI 1610**. The auditor can, in this regard, confirm whether the entity has an internal audit function and in which areas and to what extent the internal auditors' work can be used.

Since internal auditors are expected to monitor the implementation of internal controls and will have wider knowledge of the entity, they can provide direct assistance to external auditors in planning and performing the audit. Direct assistance as per **ISSAI 1610.14** refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor. The auditor needs to agree with the entity, if planned to seek direct assistance of internal auditor as suggested **AWP 4.1 B** and **AWP 4.1 C**.

Identifying the risks of material misstatements through understanding the process

4.31 **ISSAI 1315:25** requires the auditor to identify and assess the risks of material misstatement at the financial statements level and the assertion level for classes of transactions, account balances and disclosures to provide a basis for designing and performing further audit procedures.

4.32 Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud (**ISSAI 1315: A122**).

Risks at the financial statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as a lack of management competence or lack of oversight over the preparation of the financial statements may have a more pervasive effect on the financial statements and may require an overall response by the auditor (**ISSAI 1315: A123**).

In the context of an ISSAI financial audit, a misstatement is a difference between the reported amount, classification, presentation, or disclosure of financial statement item and the amount classification, presentation, or disclosures that is required for the item to be in accordance with the applicable financial reporting framework. Misstatement can arise from error or fraud.

After obtaining a complete understanding of the entity and its environment, the next step is to identify the processes involved in the entity, which will include routine and non-routine processes undergone by classes of transactions, account balances and disclosures presented in the financial statements to identify risk of material misstatement. **Figure 4.2** provides a snapshot of risk assessment process, which includes risk identification. The auditor should be able to identify as to "*What could go wrong*" at every stage of the process or at the assertion level, as a result of the risks, for instance, while processing a payment to the supplier. An example on this account is provided in the **Illustration 4.1** below:

Illustration 4.1: Risk & what could go wrong in the financial statement

Area of concern	Risk	What could go wrong	Effect on financial statement
Purchase of computer equipment	Inflated rate in the final invoice (over and above quoted rate)	Over payment to supplier	Overstatement of expenditure

4.33 A process flow can be documented in the form of narrative write up, flow chart, etc. by following the guidance provided in **AWP 4.3 B**.

4.34 The auditor is expected to apply professional judgement, while identifying the risks of material misstatement in the financial statements. The risks identified by the auditor can be documented in the process flow (an example provided in **AWP 4.3 B**) and linked to every stage of the process documented (Flow chart or narrative) by the auditor.

Upon identifying risks of material misstatement at the assertion level, the auditor needs to identify significant classes of transactions, account balances and disclosures and their relevant assertions, which are affected by those risks. (A significant class of transactions, account balance and disclosure are those where there is one or more relevant assertions).

Identification of the risks of material misstatement due to fraud

4.35 **ISSAI 1240** provides guidance on the requirements relating to fraud, in an audit of financial statements. This particular standard prescribes the requirements related to risk assessment procedures and related activities, responses to assessed risks of material misstatement due to fraud, audit evidence, etc. This section of the chapter covers the risk assessment procedures and related activities. The other requirements are covered under relevant chapters of the manual.

4.36 Unlike error, fraud is an intentional act of deception by one or more individuals to obtain an unjust or illegal advantage. This might have, as an effect, fraudulent financial reporting or misappropriation of assets.

Primary responsibility for prevention and detection of fraud lies with management and those charged with governance of the entity through implementing and operating an adequate accounting and internal control system.

4.37 Unless the audit reveals evidence to the contrary, the auditor is entitled to accept representations as truthful, and records and documents as genuine. However, the auditor should plan and perform the audit with an attitude of professional scepticism, recognizing that conditions or events may be found that indicate that fraud may exist. But the auditor should neither assume that the entity management or employees are dishonest nor assume unquestioned integrity. Instead, the auditor should objectively evaluate the conditions and circumstances observed.

4.38 Notwithstanding the auditor's past experience, the risk of material misstatements due to fraud may arise as a result of changes in circumstances, of which the auditor needs to be aware of (**ISSAI 1240:12**).

4.39 While assessing the risk of material misstatement, the risk may occur as a result of an error or fraud. The risks identified in the Process Flow will contain the risks as a result of fraud or error. Any fraud risk identified is by nature a significant risk.

4.40 Provided the audit procedures are adequately designed, the auditors may be able to detect an indication of fraud in an audit of financial statements. In such cases, the RAA shall inform the Anti-Corruption Commission (**ISSAI 1240:43** and **Section 48 b of Audit Act 2018**).

4.41 It is a common phenomenon in developing countries that a major share of national budgets is allocated for procurement, construction and the development of infrastructure. While identifying and assessing the risks of material misstatements due to fraud in governmental departments, the auditor may review the components of capital expenditure and identify the amount spent on building public infrastructure.

4.42 With different laws in different jurisdictions, public sector entities are required to have systems and procedures in place to identify and respond to risks of fraud. If such a system exists, the auditor should assess whether it operates and document its conclusions. Depending on its effectiveness, the level of risk assessment procedures that auditor needs to perform can be largely reduced.

Identifying internal control activities to prevent and detect material misstatements due to fraud or error

4.43 In order to mitigate the risks of material misstatements in the preparation and presentation of financial statements, the management and, where relevant, those charged with governance are expected to put internal controls in place. Based on establishing the understanding of an entity through process flow or narrative write-up as provided in **AWP 4.3 B** and linking the risks to every stage of the process, the auditor needs to identify those controls that are intended to mitigate the risks identified on assertion level. These control activities may be recorded in a Log suggested in **AWP 4.3B**.

4.44 Control activities are the policies and procedures that help to ensure that the organisation's activities are carried out as required and the financial statements are free from material misstatements.

4.45 It is the responsibility of the management to institute control activities to prevent and detect errors, omissions and fraud. The auditor's responsibility is to ascertain whether the controls are designed, implemented and are operating effectively. An auditor is expected to identify internal control activities related to risks that were identified and recorded in the Risk Register.

4.46 The control activities designed by the management are supposed to prevent the occurrence of these risks. Not all control activities designed by the management are relevant to audit. The auditor is expected to identify the controls that are relevant in preparing and presenting the financial statements. The auditor should be aware that the identification of control activities does not take place in isolation.

4.47 In public sector entities, the control activities relevant to the financial reporting process are in the form of financial rules and regulations, government circulars, government policies, procurement rules and regulations, etc. While following the risk based approach to auditing, the auditor is expected to take into account of the rules, regulations and policies that are related to identified risks of material misstatements. The **illustration 4.2** below is an example of identifying control activity to address a risk.

Illustration 4.2: Identifying control activity that addresses the risk

Risk	Control activity
Travel claim of an employee being paid at incorrect rates.	An independent check should be performed of standing data (eg: government approved travel claim rates) to travel claim processed by an employee.

Note: This risk will occur at the assertion level in the financial statement. Financial Statements assertions are explained later in this section.

4.48 Based on **AWP 4.3B** where the control activities are recorded, the auditor is expected to transfer these control activities to Risk Response (**AWP 4.6A**) against each risk already recorded. This ensures that each of the control activities is linked to risks of material misstatements identified and assessed at the assertion level. Further, by following this process, the auditor is constantly reminded to consider the link between risks and internal control activities.

Audit Assertions

4.49 Assertions - Representations made by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

4.50 The audit procedures are generally designed to test assertions made in the financial statements, and that the audit procedures are linked to assessed risks of material misstatements. In other words, the assertions in the financial statements are the audit objectives in an audit of financial statements.

4.51 It is important for the auditor to understand the link between risk assessment and audit assertions. Auditor identifies the risk that will cause material misstatement in the financial statements. The management of an entity makes various assertions while preparing the financial statements. Therefore, the auditor should ensure that the risk identified is relevant to the assertion(s). The term assertion is used interchangeably as audit assertion or management assertion. After identifying the risk, the auditor has to assess as to "*what could go wrong*" at the assertion level as a result of identified risk. This is further explained under designing further audit procedures section where linking of audit assertion, risk and further audit procedures are illustrated.

4.52 As per **ISSAI 1315:A124** assertions used by the auditor to consider different types of potential misstatements that may occur are grouped into three categories as follows:

A. Assertions about classes of transactions and events for the period		
No.	**Assertions**	**Description**
1	Occurrence	Transactions and events that have been recorded have occurred and pertain to the entity
2	Completeness	All transactions and events that should have been recorded were recorded
3	Accuracy	Amounts and other data relating to recorded transactions and events have been recorded appropriately
4	Cut-off	Transactions and events have been recorded in the correct accounting period
5	Classification	Transactions and events have been recorded in the proper accounts
6	Compliance	The transactions and events have been carried out in accordance with law, regulation or other authority
B. Assertions about account balances at the period end		
No.	**Assertions**	**Description**
1	Existence	Assets, liabilities, and equity interest exist at a given date
2	Rights & Obligations	An asset or liability relates to the entity at a given date
3	Completeness	All assets, liabilities and equity interests that should have been recorded have been recorded
4	Valuation & allocation	Assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded
C. Assertions about presentation & disclosure		
No.	**Assertions**	**Description**
1	Occurrence and rights and obligations	Disclosed events, transactions, and other matters have occurred and pertain to the entity
2	Completeness	All disclosures that should have been included in the financial statements have been included
3	Classification & understand ability	Financial information is appropriately presented and described, and disclosures are clearly expressed
4	Accuracy & valuation	Financial and other information are disclosed fairly and at appropriate amounts
5	Compliance	Financial and other information are disclosed in accordance with law, regulation or other authority

4.53 As recognized by **ISSAI 1315.A131**, the additional assertions in the audit of public sector financial statements need to be considered while planning the audit. This is very much related to risks of material misstatements due to non-compliance with law, regulations and authorities, which determine the design of appropriate audit procedures (additional assertion included in the preceding table as '*compliance*'). The "*compliance*" assertion below is an example of an assertion not prescribed by the financial audit ISSAI that may be added if deemed necessary to effectively evaluate the risks of material misstatement of the financial statements. It would not be appropriate to add such an assertion to evaluate the compliance with all laws and regulations that may be evaluated by a public sector auditor including those that may not be relevant to the audit of the financial statements. The scope of **ISSAI 1250** must be understood and respected when setting the scope of the ISSAI financial audit. A separate section considering these aspects and how they should be dealt with by the auditor is included in this Chapter (**ISSAI 1250** "*Consideration of laws and regulations in an audit of financial statements*").

Illustration 4.3: Audit Assertions

TRANSACTIONS & EVENTS ***For a transaction such as the purchase of office equipment, the management is asserting in the financial statements that:***	
Occurrence:	The purchase really did take place.
Completeness	All purchase transactions are included in the financial statements.
Accuracy	The quantities and prices are correctly stated.
Cut-off	The transaction is dealt with in the correct accounting period.
Classification	It really is a purchase of equipment, not a payroll cost or a motor vehicle and it has been accounted for accordingly.

ACCOUNT BALANCES AT THE YEAR END

For account balances at the year end, the assertions are slightly different, because the things about which the assertions are made are different:

Existence

- Are all these motor vehicles, office equipment, land and buildings, inventories real? Do they exist?
- Are these trade receivables real? Have we sold them something for which they owe us money?
- Have we bought something from these trade payables and therefore really owe them some money?

Rights & Obligations

- Do we own the factory? The car? The computer?
- The trade receivables may exist, but have we factored them or otherwise transferred our rights to them?

Valuation

- Has depreciation been calculated correctly on the non-current assets?
- Are the trade receivables actually going to pay us?

Is the inventory damaged, slow moving or obsolete?

Determining materiality in planning and performing an audit

4.54 According to the International Accounting Standards Board's Framework for the Preparation and Presentation of Financial Statements, information is material "*«if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements*".

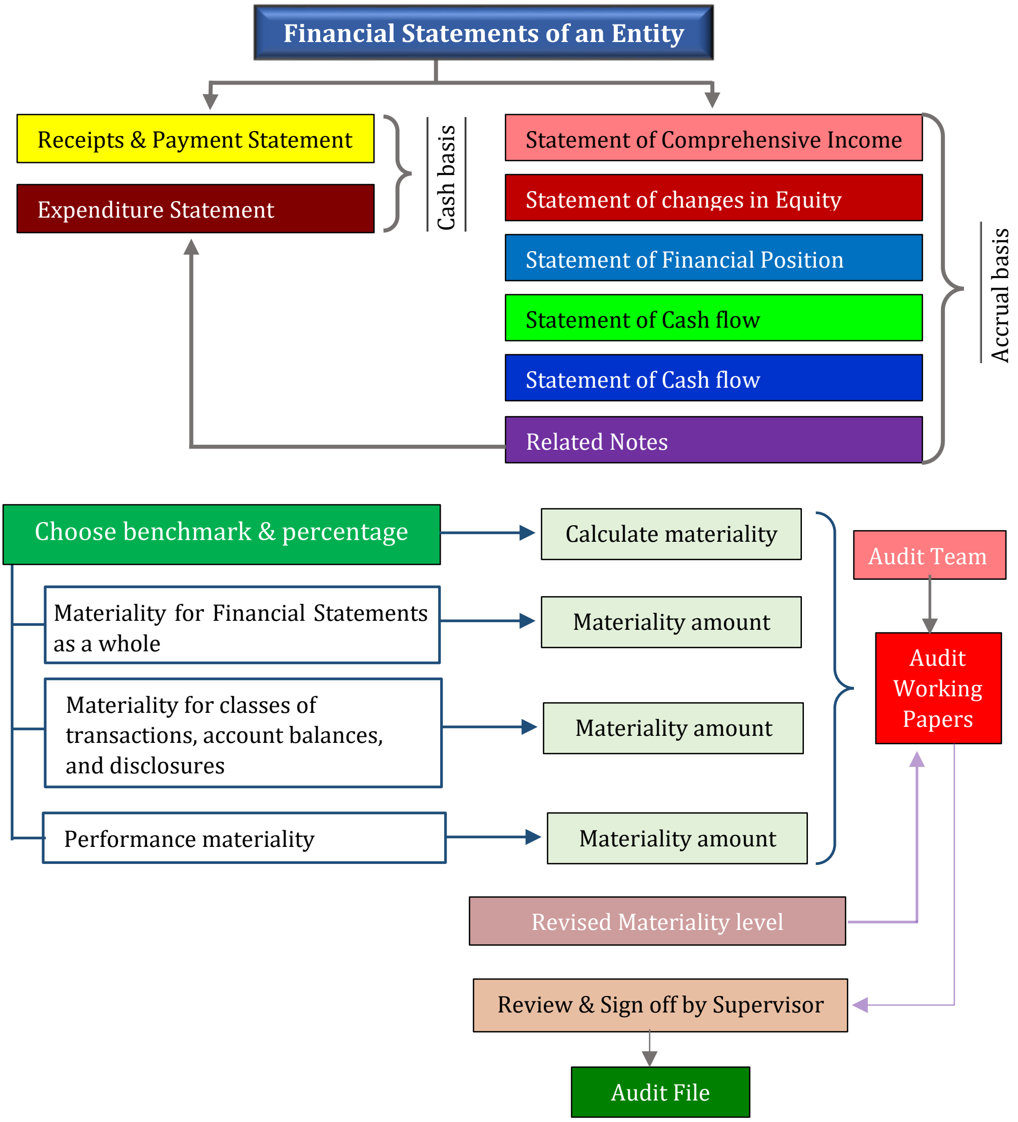
4.55 There is no standard rule as to how materiality should be calculated. **ISSAI 1320** refers to "professional judgment" and the "amount" and "nature" of misstatements as considerations. Professional judgement may be based on an understanding of the entity, the nature and extent of misstatements in previous audits, etc. The basis for professional judgement in determining materiality shall be recorded in the working paper.

4.56 **ISSAI 1320** sets a framework of reference for auditors to use in determining materiality, if there is no discussion of this concept in the applicable FRF:

- Information is material if its omission or misstatement could influence the economic decisions of users, taken based on the financial statements.
- Judgements about materiality are influenced by surrounding circumstances and the size or nature of a misstatement, or both.
- Judgements about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as an identifiable group.

The **Figure 4.3** given below provides a snapshot of determining materiality in planning and performing an audit.

Figure 4.3: Snapshot of determining materiality in planning and performing an audit



4.57 In preparing the financial statements, the preparer takes into account the concept of materiality from the perspective of the intended users of financial statements as to whether the misstatements, including omissions either individually or in aggregate could reasonably be expected to influence their economic decisions. In the context of audit, the same principle applies in determining the materiality, wherein the auditor considers the financial information needs of intended users of financial statements. In determining the materiality, the auditor is expected to apply professional judgement. (**ISSAI 1320:4**)

4.58 As explained under **ISSAI 1320:P4**, depending on the mandate of the RAA, stakeholder expectation, parliamentary directives, the public sector auditor may have additional audit objectives in addition to reporting on whether the financial statements have been prepared in accordance with the applicable financial reporting framework. The additional audit objective may be in the form of ascertaining the compliance to authorities. In this context, the materiality by nature becomes more relevant. For instance, non-compliance to Parliamentary directives in entity's operation is by nature material. Similarly, fraud is also by nature material, irrespective of the amount misappropriated or embezzled. Therefore, in planning and performing the audit, the auditor needs to consider materiality by nature and document accordingly, in the audit file.

4.59 **ISSAI 1320:P5** states that when determining materiality for planning purpose in the public sector, both quantitative and qualitative matters are of importance. Quantitative refers to "size" and qualitative refers to "nature" of transactions or events. In the public sector environment, the financial statements may be used for making other than economic decisions for which the definition of the term materiality is linked to that specific scope. Inadequate or improper description of an accounting policy whereby the user might be misled, or failure to disclose non-compliance with regulatory requirements when consequent restrictions might prejudice operating capability, are examples of qualitative misstatements.

4.60 The concept of materiality in an audit of financial statements is applied at four levels as follows:

- Planning an audit;
- Performing an audit;
- Evaluating the effect of identified and uncorrected misstatements in the financial statements; and
- Forming an opinion in the auditor's report.

The concept of materiality applied in planning an audit

4.61 When planning the audit, the auditor is required to determine the materiality for the financial statements as a whole. **ISSAI 1320:10** requires the auditor to determine materiality:

- For financial statements as a whole; and
- For particular classes of transactions, account balances or disclosures (if specific circumstances of the entity so require).

4.62 There may be items (classes of transactions, account balances or disclosures) where misstatements of less significant amounts could reasonably be expected to influence the economic and non-economic decisions of financial statements users. If the auditor concludes that such possibilities exist, then the auditor should calculate materiality for those particular classes of transactions, account balances, or disclosures. In the public sector environment, especially in the government, this would become very relevant as the users are particularly interested in areas such as entertainment expenses of ministers and government executives, travels, etc., the misstatements of which could bring them to public scrutiny.

4.63 The engagement team needs to discuss the matter of materiality from the users' perspective. When the materiality to be applied has been determined, it needs to be documented and communicated to the whole team involved, as materiality will affect the extent of the audit work that needs to be performed and the evaluation phase of the audit.

4.64 Where the engagement team can identify significant components and material classes of transactions, account balances and disclosures, materiality is determined based on the draft financial statements provided by management of the entity. This will provide an overview for at least the line manager/supervisor, allowing for the identification of areas where there may be high risk of material misstatement and on which the team needs to concentrate and focus attention.

4.65 Based on the identification of significant components and material classes of transactions, account balances, and disclosures, the engagement team may have identified areas where there may be high risk of material misstatement. Accordingly, the team leader/audit manager or the audit supervisor can allocate those high-risk areas to competent and experienced auditors on the team. These areas may even require the attention of the supervisor or team leader.

4.66 In determining materiality for financial statements as a whole, an appropriate benchmark may be used such as either total receipts, total expenditure, or net expenditure (expenditure less receipts) in cash-based accounting. In accrual-based accounting, the asset based benchmarks such as total equity or net asset value, and income statement based benchmarks such as profit before tax, total revenue, gross profit and total expenses can be used. Profit before tax is often used for profit oriented entities (**ISSAI 1320.A5**).

4.67 Materiality level is usually set as a percentage of gross expenditure or receipts depending upon the importance of each variable. The auditor needs to apply professional judgement as to which one is considered important. The table provides summary of materiality percentage on the basis of classification by sensitivity of the account.

Sensitivity	Materiality Percentage
Very sensitive	0.5%
Sensitive	0.5% to 2%
Not sensitive	2%

The **Illustration 4.4** below illustrates the calculation of materiality for financial statement as a whole:

Illustration 4.4: Calculating materiality for financial statement as a whole

Benchmark	Amount (Nu)	Sensitivity	Percentage used	Materiality Amount(Nu)
Total receipts	10,000,000.00	Very sensitive	0.5%	50,000.00
Reason for applying 0.5% - why 0.5%?				

Note: The percentage used here is just for example. It should not be used as a prescribed basis for calculating materiality while conducting the audit. The auditor should use professional judgement to determine the percentage to be used in calculating the materiality based on the sensitivity.

4.68 The identification of benchmark for the purpose of calculating the materiality would depend on many factors such as the criticality of the chosen benchmark to the users of the financial statements, nature of the entity, etc. In the above illustration, if an entity is a revenue generating entity, the total receipts become critical to the intended users of the financial statements. The materiality of the item is considered from users point of view. The misstatement above Nu. 50,000 as worked out in the above illustration will be considered as material misstatement in the financial statements.

4.69 The same principle applies to calculating materiality for classes of transactions, account balances and disclosures. The **Illustration 4.5** illustrates the calculation of materiality in this regard.

Illustration 4.5: Calculating materiality for classes of transactions

Benchmark	Amount (Nu.)	Percentage used	Materiality amount (Nu.)	Reason for applying given percentage
Classes of transaction				
Travel	1,000,000.00	1 %	10,000.00	
Employee Cost	5,000,000.00	2%	100,000.00	

Note: The percentage used here is just for example. It should not be used as a prescribed basis for calculating materiality while conducting the audit. The auditor should use professional judgement to determine the percentage to be used in calculating the materiality.

4.70 **ISSAI 1320** requires calculation of materiality for classes of transaction, account balances, and disclosures only if applicable depending on the circumstances and situations in an entity being audited.

Following the above illustration, any misstatement above Nu. 1000 in travel expenditure will be considered as material. However, while comparing the misstatement amount with materiality for financial statement as whole, the amount may not be material, but would still influence the decision of the intended users of the financial statements, and the travel expenditure could be a critical area of expenditure.

4.71 The suggested template for calculating the planning materiality at financial statement level and documentation thereof is provided as **AWP 4.4 A**.

The concept of performance materiality applied in planning an audit

4.72 In addition to the overall materiality level, **ISSAI 1320** requires the auditor to determine performance materiality level for the purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. The purpose of determining performance materiality is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceed materiality for the financial statements as a whole. In other words, the performance materiality is set lower than the planning materiality for financial statements as a whole.

4.73 The **Illustration 4.6** illustrates the calculation of performance materiality for financial statements as whole. The suggested template for calculating the performance materiality at financial statement level and documentation thereof is provided as **AWP 4.4 B**.

Illustration 4.6: Calculating performance materiality for financial statement as a whole

Benchmark	Materiality amount (from illustration 4.4) (Nu)	Percentage used	Performance Materiality Nu.
Total receipts	50,000.00	75%	37,500.00

Note: Taking the planning materiality for financial statements as a whole from Illustration 4.4. As a general principle, Performance Materiality could be in the range of 60-80% of Planning Materiality. Normally auditors use 75% of Planning Materiality as Performance Materiality.

4.74 Similarly, the same principle applies when determining performance materiality for classes of transactions, account balances, and disclosures. The **Illustration 4.7** illustrates the calculation of performance materiality for particular class of transactions, account balance or disclosure:

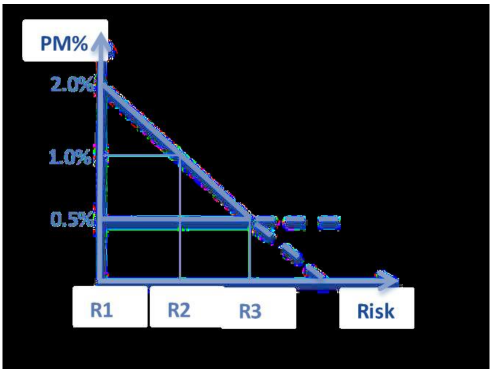
Illustration 4.7: Calculating performance materiality for classes of transactions

Classes of transaction	Materiality amount (from illustration 4.5) (Nu)	Percentage used	Performance Materiality Nu.
Travel	10,000.00	75%	7,500.00
Employee Cost	100,000.00	75%	75,000.00

Note: Taking the planning materiality for financial statements as a whole from Illustration 4.5. As a general principle, Performance Materiality could be in the range of 60-80% of Planning Materiality. Normally auditors use 75% of Overall Materiality as Performance Materiality.

Performance Materiality and Risk

4.75 The choice of performance materiality levels will depend on the detection risk of material misstatement: the higher the detection risks the lower the level of performance materiality, leading to more tests of controls or substantive procedures (and vice versa). Hence, there is an "inverse" relationship between performance materiality and detection risks of material misstatement.



Note: If the detection risk is the lowest (R1), the highest possible performance materiality percentage can be applied. If the detection risk is the highest (R3), then the lowest possible percentage can be applied by an auditor. If the detection risk is somewhere in the middle (R2) then a percentage can be selected from between the lowest and the highest possible percentage terms. Which corresponding percentage can be selected is based on the auditor's judgement.

4.76 In the process of determining materiality, sensitivity of the items of underlying accounts should also be taken into consideration by the auditor. If the audited entity or particular financial statement account are more sensitive, the auditor should lower the materiality level respectively. Sensitivity is considered in terms of the intended users of the financial statements. In the public sector, main users of information who may be considered when determining materiality can be the parliament, media, state authorities and the general public. Based on the users' expectation, different thresholds may be applied.

Revision of materiality level as the audit progresses

4.77 During an audit, there may be new situations or changes in circumstances that were not foreseen while determining materiality at the planning stage of the audit. In such circumstances, **ISSAI 1320.12** requires the auditor to revise materiality for financial statements as a whole and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures. The revision of materiality levels and the reasons underlying the revision should be documented in the audit file.

Consequently, the auditor also needs to determine whether there is a need to revise the performance materiality based on the revised materiality for financial statements as a whole and particular classes of transactions, account balances and disclosures. The revised performance materiality should be documented in the similar manner as suggested in the preceding Paragraph.

The revised materiality can be recorded as suggested in **AWP 4.4. Table A, B & C** respectively.

Assessing risk of Material Misstatement

4.78 As explained in **ISSAI 1320.5 A1**, materiality and audit risk are considered when identifying and assessing the risk of material misstatement in classes of transactions, account balances and disclosures. To maintain the link and to follow the process of risk assessment, the methodology on determining the materiality is included before a section on risk assessment. However, this methodology needs to be followed and read in an iterative process, and the materiality can be determined simultaneously while identifying and assessing the risks of material misstatement.

4.79 After completing the risk identification process, the auditor needs to assess the risks of material misstatement at the financial statement level and the assertion level.

4.80 At the financial statement level, the auditor determines whether the risks of material misstatement relate pervasively to the financial statement as a whole and affects many assertions. If applicable, the auditor needs to identify the affected assertions.

4.81 At the assertion level, the auditor needs to assess the risks of material misstatements in terms of likelihood and magnitude (inherent risks) and their significance and impact on the presentation of the financial statements that may result in material misstatements in the financial statements. At the same time, the auditor needs to assess the control risk which will have an impact on auditor's plan to test the operating effectiveness of controls.

4.82 **ISSAI 1315.6** prescribes the risk assessment procedures, which include inquiries of management and appropriate individuals within the entity, analytical procedures, observation and inspection.

4.83 Whether an identified risk requires special audit consideration, i.e. if it is a significant risk or not, is also to be evaluated by the auditor using professional judgement and taking account of likelihood and magnitude of misstatements as a result of inherent risks assessment. However, in this regard **ISSAI 1315.28** prescribes that the auditor must at least consider whether the risk involves:

- a possibility of fraud;
- recent significant developments (e.g. accounting reforms, political or economic instability, new contract arrangements of significant amount, etc.) that require specific attention to the risk;
- complex transactions;
- significant related-party transactions;
- transactions that are outside the normal course of entity's activity, or appear to be unusual; and
- a degree of subjectivity in the measurement of the financial information related to the risk, especially where there is a wide range of measurement uncertainty.

4.84 In this assessment, the auditor should also account for a degree of subjectivity in the measurement of financial information of the entity as a whole or the complexity of transactions or events the financial statements may represent.

4.85 The need to identify significant classes of transactions, account balances and disclosures based on the identified risks of material misstatement is highlighted under the section identifying risk of material misstatements at the assertion level. There may be classes of transactions, account balances or disclosures that are quantitatively and qualitatively material but were not determined as significant. These needs to be identified since the auditor is required to perform minimum substantive audit procedures as required by **ISSAI 1330.18**.

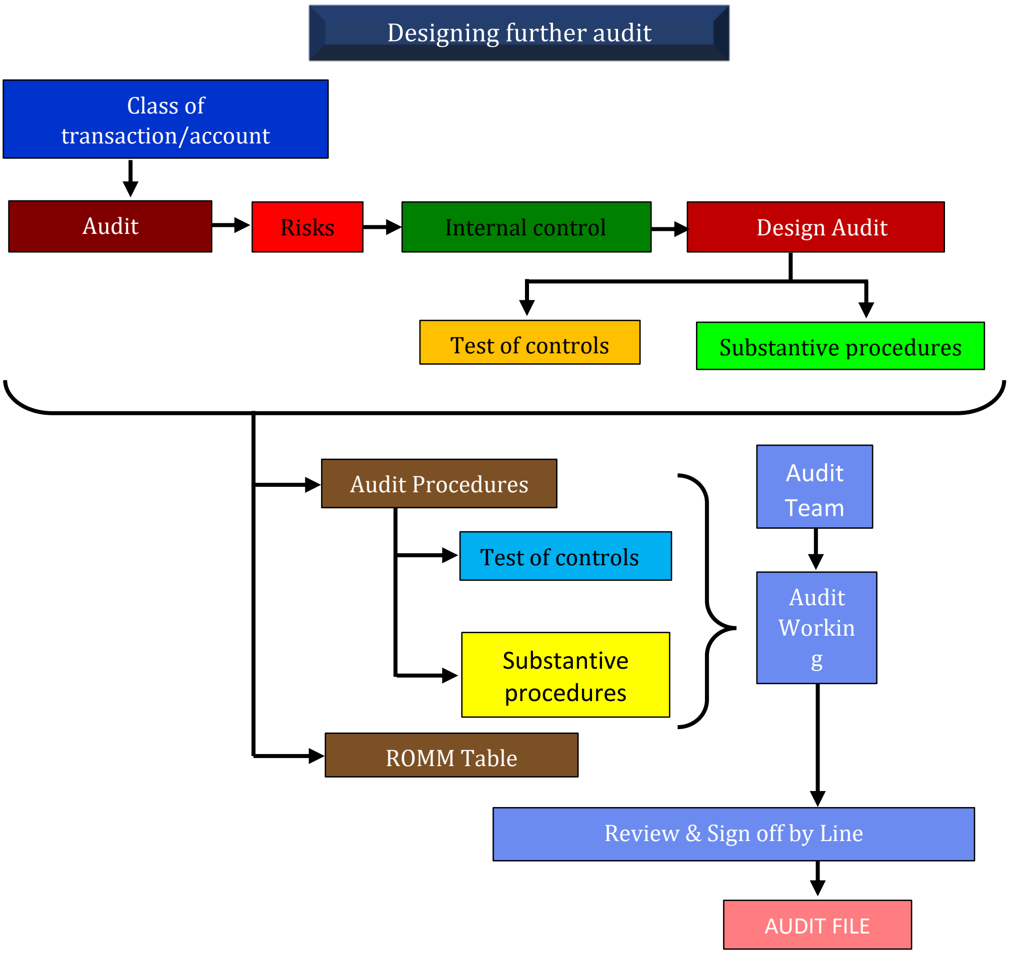
4.86 The auditor can use **AWP 4.5A** for assessing and documenting the risk of material misstatement at both the financial statement level and the assertion level. Those classes of transactions, account balances or disclosures identified as neither significant nor material can be derived from **AWP 4.5 Table A** and document in **AWP 4.5 Table B** to address appropriately at conducting phase of the audit.

4.87 The risks identified and assessed either due to fraud or error may change during an audit as the auditor obtains additional audit evidence. **ISSAI 1315.31** requires the auditor to revise the risk assessment and modify planned audit procedures (see also **ISSAI 1330** "*Auditor's response to assessed risks*"). The revisions made to the assessment and the reasons for them need to be documented and signed off by the reviewer.

Risk Response – designing further audit procedures

4.88 Upon identifying and assessing the risks of material misstatement, an auditor is expected to respond appropriately to those assessed risks. Such response is in the form of designing appropriate audit procedures. This is termed as designing further audit procedures as defined in **ISSAI 1330** and also the risk assessment procedures are considered as audit procedures as per **ISSAI 1315**. The risk assessment procedures include enquiries of management, analytical procedures, observation and inspection (**ISSAI 1315:6**). The purpose of designing audit procedures is also to gather sufficient appropriate audit evidence. **Figure 4.4** provides a snapshot of designing further audit procedures:

Figure 4.4: Design further audit procedures as a response to assessed risks of material misstatements



4.89 The risks identified and assessed at both financial statements and assertion level are transferred to the Risk Response (**AWP 4.6 Table A & B**), which also specifies the column on audit procedures. This template ensures that specific audit procedures are linked to the risks and also the assertions indicated against each risks and audit procedures.

4.90 Before suggesting as to how the requirements of **ISSAI 1330** can be met, it is important for auditors to understand different categories of audit procedures as indicated in **ISSAI 1330:4**, which are detailed below:

a) **Test of controls**: An audit procedures designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. In designing test of controls procedures, the auditor should first consider designing procedures to test whether the controls have been designed and implemented, and then design procedures to test the operating effectiveness of relevant internal controls put in place. These tests are necessary when (i) the auditor's risk assessment includes an expectation of the operating effectiveness of controls; thereby testing those controls to support the risk assessment shall be done and (ii) substantive procedures alone do not provide sufficient appropriate audit evidence; thereby performing tests of controls to obtain audit evidence about their operating effectiveness is required.

The purpose of designing and performing test of controls procedures is to obtain sufficient appropriate audit evidence as to the operating effectiveness of the relevant controls, and the extent of determining the level of substantive testing.

Considering **Illustration 4.2** under risk assessment section above, let us look at how the auditor can design the test of control as provided under **illustration 4.8** below. This is linked to material misstatement at the assertion level. Here the auditor needs to link the risk and control activity to audit assertion in order to design test of control procedure

Illustration 4.8: Designing test of control against identified risk and control activity

Risk	Control activity	Test of control procedure	Financial Statement Assertion
Travel claim of an employee being paid at incorrect rates.	An independent check should be performed of standing data (eg: government approved travel claim rates) to travel claim processed by an employee.	Inspect the travel claim of an employee for evidence of independent check being performed.	Accuracy *(checking if rates of travel claim were applied correctly).*

b) **Substantive procedure**: An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

- Tests of details (of classes of transactions, account balances and disclosures); and
- Substantive analytical procedures.

Following the explanation from **illustration 4.8** above, let us look at how the auditor can design substantive audit procedure as given in **illustration 4.9** below:

Illustration 4.9: Designing substantive audit procedure against identified risk

Risk	Control activity	Test of control procedure	Substantive audit procedure	Financial Statement Assertion
Travel claim of an employee being paid at incorrect rates.	An independent check should be performed of standing data (eg: government approved travel claim rates) to travel claim processed by an employee.	Inspect the travel claim of an employee for evidence of *independent check* being performed.	Obtain printout of standing data (eg: government approved travel claim rates) and *compare* with the rates being applied in travel claim of an employee.	Accuracy *(checking if rates of travel claim were applied correctly)*

As can be seen from the above, both the categories deal with detecting material misstatements at the assertion level. The difference is that the test of controls deals with evaluating operating effectiveness of internal controls that are supposed to prevent and detect material misstatements at the assertion level, while the substantive procedures is detailed procedures that needs to be designed and performed on classes of transactions, account balances and disclosures irrespective of whether internal controls exist or not. The basis to design and perform test of controls will depend on internal controls put in place by an entity.

Substantive procedures comprise of test of details and substantive analytical procedures. Test of details include tracing figures to relevant supporting documents to determine the validity of transactions, proper classification and completeness. Substantive analytical procedures consist of comparison of financial information in the financial statements to that of other reliable information or with that of auditor's expectation to determine if reported information is accurate. In other words, analytical procedure is a comparison of one information with that of the other to arrive at a conclusion. The unexpected variation or differences by performing analytical procedure may lead to further review and investigation. The difference between these two procedures may be understood by following **illustration 4.10**:

Illustration 4.10: Substantive Analytical procedures

Financial Statement Assertion	Account balance	Substantive Analytical procedures
Accuracy	Payroll cost	• Define the acceptable tolerance for the difference between the independent expectation of the total 20X1 employee basic salary expense and the actual total employee basic salary expense recognized in the 20X1 financial statements. • Develop an independent expectation of the total employee basic salary expense for 20X1. • Determine the actual basic salary expense recognized in the 20X1 financial statements. • Calculate the difference between the independent expectation and the actual outcome. • Explain a difference that exceeds the acceptable tolerance.

The choice of appropriate procedures is a matter of professional judgment in the circumstances. The factors to be considered in determining the relative mix of tests of details and analytical procedures include:

- nature of the transactions and balances in relation to the assertions involved,
- availability of historical data or other criteria for use in analytical procedures. If historical data is not available for the financial year in question or the immediately preceding year this should be red flagged; and
- availability of records required for effective tests of details and the nature of the tests to which they are susceptible.

4.91 The risks identified and assessed are linked to audit assertions affecting the classes of transactions, account balances, and disclosures in the financial statements. The audit procedures are then linked to both assessed risks of material misstatements and audit assertions. By having this understanding, the auditor is able to establish a clear link between three components, i.e. assessed risks of material misstatements, audit assertions and audit procedures. At the planning stage the auditors need to design further audit procedures. Both the tests of controls and substantive audit procedures can be designed and documented in the Risk Response as suggested in **AWP 4.6**.

4.92 Under different categories of audit procedures as explained above, there are different techniques in designing and performing audit procedures such as examination, inquiry, recalculation, inspection, observations and confirmation of individual items or transactions. This is better understood and remembered by using a common mnemonic AEIOU:

A: **A**nalytical procedures
E: **E**nquiry and confirmation directly from a third party – i.e. inquiry
I: **I**nspection of records and assets
O: **O**bservation
U: recalc**U**lation and performance

The following **Figure 4.5** steps may be followed for designing further audit procedures

Figure 4.5: Step-by-step approach to designing audit procedures

STEP 1: Identify the risk that will cause material misstatement in the financial statements

The identified risk that will cause material misstatements in the financial statements should relate to assertion being identified for testing, which will also provide a clarity in terms of designing the audit procedures.

STEP 2: Identify the assertion to be tested

Audit procedures are designed and performed in order to test financial statement assertions based on assessed risks of material misstatements. Therefore, the second step in designing audit procedure is to identify the assertion that needs to be tested.

STEP 3: Design Audit Procedures

The next step is to design appropriate audit procedure to test the assertion and detect material misstatement in the financial statements as a result of risk identified under Step 2 above. The audit procedures can take the form of Tests of controls or Substantive test

The following illustration explains the link between assertion, risk and audit procedure.

Illustration 4.11: Audit Assertion, Risks and Audit Procedures

Audit assertion	Accuracy
Class of transaction/ Account balance	Closing balance (Cash & Bank)
Risk	Misappropriation of cash
Audit procedure	Obtain an independent bank confirmation letter from the bank and the written confirmation from Treasury Management Division (TMD), DPA for the lapsed fund and compare with that of closing

	balance reflected in the Cash Book and the financial statements to ensure that the balance reflected are accurate.

Ensure clarity of audit procedure

Audit procedures should be designed in such a way that even a new or junior auditor in an audit team will be able to understand what is to be done. The vague procedures should be avoided, such as *"Check travel claim of an employee"*, which, does not specify what is to be checked in the travel claims. Typically, the travel claim would contain many details such as dates of travel, the rates for per diem/daily allowance, mileage for use of personal car/payment of taxi fares, time of travel etc. Therefore, the procedures should specify what needs to be checked in the travel claims.

Mention the reason for performing audit procedure

There should be a purpose for designing and performing the audit procedure. Considering the above example of travel claims, the audit procedure stating as *"Check travel claim of an employee"* does not mention why travel claim is to be checked. Instead this procedure can be designed as *"Agree the per diem/daily allowance amount reflected in the travel claim form of an employee with that of the government approved rates to ensure that the per diem/daily allowance is paid as per the approved government rates"*. By designing and performing this procedure, it confirms that the per diem/daily allowance to an employee was paid as per the government approved rates.

What is the assertion that is being tested?

Audit procedures are supposed to test the assertions made in the financial statements. In other words, the reasons for performing the audit procedure as indicated above is to test the assertion. However, it is important for an auditor to understand which assertion will be tested before designing the audit procedure. Taking the above example; *"Agree the per diem/daily allowance amount reflected in the travel claim form of an employee with that of the government approved rates*
(1) to ensure that the per diem/daily allowance is paid as per the approved government rates"
(2).This will confirm the assertion of accuracy of travel expenditure in the financial statement (3). (1= Audit Procedure; 2= the reason for audit procedure; and 3= the assertion). Having these three components ensures completeness of audit procedure.

Commonly used terminologies while designing audit procedures

The terminologies relating to audit such as *'agree', 'cast', 'trace'* may be used while designing audit procedures so that it is very specific.

The word *'cast'* would mean totaling up a list – example cast the travel expenditure reflected in the financial statements. The words *'agree'* or *'trace'* would mean matching information from two documents/records – for example agree the per diem claim made by an employee with government approved rate, or trace total travel expenditure in the financial statements to travel ledger to confirm accuracy.

Illustration 4.12: Things to consider while designing audit procedures

4.93 The illustration provided on designing audit procedures are further corroborated in Risk Response suggested in **AWP 4.6 B**. The auditor can adopt this methodology to document further audit procedures in an audit of financial statements.

4.94 The planning phase of the audit of financial statements ends with designing further audit procedures based on risks of material misstatements identified and assessed at financial statement and assertion level. However, the audit procedures designed at the planning phase may undergo a change while performing them at the execution phase based on new circumstances and situation that may arise in the field, and which were not taken into account while planning. The planning phase of the audit is an iterative process, and should be updated throughout the audit process.

General Procedures of test of details of transaction and account balances

4.95 The types of test of details of transaction and account balances commonly used in an audit are as follows:

- **Inspection of Assets**: Inspection of assets by the auditor is a dual-purpose test, and the extent of testing will depend on the quality of the underlying controls. Inspection of assets is used primarily to detect misstatements relating to existence and to check the condition of the assets.
- **Review of Reconciliations**: Review of reconciliations by the auditor is a dual-purpose test, and the extent of the tests will depend on the quality of the underlying controls. Reconciliation of a general ledger control account to supporting detail records is a control technique ordinarily performed by the entity on a periodic basis.

  Ordinarily, the auditor would review the reconciliation for reasonableness of the reconciling items. It may also perform a test of clerical accuracy and trace selected reconciling items to supporting documentation. In rare instances, the auditor may perform the reconciliation itself, e.g., when control techniques are not effective.
- **Analysis of Accounts**: Analysis of accounts are often prepared for financial statement accounts that reflect financial position at a point in time, presenting the balances at an initial date, the current balances, and summaries of transactions affecting the account between these dates. The analysis may be performed between an interim date and the Financial Statement date or for the entire audit period.

  Analysis of accounts may be performed in order to:

  - Evaluate the reasonableness of transactions affecting an account,

- Select transactions for further testing, or
- Identify any unusual transactions for further investigation.

- **Vouching**: Vouching is one of the most widely used substantive audit procedures and consists generally of document examination such as scrutinizing documents to determine authenticity and regularity, scanning to determine proper authorization and agreement, comparison and cross referencing with other records or documents. It may be performed to examine the details supporting the transactions recorded during the audit period.

  Vouching may be used to detect possible misstatements relating to "existence or occurrence," "completeness" “validity” or "rights and obligations.” In many cases, the auditor may choose to rely on transaction processing controls to address these misstatements and perform only limited or no vouching tests. However, in some cases, the auditor may decide that it is more efficient to perform vouching or that vouching is necessary to detect possible misstatements due to weaknesses in controls.

- **Re-computation and Tests of Clerical Accuracy**: Certain accounts included in the financial statements represent computations or an accumulation of computations made by the entity. The audit of these accounts often includes re-computing some or all of the detailed computations. Tests of clerical accuracy are usually broader than re-computation and may include the testing of postings, listings, extensions, footings, cross-footings, etc.

- **Other Tests of Details**
  - ***Exception Tests*** - Exception tests involve scanning lists of recorded transactions and account balances for unusual items that may indicate possible misstatements.
  - ***Cut-off Tests*** - The purpose of cut-off tests is to obtain evidence that transactions are recorded in the proper accounting period. Cut-off tests address the "occurrence" type of misstatement, e.g., whether recorded transactions actually occurred during the audit period. They also address the "completeness" type of misstatement, e.g., whether transactions recorded subsequent to the financial statement date should have been recorded prior to that date.

- ***Inquiries*** **-** Inquiries with management and employees are among the most commonly used auditing procedures to identify:
  - Possible misstatements for further investigation and to follow up on differences and exceptions noted in other substantive tests.
  - Matters for possible disclosure, such as litigation and other contingencies, commitments, changes in accounting principles, and events subsequent to the financial statement date (mostly relevant for private sector auditing).
- **Valuation Tests and Judgments and Estimates** (mostly relevant for private sector auditing): Valuation tests are performed to address possible misstatements in the valuation of assets and liabilities. Valuation misstatements may occur whenever accounting estimates are used to record assets at realizable value and liabilities at expected settlement accounts. Accounting estimates are often necessary where the measurement or valuation of an account balance is uncertain, e.g., pending the outcome of future events, or where relevant data concerning events that have already occurred cannot be accumulated on a timely, cost-effective basis.

  Valuation tests ordinarily consist of a variety of procedures including analytical procedures, analyses of accounts, reviewing documents and records supporting the accounting estimate re-computations, scanning accounting records for unusual items and reading of minutes of meetings for indications of management plans or actions that may affect accounting estimates. These tests may be used in reviewing subsequent events or transactions occurring prior to completion of fieldwork to provide an indication of the appropriate valuation of the account balance.

  The performance of valuation tests may result in differences between the estimates of account balances prepared by the auditor and the entity. These differences may represent misstatements of the balances.

Considerations of laws and regulations in an audit of financial statements

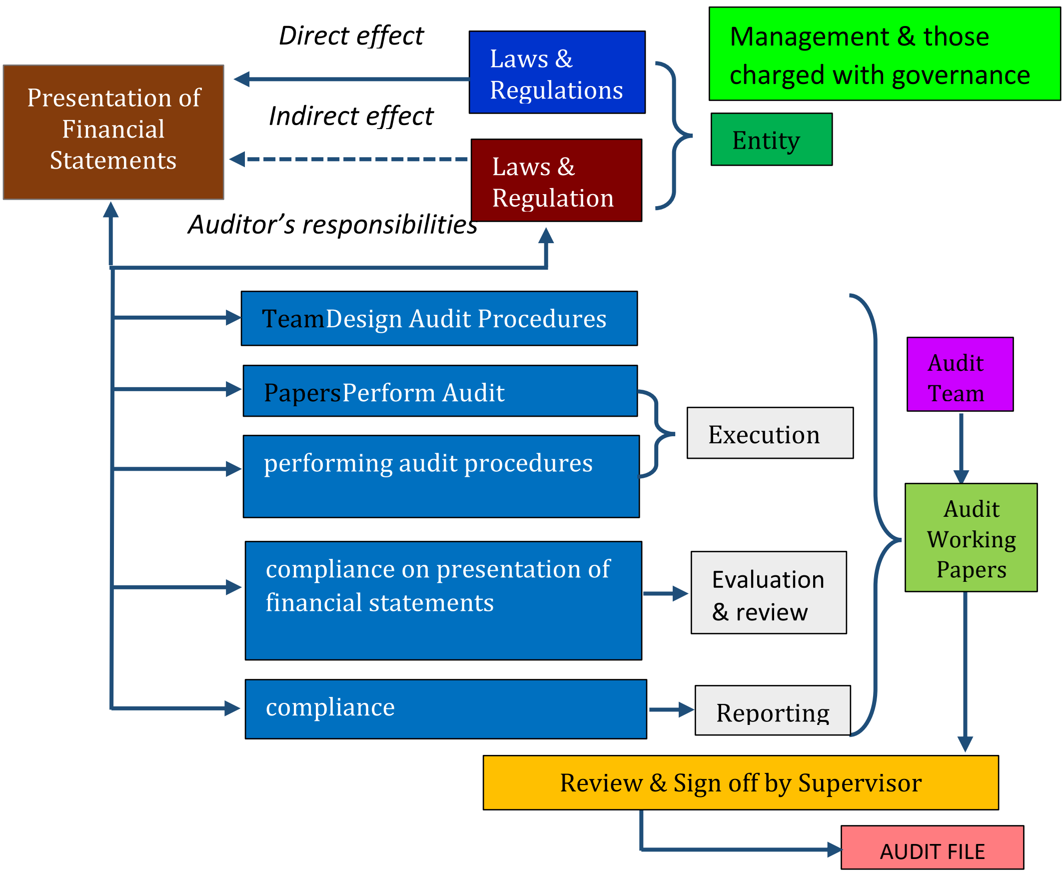
4.96 The principles related to consideration of laws and regulations in an audit of financial statements are dealt in **ISSAI 1250**. This section builds upon those principles and outlines the methodology on consideration of laws and regulations in an audit of financial statements.

4.97 In considering laws and regulations in an audit of financial statements, the objectives of the auditor as per **ISSAI 1250.10** are:

- To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have direct effect on the determination of material amounts and disclosure in the financial statements;
- To perform specific 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.

4.98 Some of the applicable laws may have direct effect on the presentation of the financial statements, whereas some may have indirect effect. The non-compliance of both may have material effect on the presentation of financial statements. **Figure 4.6** represented below provides a snapshot of how laws and regulations should be considered by the auditor at the time of planning and performing the audit.

Figure 4.6: Snapshot of considerations of laws and regulations while planning and performing an audit of financial statements



4.99 It is the responsibility of the management and those charged with governance to ensure that the entity's operations are conducted in accordance with the provisions of the laws and regulations, including compliance with those provisions that determine the reported amounts and disclosures in an entity's financial statements. The auditor's responsibility is to identify material misstatements in the financial statements due to non-compliance with laws and regulations.

4.100 In an audit of financial statements of an entity, the auditor needs to identify applicable laws and regulations affecting the entity's operations, while obtaining an understanding of the entity at the planning stage. In the context of public sector entities, those applicable laws and regulation may be in the form of environmental regulation, public finance Act, financial regulation, procurement regulation, employment Act, Parliamentary resolutions, etc.

4.101 In public sector operations, especially in the government, the amounts reflected in the financial statements are based on laws enacted by the Parliament such as budget law, regulations, and other standing orders and circulars issued by the government, besides the applicable financial reporting framework, which provides the basis for preparation of financial statements. These laws and regulations may have direct effect on the determination of material amounts and disclosures in the financial statements. The non-compliance of these laws and regulations will have material effect in the financial statements as in **illustration 4.13** below:

Illustration 4.13: Non-compliance of regulation having direct effect on the financial statements

Class of transaction	Ministry of Finance Rule – Travel abroad	Amount Paid (Nu.)	Amount entitled as per MoF Rule (eligible for 50% of DSA) Nu.	Excess amount Paid (Nu.)
Travel	*Clause* 9 states; *'An employee shall be paid 50% of Daily Subsistence Allowance per day as per the applicable rate of the country to which the travel has been performed, if the accommodation is provided by the host'*	27,500.00	13,750.00	13,750.00
Case: ***An employee of X entity performed business travel abroad to attend a seminar on challenges and opportunities in implementing IPSAS in the government. An invitation from the organiser and host of the seminar states that an accommodation for the entire period of seminar will be provided by the host. The seminar was for five days, and was held in New Delhi. The DSA rates applicable for the government employee in New Delhi as per Schedule 9 of the Ministry of Finance is Nu.5,500.00 per day.***				

Fact: ***Clause 9 of the Ministry of Finance Rule determines the amount of Daily Subsistence Allowance to be paid to an employee for attending 5 days seminar, which worked out to Nu. 13,750.00. However, an employee was paid Nu. 27,500.00 which was in deviation to Clause 9 of the MoF Rule. Therefore, this is a case of non-compliance to applicable Rule. In this case, it is assumed that excess payment of Nu. 13,730.00 will have material effect in the financial statements. However, in the real scenario, whether excess payment will have material effect or not will depend on materiality determined for Travel (Class of expenditure).***

4.102 An entity is also required to comply with other laws and regulations such as environment law, employment law, labour Act, etc., in its day to day operation, which do not have a direct effect on the determination of amounts and disclosures in the financial statements. However, non-compliance to those laws and regulations may have material effect on the financial statements. For instance, violation of a provision of environment law may attract fines and penalties that will have material effect in the financial statements as in **illustration 4.14** below:

Illustration 4.14: Non-compliance of regulation having indirect effect on the financial statements

Class of transaction	Section of Solid Waste Management Act – Environment Authority	Amount of fines & penalties (Nu.)
Miscellaneous (fines & penalties)	Section 55 states; *'Dumping of solid waste in an area other than the designated ones will result in fines and penalties prescribed by the Environment Authority'*.	50000.00
Case: ***In a routine monitoring of office premises and public places by the Environment Officers from the Environment Authority during the year, it was observed that the X entity had dumped eWaste across the road - about 100 meters from its office premises, instead of dumping in the designated area, which is about 20 kilometers away from the city. The X entity was penalised for violation of Section 55 of the Solid Waste Management Act by issuing a demand notice to pay Nu. 50,000.00 to the Environment Authority by 31 July 2015. The notice further states that failure to pay the penalty within the given deadline will attract penal interest of 15%.pa. The rate of penalty was in accordance with the Schedule of rates of fines and penalties prescribed by the Environment Authority in 2014. In accordance with the demand notice, the X entity paid the penalty by issuing bank cheque No. 000100 dated 25 July 2013 for Nu. 50,000.00 in favour of the Environment Authority. The penalty amount of Nu. 50,000.00 was booked under Miscellaneous account – fines & penalties.***		
Fact: ***The payment of Nu. 50,000.00 to the Environment Authority and booked under the Miscellaneous account is not a payment that was incurred for normal course of business in the X entity. The payment was on account of violation of the law. The payment of Nu. 50,000.00 not only has material effect on the financial statements in terms of amount (to be compared with materiality set at the planning stage of the audit), but the violation of law in itself is by nature material. The Environment Law may not have direct effect on presentation of financial statements, but violation, which is non-compliance would have an effect as stated in this case.***		

4.103 For those laws and regulations that will have direct effect on the determination of material amounts and disclosures in the financial statements, the auditor's responsibility is to obtain sufficient appropriate audit evidence regarding compliance with those laws and regulations, such as the Ministry of Finance rules as given in **Illustration No 4.14** above.

4.104 The auditor needs to design and perform audit procedures in order to gather sufficient appropriate audit evidence regarding compliance with the laws and regulations. The procedures could be in the form of inquiry with the management, and where appropriate those charged with governance, and inspection of documents within and outside of an entity, such as the one provided in the above illustrations where the documents can be obtained from the Environment Authority, to see whether there were any instances of non-compliance by the entity audited to relevant environment laws. The audit procedure in case of **Illustration 4.14** above can be designed as follows in **illustration 4.15**:

Illustration 4.15: Audit procedures to detect non-compliance to laws and regulations

Class of transaction	Assertion	Audit Procedures	Conclusion
Travel (Travel abroad)	Accuracy	Extract five samples of travels made abroad by the employees from the travel ledger and agree that the Daily Subsistence Allowances paid were in accordance with rates prescribed by Clause 9 of the Rules on Travel abroad issued by the Ministry of Finance.	Out of five samples tested, the payment for one employee was made in excess by Nu. 2500. The travel expenditure has been overstated to that extent in the financial statement.
Purpose**:** ***The objective of performing this procedure is to see that the payment for travel abroad was made in accordance with the rules issued by the Ministry of Finance. By performing this procedure, it ensures the accuracy of expenditure booked against travel abroad in the financial statements. Besides ensuring that correct treatment of travel expenditure in the Books of Accounts of an entity, the management is also responsible to ensure that the expenditure incurred for the purpose complies with the rules issued by the Ministry of Finance.*** Evidence**:** ***The audit procedure, conclusion of audit procedure performed, extract of Clause 9 & Schedule 9 of ministry of Finance Rules, printed extract of five samples (generated from entity's accounting system) of travel abroad for five employees are the audit evidence.***			

4.105 The instances of non-compliance to laws and regulations observed by the auditor can be reported to the management and those charged with the governance, and other concerned authorities. The need to report to concerned authorities would depend on the significance and severity of non-compliance.

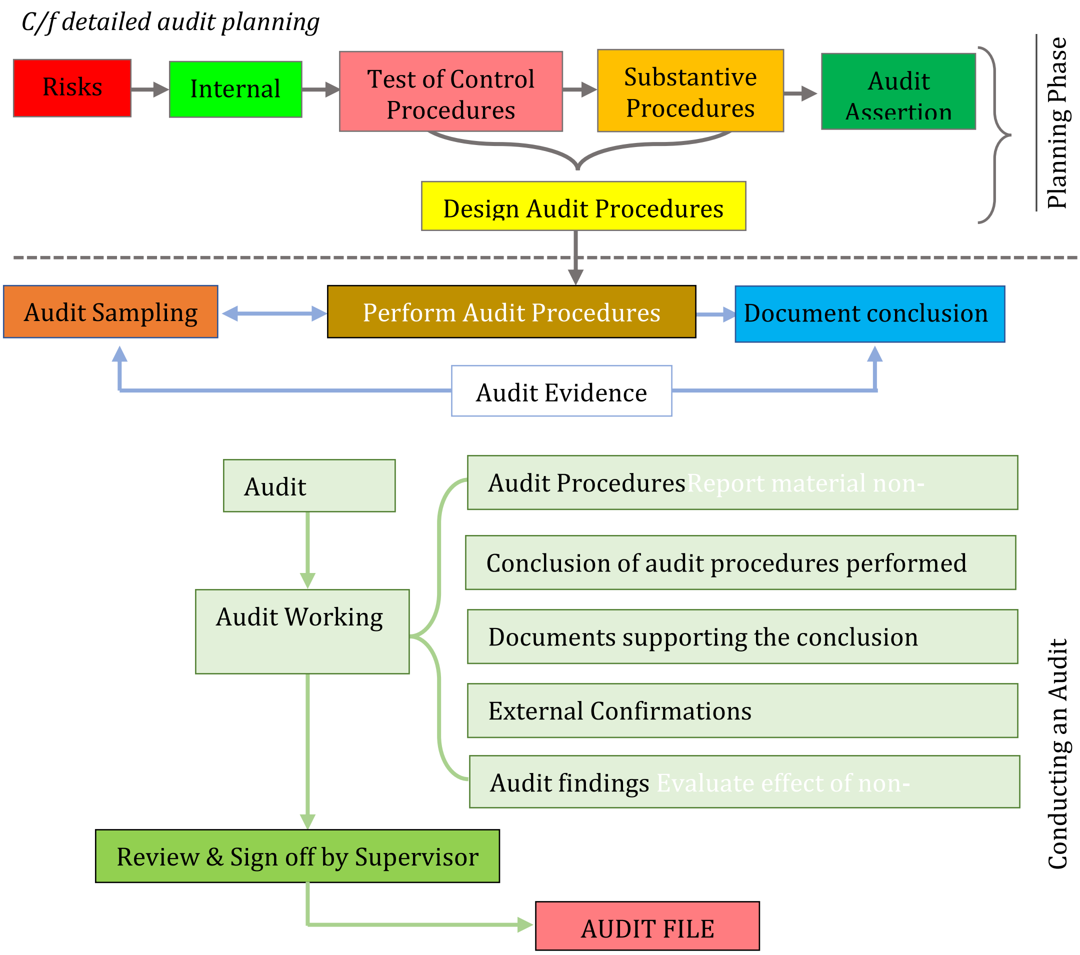
4.106 The instances of non-compliances may be incorporated in the audit findings to be reported along with the auditor's report on the financial statements. If the matter is not significant and in auditor's judgement can be resolved at the instances of audit, such matter may be reported to the management or those charged with the governance. These issues may still be reflected in the audit findings or maintained in a separate working file as matters resolved during the course of audit.

4.107 If an instance of non-compliance warrants attention of the concerned higher authorities, or for that matter the Parliament, those matters may be reported separately in the form of audit findings, which can be appended along with the auditor's report on the financial statements.

Chapter 5: Conducting an audit

5.1 The conducting phase of the audit process covers performing the audit procedures and gathering audit evidence. Based on the assessed risk of material misstatement, the auditor designs audit procedures (test of control and substantive audit procedures) at the planning stage. Since whole audit process is an iterative process, it may so happen that the audit procedures are designed and performed at the conducting phase as well. **Figure 5.1** below provides a snapshot of the conducting phase of the financial audit process:

Figure 5.1: Snapshot of conducting Phase of Audit (Performing Audit Procedures & gathering audit evidence)



Performing audit procedures and documenting the conclusion

5.2 The auditor performs audit procedures in order to gather audit evidence, which would form the basis of auditor's conclusion. The auditor is required to gather sufficient appropriate audit evidence. While the sufficiency is related to quantity of audit evidence, the appropriateness is the quality in terms of relevancy and reliability.

5.3 Upon performing the audit procedures, the auditor needs to record the conclusion. The conclusions arrived at after performing the audit procedures should also indicate whether the purpose of audit procedures have been met. The need to document the conclusion also ensures that the auditor performs the audit procedures designed at the planning stage, and it serves as an audit evidence. In other words, the conclusion is an evidence that the audit procedures have been performed. The **illustration 5.1** below is the example of importance of documenting conclusion of audit procedures performed.

Illustration 5.1: The importance of documenting conclusion of audit procedures performed

*The **SAIS** ABC (real situation) in 2014 engaged a team **from** SAIS XYZ of another country to conduct the **SAIS PMF** assessment. The assessment team while reviewing the audit file of one financial audit conducted in 2013 found that the audit team had designed the audit procedures based on the assessed risk of material misstatement in the audit planning document. However, the assessment team did not find any evidence of audit procedures being performed by the auditors since no conclusions were recorded against each procedure designed at the planning stage. The assessment team interviewed the audit team to ask whether they had performed the audit procedures that they have designed at the planning stage. The audit team responded that the audit procedures were performed accordingly. When asked whether conclusions arrived at were recorded, the team responded that conclusion against each procedures were not recorded. The team submitted that the audit observations were regarded as their conclusion. As a result, the rating was very low under Domain C of the **SAIS-PMF** assessment report.*

Considering the above example, it is very important for auditors to record the conclusion of audit procedures performed irrespective of whether or not there were audit observations on performing the audit procedures.

5.4 The test of control is performed in order to see whether the controls designed and implemented were operating effectively. With reference to **illustration 4.2** given under the planning an audit (refer chapter 4) one of the control activities put in place by the entity for the purpose of approving the travel claim of an employee is that the claim needs to be verified and approved by immediate supervisor, which is forwarded to Account Section. The Accounts Personnel verifies and prepares Cheque and submits for authorization by

Designated Drawing & Disbursing Officer. As mentioned earlier, the audit procedures are not designed in isolation, but are always linked to the risk and assertion. Taking an example from **illustration 4.2**, let us look at how the auditor can record the conclusion based on performing the test of control as follows in **illustration 5.2**:

Illustration 5.2 Recording the conclusion of performing test of control

Risk	Travel claim of an employee being paid at incorrect rates.
Control activity	An independent check should be performed of standing data (e.g.: government approved travel claim rates) to travel claim processed by an employee.
Test of control procedure	Inspect the travel claim of an employee for evidence of *independent check* being performed.
Conclusion	***Positive conclusion****: An independent check was performed by the designated staff in the entity. The internal control is operating effectively.*
	Negative conclusion*: An independent check was not performed for travel claim rates being paid.*
Audit assertion	Accuracy *(checking if rates of travel claim were applied correctly).*

Note: The conclusion could be of two types. Positive conclusion is where the control activity is operating effectively, and Negative conclusion is where the control activity is not operating effectively. Negative conclusion would then lead to formulating audit observations and recommendations to be communicated to the management and those charged with governance.

5.5 The auditor should perform test of controls and accordingly record those conclusions in AWP 5.1 Step 2 control testing table based on the control procedures designed at the planning stage. This should be signed off by the reviewer upon verification of performing control testing procedures.

5.6 The tests of controls are performed at two levels; i.e. testing design and implementation (D&I) of controls to evaluate whether the relevant controls have been designed & implemented and testing operating effectiveness of the controls to see whether the controls designed and implemented are operating effectively throughout the period. In the latter part, the auditor intends to gather sufficient appropriate audit evidence as to the operating effectiveness of the relevant controls put in place to prevent and detect material misstatements in the financial statements, and to determine the extent of level of substantive testing.

5.7 The evaluation of design and implementation of controls is important to assess whether the audited entity has actually designed and implemented the internal controls. In the financial audit of government entities, the internal controls might be determined by laws, rules and regulations. As such it is not common practice for auditors to evaluate the design and implementation of controls, when those are already in place, in which case the auditor's directly tests the operating effectiveness of controls.

5.8 The manner in which the auditor can perform the audit procedures for testing operating effectiveness of controls and document the procedures performed and conclusion as suggested in **AWP 5.1**.

5.9 Regardless of performing tests of controls and arriving at a conclusion on operating effectiveness of internal controls, the auditor should perform substantive procedures for material classes of transactions, account balances and disclosures because the auditor's risk assessment is judgmental and may not be sufficiently precise to identify all risks of material misstatement. Additionally, there are inherent limitations to internal control, including the risk of management override, the possibility of human error or the effect of systems changes.

5.10 **ISSAI 1330:6** requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (**ISSAI 1300:A4-A8**).

5.11 Substantive tests are performed in order to detect material misstatements at the assertion level, and include tests of details of classes of transactions, account balances, and disclosures and substantive analytical procedures. The auditor plans and performs substantive procedures responsive to the related assessment of the risk of material misstatement. An illustration on difference between test of details and substantive analytical procedures is given in **Illustration 4.9** and **4.10** under **chapter 4**.

Following example from **Illustration 4.2** given under the detailed planning of an audit (chapter 4), let us look how the auditor can document the conclusion of performing substantive audit procedures, risks addressed and audit assertion identified in the **illustration 5.3** below.

Illustration 5.3: Documenting conclusion of performing substantive audit procedures

Risk	**Travel claim of an employee being paid at incorrect rates.**
Control activity	An independent check should be performed of standing data (eg: government approved travel claim rates) to travel claim processed by an employee.
Test of control procedure	Inspect the travel claim of an employee for evidence of *independent check* being performed.
Substantive Audit procedures (test of details)	Obtain printout of standing data (eg: government approved travel claim rates) and *compare* with the rates being applied in travel claim of an employee.
Conclusion	***Positive Conclusion****: The rates applied in an employee's travel claim agreed with the standing data (government approved travel claim rates).*

	Negative conclusion: *The rates applied in an employee's travel claim did not agree with the standing data (government approved travel claim rates). There was a difference of XX amount between the two records.*
Audit assertion	Accuracy *(checking if rates of travel claim were applied correctly).*

Note: The conclusion could be of two types. Positive conclusion is where the travel claims rates in two records agree, and Negative conclusion is where there were differences, and hence misstatements in the financial statements. The negative conclusion, depending on the materiality level would then have an impact on audit opinion on the financial statements.

5.12 The auditor needs to perform substantive audit procedures to gather substantial and corroborative audit evidence. The objective as stated above is to confirm the accuracy of payment of travel claims to an employee of the entity. The manner in which the auditor can perform and document the substantive audit procedures is suggested in **AWP 5.2** for classes of transaction, account balances. The **AWP 5.5B** is the template on recording Joint Physical verification conducted and it should also form a part of substantive audit procedures.

5.13 The auditor should continually maintain an attitude of professional skepticism when performing substantive procedures and evaluating the results.

5.14 Certain conditions or circumstances may indicate the possibility of a material misstatement. Examples include:

- Analytical procedures that disclose significant differences from expectations;
- Significant un-reconciled differences between the reconciliation of a control account and the subsidiary records or between a physical count and a related account;
- Confirmation requests that disclose significant differences or yield fewer responses than expected;
- Transactions selected for testing that are not supported by proper documentation or not appropriately authorized;
- Supporting records or files that should be readily available but are not promptly produced when requested; and
- Audit tests that detect errors that apparently were known to the entity personnel, but were not voluntarily disclosed to the auditor.

5.15 When the foregoing conditions or circumstances exist, the substantive procedures as originally planned may not be sufficient to detect material misstatements that may have occurred. The auditor should consider whether the initial assessment of the risk of material misstatements and the planned substantive tests are still appropriate. Additional substantive tests should be performed as necessary to determine whether material misstatements have occurred and to quantify the amount of such misstatements. The choice of appropriate procedures, including the extent of performing a combination of analytical procedures and tests of details, is a matter of professional judgement.

External Confirmations

5.16 External confirmation is a very powerful substantive audit procedure, especially when the auditor is not able to rely on audit evidence gathered within the entity, and that required third party confirmation. External confirmation is a direct written response to the auditor from a third party in paper form, or by electronic or other medium.

5.17 External confirmation procedures to obtain audit evidence is guided **by ISSAI 1505** which provides, among others, that corroborating information obtained from a source independent of entity may increase the assurance the auditor obtains from evidence within the accounting records or from representations made by management (**ISSAI 1505:2**).

5.18 In the public sector, external confirmations can be used to obtain evidence about:

- The presence or absence in agreements or arrangements with third parties or other terms and conditions such as guarantees of performance or funding;
- The commitment of expenditures that have not yet been authorized by the legislature;
- The continued eligibility of individuals in receipt of pensions, income assistance, annuities or other ongoing payments; or
- The presence of “side deals” with suppliers for the return of goods for credit in order to use funding that would have otherwise lapsed in subsequent fiscal period.
- Advances, refundable payments, closed work, insurance related to works, debtors, creditors, etc.

5.19 Confirmation from third parties is an important audit procedure because, ordinarily, evidential matter obtained from independent sources outside an entity may provide greater assurance of reliability than evidence secured solely within the entity.

5.20 The auditor is expected to exercise controls to provide reasonable assurance that the confirmation requests are directed to the third parties it has selected. This requires:

- Control over the preparation and sending the requests (either personal delivery, by mail or fax);
- Investigation of the reasons for addressing requests to specific individuals within an entity;
- Mailing requests in envelopes bearing the auditor's return address so that any items undelivered by the post office are returned to the auditor for redirection, if possible;
- Investigation of undelivered requests; and
- Alertness for replies that are suspiciously uniform in some respect, e.g., handwriting, address, etc. and delivery through management.

5.21 The external confirmation can be a positive or negative confirmation. The difference between the two is in the formulation of the content of the confirmation letter, and also indicating whether and how the third party should respond to such request from the auditor. The examples of positive and negative confirmation letters are provided as **AWP 5.4A** and **AWP 5.4B** respectively.

5.22 A positive external confirmation request requires the respondent to respond to the auditor in all cases regardless of whether the party agrees or disagrees with the balance reflected in the confirmation request. The auditor may also use positive confirmation requests that do not state the amount (or other information) on the confirmation request and ask the confirmation party to fill in the amount or furnish other information. A response to a positive confirmation request generally provides reliable audit evidence. A negative external confirmation request requires the respondent to reply only in the event of disagreement with the balance reflected in the letter.

5.23 A copy of the confirmation exceptions may be given to the entity's management for investigation after due process of safeguarding measures have been instituted. If the entity personnel investigate exceptions, the auditor should inspect, at least on a test basis, the evidence explaining and reconciling the exceptions.

5.24 The auditor should determine whether there are any significant and/or frequently recurring exceptions which may be indicative of a pattern of errors in the unconfirmed accounts. The auditor should also exercise professional skepticism when dealing with unusual or unexpected responses to confirmation requests. (e.g. significant change in the number or timeliness of responses to confirmation requests relative to prior audits), or a non-response when a response would be expected. These circumstances may indicate previously unidentified risks of material misstatement due to fraud.

5.25 When the auditor does not receive replies to confirmation requests, alternative audit procedures should be performed to obtain the evidence necessary to reduce audit risks to an acceptably low level. The nature of alternative procedures to be performed varies according to the account and assertion. The auditor should apply alternative procedures to each item that make up the entire balance of the confirmations that were not received.

5.26 The most common example is obtaining the confirmation of bank balances. The auditor confirms the year-end bank balance by direct correspondence with all banks which the entity has had accounts during the period. Confirmation procedures provide evidence that the cash in the Statement of Financial Position or Receipts and Payments exist at the year end and that it is owned by the entity.

5.27 Bank confirmation requests ask a bank to provide independent confirmation of the entity's account balances and other information held by the bank on behalf of the client, including securities, treasury management instruments and documents. The information contained on the confirmation relates to the normal banking activities. An example of Bank Confirmation Request format is presented in **AWP 5.4C**.

Analytical Procedures

5.28 "Analytical Procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount (**ISSAI 1520:3**).

5.29 Analytical procedures may be used for the following purposes:

- To assist in planning the nature, extent and timing of the audit procedures;
- As a substantive test to detect possible misstatements in the financial statements; and
- As an overall review of the financial statements.

5.30 Analytical procedures performed during audit planning and as an overall review would generally consist of relatively simple methods applied at aggregate levels, such as financial statement balances; those performed as substantive audit procedures may include higher precision analytics, depending on the effectiveness and efficiency of these tests relative to other audit procedures.

5.31 **ISSAI 1520** provides guidance in the performance of analytical procedures as substantive audit procedures. As per **ISSAI 1520:P12**, in performing analytical procedures, either as substantive analytical procedures or to assist when forming an overall conclusion, public sector auditors may also consider relationships such as:

- Comparisons
  - Expenditure versus budget or appropriations;
  - Benefit payments, such as child support and pensions versus demographic information;
  - Tax revenues versus demographic information or economic conditions or indicators;
  - Interest as a percentage of national debt compared to the government borrowing rate;
  - Results accomplished in relation to expenditure, where performance information is included as part of the financial statements; and
  - Government grants for economic and social development, e.g. grants for low income farmers and grants for school buildings versus economic and demographic indicators.
- Proof in total, i.e. when the auditor predicts the value of a balance and compares it to the reported balance.
- Consideration of relationships, e.g. payroll costs to number of employees.

5.32 Analytical procedures involve comparing recorded amounts and ratios to expectations developed by the auditor. Plausible relationships that are reasonably expected to exist based on the auditor's understanding of the entity's operations and environment are identified and used to develop expectations. There are a wide variety of analytical procedures that may be performed, including:

- Comparison of financial statement or account balances to prior periods, budget, the entity environment averages, etc. Comparison may also be made by month or across locations, other local cluster/sub-clusters, etc.;
- Computation of ratios involving relationships between different elements of the financial statements, such as liquidity ratio, total Personal Services over total Expense, etc.; and
- Predictive tests of account balances based on expected relationships between underlying financial and non-financial data.

5.33 The auditor considers the level of assurance needed based on the risk of misstatements when determining the appropriate combination of analytical procedures and tests of details for a particular account balance or assertion. Substantive procedures should be designed to reduce the level of audit risk to an appropriately low level.

5.34 The results of analytical procedures alone may not be sufficient to provide the desired level of assurance. However, analytical procedures alone may be sufficient when the account balances or assertions are low risk, or when the results of the analytical procedures are very precise.

5.35 In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. The level of assurance desired from analytical procedures is affected by the following factors:

- **Nature of account balance or assertion:** Analytical procedures may be effective and efficient tests for account balances or assertions when potential misstatements would not be apparent from an examination of the detailed evidence or when detailed evidence is not readily available.
- **Plausibility and Predictability of the Relationship:** As higher levels of assurance are desired from analytical procedures, more predictable relationships are required to develop the expectation. Relationships in a stable environment are usually more predictable than relationships in a dynamic or unstable environment.

  Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts or accounts indicating the financial position since income statement accounts or similar statements represent transactions over a period of time, whereas balance sheet accounts or accounts indicating the financial position represent amounts as of a point in time. Relationships involving transactions subject to management discretion are sometimes less predictable.
- **Availability of Data:** Data may or may not be readily available to develop expectations for some account balances or assertions.

- **Reliability of Data:** The following factors influence the auditor's consideration of the reliability of data for purposes of achieving audit objectives:
  - Whether the data was obtained from independent sources outside the entity or from sources within the entity;
  - Whether sources within the entity were independent of those who are responsible for the amount being audited;
  - Whether the data was developed under a reliable system with adequate controls;
  - Whether the data was subjected to audit testing in the current or prior year; and
  - Whether the expectations were developed using data from a variety of sources.
- **Precision of the Expectation:** The expectation should be precise enough to provide the desired level of assurance that differences which may be potential material misstatements, individually or when aggregated with other misstatements, would be identified. As expectations become more precise, the range of expected differences become narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. Any of the following concepts may be used to improve the precision of analytical procedures:
  - Increase the level of detail
  - Analyzing results over shorter time periods

5.36 The auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.

5.37 The auditor should evaluate significant unexpected differences. Reconsidering the methods and factors used in developing the expectation and inquiry of entity management may assist the auditor in this regard. Management responses, however, should ordinarily be corroborated with other evidential matter. In those cases, when an explanation for the difference cannot be obtained, the auditor should obtain sufficient evidence about the account balance or assertion by performing other audit procedures to satisfy itself as to whether the difference is a likely misstatement. In designing other procedures, the auditor should consider that unexplained differences might indicate a material misstatement. Typical example of performing analytical procedures related to outsourcing of postal ballot is in **illustration 5.4** below:

Illustration 5.4 Documenting analytical procedures performed as a part of substantive audit procedures

Risks	What Could go wrong?	Assertions	Substantive Procedures
Invoicing beyond the limit	Over-statement of expenditures	Occurrence and accuracy	1. Determine estimated expenditure by Dzongkhag wise registered Postal Ballot (as per ECB) and agreed rate and compare with actual expenditure recorded; 2. Obtain the list of registered and dispatched Postal Ballot and compared with the list provided in the invoice 3. Confirm the number of postal ballot received (valid and rejected) from respective stations/dzongkhag and compared with the list provided in the Invoice by Bhutan Post

Documentation of performance of Analytical procedures

Sl. No.	Dzongkhag	Total registered Postal Ballot	Postal ballot dispatched as per Bhutan Post	Agreed rate with Bhutan Post per postal Ballot	Total Value
1	XYZ Dzongkhag	77,000.00	76,000.00	15	1,140,000.00
2					
3					
				Total	**1,140,000.00**
				Expenditures as per Expenditure statements	**2,100,000.00**
				Variance	**960,000.00**
				In percentage	**45.71%**
Conclusion: Analytical Procedures **Analytical performance of aforementioned area revealed variation of 45.71% (overstatement) of actual expenditure. As such, the team will investigate in details**					

Selecting Items for Testing

5.38 Application of audit procedures often involves the selection of items for testing to gather audit evidence from a population. The auditor should determine the appropriate means of selecting items for testing to gather audit evidence. These are:

- **selecting all items (100% examination) – this is appropriate when:**
    - The population constitutes a small number of large-value items;
    - There is a significant risk and other means do not provide sufficient appropriate audit evidence; and
    - The repetitive nature of calculation or other process performed automatically by an information system makes 100 per cent examination cost effective, for example, through the use of computer-assisted audit techniques (CAATs).
- **selecting specific items – this is appropriate for:**
    - High-value or key items that could individually result in a material misstatement;
    - All items over a specified value;
    - Any unusual or sensitive items or financial statement disclosures;
    - Any items that are highly susceptible to misstatement;
    - Items that will provide information about matters such as the nature of the entity, the nature of transactions, and internal control; and
    - Items to test the operation of certain control activities.
- **Use of sampling (Representative sample of items from the population) - this is appropriate for:**
    - Reaching conclusion about an entire set of data (population) by selecting and examining a representative sample of items within the population, which is possible when auditor uses both statistical and non-statistical method of sampling.

5.39 While allowing the auditor to obtain and evaluate audit evidence about specific characteristics, the decision would depend on the judgment of the auditor and on circumstances, and the application of any or combination of the means that may be appropriate in certain cases. Factors to be considered by the auditor are risk of material misstatement related to the assertion being tested and audit efficiency. The auditor needs to be satisfied that methods used are effective such that sufficient appropriate evidence obtained from the sample meets the objectives of the audit.

Use of Sampling

5.40 Audit sampling involves the application of audit procedures to less than 100% of items within a class of transactions or account balance such that all sampling units have equal chances of getting selected. It enables the auditor to obtain and evaluate audit evidences about some characteristics of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. The determination of sample size may be made using either statistical or non-statistical methods.

- **Statistical sampling -** is a method for selecting samples randomly, i.e. in such a way that each population item has a known probability of being included in the sample. Probability aids an auditor in designing an efficient sample, in measuring the sufficiency of evidence obtained and in evaluating the sample results.
- **Non-statistical sampling** – the auditor uses professional judgement to determine sample size, to select sample and to evaluate results from the sample. In exercising professional judgment, the auditors use the knowledge, skills, and experience to diligently perform the gathering of evidence in good faith and with integrity. The exercise of professional judgment allows auditors to obtain reasonable assurance that any material misstatements or significant inaccuracies in data will likely to be detected.

5.41 Although a properly designed non-statistical sampling application can provide results that are as valid as those obtained from a properly designed statistical sampling, there is one key difference: the statistical sampling explicitly measures the sampling risk associated with the sampling procedure.

5.42 The use of sampling offers many benefits. For example, it:

- Expedites review of working papers;
- Enable the auditors to draw valid conclusions and attain the objective of obtaining reasonable risk reduction;
- Allows to combine substantive test results from other tests such that evidence obtained from one source can be corroborated by evidence obtained from another source to reduce audit risk; and
- Reduce audit costs - The cost of examining every entry in the accounting records and all supporting evidence would be uneconomical.

5.43 The use of sampling in audit is guided by **ISSAI 1530**. Specifically, **ISSAI 1530:6** requires that when designing an audit sample, the auditor shall consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn.

Key steps in the audit sampling process

5.44 Regardless of the statistical or non-statistical sampling technique applied, the key steps in the audit sampling process are:

a) **Design the audit sample** – the auditor should consider the objectives of the audit procedures and the attributes of the population from which the sample will be drawn:

- *Determine test objectives* – Consider specific objectives to be achieved and the combination of audit procedures that is likely to achieve those objectives;
- *Define error conditions* – define the conditions that constitute an error;
- Define population - define the population from which the sample will be drawn;
- *Determine sampling method and selection technique* – Determine appropriate sampling method and sampling technique to be applied; and
- *Define sampling units* – Define the individual items comprising the population.

b) **Determine sample size** – Sample size is affected by the level of sampling risk the auditor is willing to accept. The lower the risk the auditor is willing to accept the greater the sample size will be. The sample size can be determined by the application of a statistically-based formula or through the exercise of the professional judgment objectively applied to the circumstances.

Among the factors influencing sample size are as follows:

- *Confidence level or Reliability factor* - the greater the degree of confidence or reliability that the auditor requires that the results of the sample are in fact indicative of the actual incidence of error in the population, the larger the sample size needs to be;
- *Extent to which the risk of material misstatement is reduced by the operating effectiveness of controls* – the more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of risk of material misstatement will be and the larger the sample size needs to be;
- *Assessment of the risk of material misstatement* – the higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be;
- *Tolerable deviation rate* - i.e. a rate of deviation from prescribed internal control procedures set by the auditor, in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population - the lower the deviation rate the auditor is

willing to accept, the larger the sample size needs to be. (Tolerable rate of deviation as defined by ISSAI 1530.5j is a rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population);

- *Expected population deviation rate* – the higher the rate of deviation the auditor expects, the larger the sample size needs to be so as to be in a position to make a reasonable estimate of the actual rate of deviation; and
- *Tolerable error* – the smaller the error the auditor is willing to accept the larger the sample size needs to be. (Tolerable error or misstatement as defined by ISSAI 1530.5i is a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population).

c) **Select the sample -** Select the sample with the expectation that all units in the population have an equal chance of selection. Commonly used sample selection techniques are random, systematic or monetary unit sampling. Each auditor can choose sampling techniques using professional judgement based on the nature of the population to be tested.

d) **Perform the audit procedure** - The auditor should perform audit procedures appropriate to the particular test objective on each item selected:

- For tests of controls, the auditor selects the sample and examines them to determine whether they contain deviations from the prescribed control. Some auditors find it practical to select a single set of samples for more than one test objective and to select several extra sampling units for possible replacement;
- If the auditor is unable to apply the planned audit procedures because the selected item is unavailable and no alternative procedure can be done to test whether the control was applied as prescribed, the item should be considered to be a deviation from the control for purposes of evaluating the sample;
- In case the auditor finds a large number of deviations in testing the first part of the sample, the auditor may reassess the level of control risk and consider whether it is necessary to continue the test to support the new assessed level of control risk; and

- For tests of details, in instances where the auditor was not able to apply the planned audit procedures to selected samples because supporting documentations are missing, the treatment on the unexamined items would depend on their effect on the evaluation of the sample. It is not necessary to review those unexamined items if the auditor's evaluation of sample results would not be altered by considering them to be misstated. On the other hand, when misstatement of these unexamined items would lead to a preliminary conclusion that the balance of the affected account is materially misstated, the auditor should consider alternative procedures that would provide sufficient evidence to form a revised conclusion.

e) **Evaluate the sample results -** After testing the samples and summarizing the observed errors, the auditor shall evaluate the results to reach an overall conclusion, as follows:

- *Consider the nature and causes of errors* – the direct effect of identified errors on the financial statements should be considered by the auditor in the evaluation of the results. It may be possible that errors may have a common feature or trend. In such case, the auditor may decide to identify all the items in the population that possess the common feature and extend audit procedures in that stratum. It is also possible that such errors may be intentional and may indicate the possibility of fraud;
- *Calculate and projects the sample error*;
- *Reach an overall conclusion* - the auditor should evaluate the sample results to determine whether the preliminary assessment of the relevant characteristics of the population is confirmed or needs to be revised, and the effect of the sample result on both the particular test objective and other areas of audit; and
- Considers the need for deciding whether more sampling and additional testing is needed in relation to the identified errors.

f) **Document the sampling procedures** – the auditor should document the sampling plan and procedures in the form of working papers as suggested in **AWP 5.3**. However, the documentation of sampling methods used/applied will depend on the audit Engagement Team for other than the use MUS.

5.45 The SAI Bhutan can adopt either the Monetary Unit Sampling (MUS) method provided as **AWP 5.3A** or Random Sampling Method using Pivot table function in MS Excel provided as **AWP 5.3B.**

Completion and Review procedures

6.1 At the completion and review stage, the auditor reviews the evidence obtained during the audit together with the financial statements. ISSAI 1220:17 requires the supervisor to review the audit documentation and discuss with the engagement team and ensure that sufficient appropriate audit evidence has been obtained to support the conclusion reached and for the auditor's report to be issued.

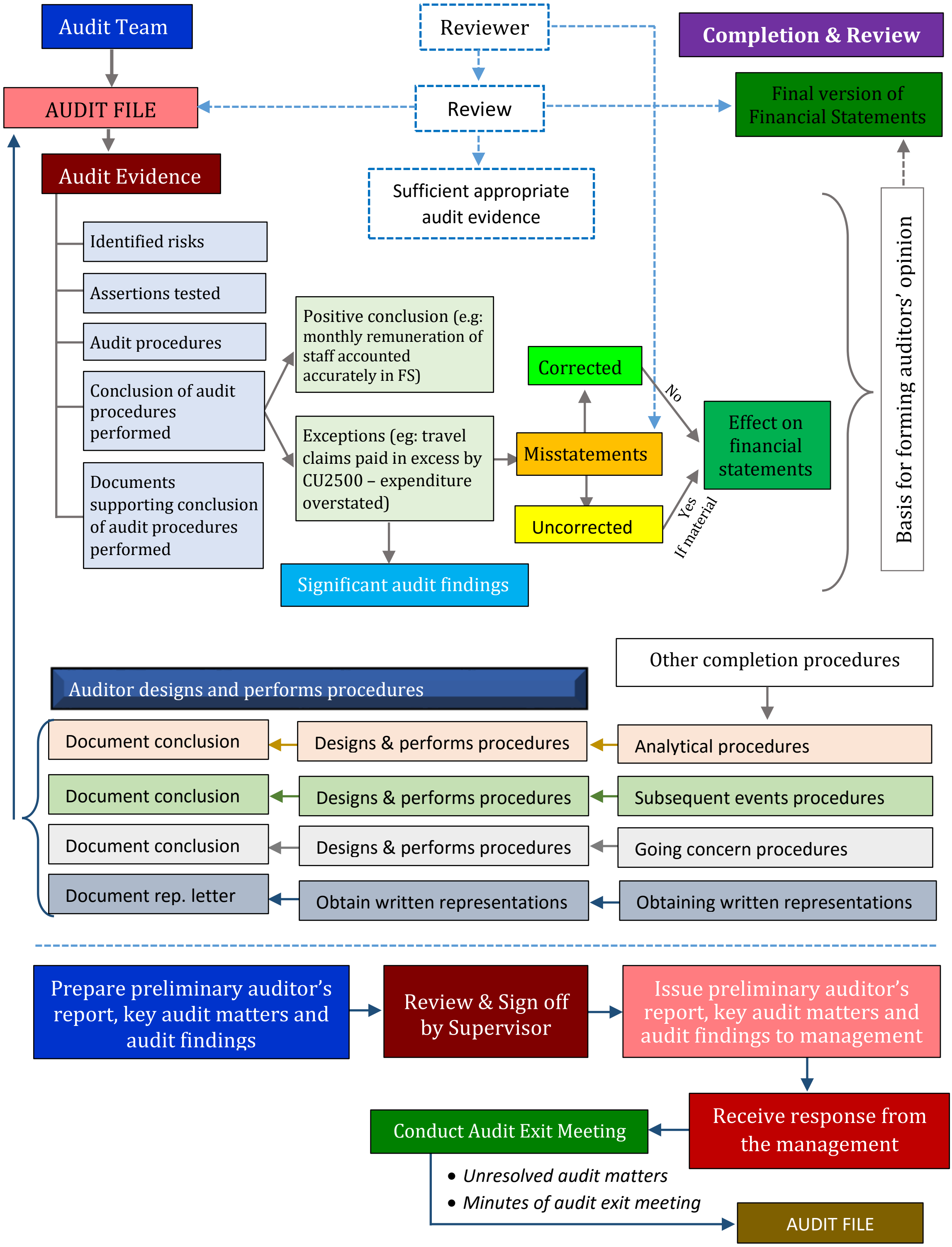
6.2 The supervisor is expected to play a very important role at completion stage of the audit, notwithstanding the review that he/she is supposed to perform at every stage of audit for quality purpose. Inadequate review and evaluation at the completion stage of audit will result in expressing an inappropriate audit opinion on the financial statements. The detailed procedures to conduct the review and performing other procedures as required by aforementioned ISSAIs are highlighted in the subsequent paragraphs.

6.3 Other ISSAIs require specific procedures to be performed at the completion and review stage, such as final analytical procedures (**ISSAI 1520**), subsequent events procedures (**ISSAI 1560**), going concern procedures (**ISSAI 1570**), obtaining management representation (**ISSAI 1580**) and communication with the management or those charged with governance (**ISSAI 1260**). **Figure 6.1** provides a snapshot of the completion and final review stage of audit. Some additional steps are suggested which are not required by ISSAI but considered as best practices.

6.4 The **audit file** becomes the basis for review as it contains the audit evidence. Amongst others, typically, the audit file should contain the identified and assessed risks, audit assertions tested, audit procedures performed, conclusion of audit procedures performed and documents supporting the conclusion of audit procedures performed. This becomes the basis to conduct the review against the final version of the financial statements provided by the entity.

6.5 The reviewer needs to revisit the detailed audit plan (can be inferred from Risk response suggested in this Manual – see **AWP 4.6**), where the auditor is supposed to record the audit procedures and the conclusion reached on performing those procedures and reassess whether adequate audit procedures have been designed and performed.

Figure 6.1 Snapshot of completion and review stage of audit



6.6 The copies of documents obtained from the entity and third parties are considered as audit evidence, but this cannot be considered as sufficient appropriate audit evidence per se. The audit evidence is by and large the record of work performed by the auditor. The sufficient appropriate audit evidence will also depend on quality of evidence and level of procedures performed.

6.7 Upon performing audit procedures on classes of transactions, account balances and disclosures, the auditor is expected to arrive at both positive and negative conclusions – both need to be recorded in the audit working paper. Taking the example given in above snapshot, *monthly remuneration of staff accounted accurately in the books of accounts is a positive conclusion, whereas travel claims paid in excess by Nu. 2,500.00 is a negative conclusion – misstatement*. Both cases become the basis of auditor's opinion on the financial statements, which will be dealt in detail in chapter on audit reporting.

6.8 **ISSAI 1450** requires that all misstatements identified should be accumulated during the audit. These misstatements can be recorded in a suggested working paper named as Evaluation of the effects of uncorrected misstatement on the Financial Statement given in **AWP 6.2**. In response to these identified misstatements, the auditor may need to perform further audit procedures, for example to determine whether further travel claims were paid in excess (*considering the above example*) – meaning whether further misstatements exist. The reviewer may direct the auditor to extrapolate the sample size of travel claims and perform further audit procedures and arrive at a conclusion.

6.9 **ISSAI 1450** prescribes the requirements on evaluation of misstatements identified during the audit. This evaluation is done at the completion stage of audit. The objective of this evaluation as defined by **ISSAI 1450** is for the auditor/reviewer to evaluate both the effect of identified misstatements on the audit (*performing further audit procedures*), and the effect of uncorrected misstatements, if any, on the financial statements (*implication on auditor's opinion*).

6.10 **ISSAI 1450** also requires all misstatements to be communicated to management on a timely basis, along with a request to amend the misstatements identified. The common understanding is that the auditor communicates with the management throughout the entire audit process, and therefore the misstatements identified and detected during the audit should have been communicated for correction. The reviewer should review the misstatements identified during the audit, and assess whether those were communicated to the management on a timely basis.

6.11 Typically, the auditor issues the management with a list of misstatements (*may use the observation list suggested in this Manual*), quantifying the amount of each misstatement, and proposing necessary action and adjustment in the financial statements. Taking the above example of excess travel claim, the auditor may propose for recovery of the excess amount from an employee, and make necessary accounting entries in cash/bank and the travel ledger. The total travel cost needs to be adjusted to ensure accuracy, and also the closing balance of cash/bank, thereby adjusting the financial statements.

6.12 When management makes the necessary adjustments to the books of accounts and financial statements, the auditor should check that the adjustments have been made correctly. The auditor then needs to record the revised conclusion on audit procedures performed based on the verification of the adjustments made by the management. The necessary adjustment entries and further supporting documents should be documented by the auditor to support the revised conclusion on audit procedures performed.

In an audit of financial statements, the misstatements are not necessarily in the form of quantitative figures, but they could be in the form of non-compliances to laws and regulations. For instance, in the above example of travel claim (detailed illustration provided in section under consideration of law and regulation in an audit of financial statements), the excess payment was made as a result of making payment in deviation to the rule of the Ministry of Finance, and hence non-compliance to the rule. Therefore, both quantitative and qualitative aspects need to be considered while evaluating the misstatements identified by the auditor.

6.13 While the misstatements may have been corrected in the financial statements, for instance, fraud is by nature material, irrespective of the amount misappropriated or embezzled. Similarly, non-compliance to Parliamentary directives in entity's operation is also by nature material and may still affect the auditor's opinion.

6.14 In the event where the management does not agree to rectify the misstatements, the auditor may consider reassessing the level of materiality determined at the planning stage to ensure that it remains appropriate. The revision of the materiality with reasons thereof, if any should be clearly documented in the audit working paper on materiality (refer **AWP 4.4** as to how the revised materiality can be recorded). The uncorrected misstatements should then be compared with the level of materiality, to determine if they individually or in aggregate are material.

6.15 The uncorrected misstatements if found material would affect the auditor's opinion on the financial statements. Based on the suggested format as Evaluation of the effects of uncorrected misstatement on the Financial Statement (refer **AWP 6.2**) in this manual to record the misstatements, the auditor should revise the Evaluation of the effects of uncorrected misstatement on the Financial Statement where only uncorrected misstatements will remain, and can be communicated in the form of audit findings to the management, and where appropriate to those charged with governance depending on the significance of the matters. **AWP 6.2** suggests the manner in which the effect of uncorrected misstatements on the financial statements can be evaluated, and how the effect on auditor's opinion can be documented.

6.16 The audit findings including the uncorrected misstatements shall be issued to the audited entity in the form of preliminary audit observations. The auditors should communicate to the management and those charged with governance the effect of uncorrected misstatements and its likely impact on auditor's opinion.

6.17 The auditors should provide adequate time to the management to respond to preliminary audit findings.

Other completion procedures

Analytical procedures

6.18 **ISSAI 1520:6** *Analytical Procedures* states that the auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. The conclusion arrived at upon performing analytical procedures at the end of the audit is to corroborate conclusions formed during the audit of the individual component or individual elements of the financial statements. The analytical procedures performed at the end of the audit are not different to those performed at the execution stage of the audit. In this respect, the auditor may also **re-perform those procedures**, and design and perform **new audit procedures** to arrive at a conclusion that financial statements are free from material misstatement.

6.19 Also because financial statements contain Notes to Accounts as required by different Financial Reporting Framework and other legislation used by the entity, the auditors need to audit the notes for compliance with the applicable FRF. Notes are technically equivalent to financial statements, and therefore the auditors must ensure that sufficient appropriate audit evidence is obtained to gain comfort over those notes.

6.20 The analytical procedures designed and performed at the end of audit should again be linked to audit assertion, and performing this procedure may indicate risks of material misstatement that were not recognised earlier. In this regard the auditor needs to update the process flow (refer **AWP 4.3**) and risk response (refer **AWP 4.6**) suggested in this Manual.

6.21 The financial statements contain schedules to accounts as required by Financial Rules and Regulations. Besides, reviewing the main elements of financial statements, the auditor needs to review the schedules to financial statements. In this regard, the auditor needs to design and perform new audit procedures. The additional procedures designed and performed need to be documented in the analytical procedure template suggested as **AWP 6.3** but should be clearly indicated in the working paper that these procedures were performed at the end of audit as evidence for the purpose of quality control, and Quality Assurance Review.

Subsequent events procedures

6.22 **ISSAI 1560** Subsequent Events requires auditors to perform audit procedures to obtain sufficient appropriate audit evidence that all events occurring between the date of financial statements and the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

6.23 The subsequent events will affect the presentation of the financial statements, and as a result the auditor's opinion, to the extent that the management will be required to amend the financial statements, and the auditor to amend the auditor's report.

6.24 Based on the financial reporting framework used by the entity to prepare the financial statements, the management is supposed to identify subsequent events if any, and how those events were dealt with in the financial statements. The auditor needs to see whether the management has established adequate procedures to identify relevant subsequent events.

6.25 The auditor needs to review whether those events are adjusting or non-adjusting events with reference to applicable financial reporting framework used by the entity to prepare the financial statements. Adjusting events after the reporting date are those that provide evidence of conditions that existed at the reporting date. Non-adjusting events after the reporting date are those that are indicative of conditions that arose after the reporting date.

Adjustable events

6.26 An adjustable event is one that provides further evidence of conditions that existed at the reporting date. Accordingly, an entity shall adjust the financial statements to reflect these events. In other words, an adjustable event provides additional information of an event that existed at the end of the reporting period, but the amount was uncertain and had to be estimated. The additional information after the reporting period usually confirms the correct amount that must be provided in the financial statements.

Non-adjustable events

6.27 A non-adjustable event is one that arises after the reporting date for the first time. In other words, this event did not relate to a condition that existed at the reporting date. An entity shall not adjust the financial statements in respect of these events. Instead, the event should be disclosed as a note in the financial statements.

Going concern procedures

6.28 The management is supposed to prepare the financial statements on a going concern basis with the assumption that the entity will continue its business for foreseeable future, which is 12 months from the date that the auditor's report has been signed. The extent of relevance of the concept of going concern assumption in the public sector, especially in the government may be less as compared to private sector context, since the public finance is mobilised through taxes and other sources of non-tax revenue. However, the applicability cannot be ruled out owing to sovereign debt crisis in different parts of the world, and the government of the day is the custodian of the public finance of the country.

6.29 In SAI Bhutan context, the application of going concern concept is relevant while conducting the Annual Financial Statements of the RGoB where it would indicate the sources of public expenditure.

6.30 **ISSAI 1570** *Going Concern* states that the auditor shall remain alert throughout the audit for evidence of events or conditions that may cast doubt on the entity's ability to continue as a going concern. At the end of the audit, the auditor needs to perform audit procedures on the going concern assumptions used by the management in preparing the financial statement, including obtaining evidence that can be used to assess appropriateness of the entity's management assumptions, in regard to going concern and forming a conclusion as to whether that evidence indicates any **material uncertainties** in the ability of the entity to continue as a going concern. In fact, the going concern assumption involves judgements about events occurring in the future, which are inherently uncertain.

6.31 The extent of relevance of the concept of the going concern assumption in the public sector, especially in government, may be less than compared to the private sector context, since public finance is mobilised through taxes and other sources of non-tax revenue. However, the applicability cannot be ruled out. In fact:

- In the public sector the application of going concern concept could be more relevant, when the whole of government accounts are audited by SAI Bhutan, as the influence or government's interest in enterprises, either public or private, shall be accounted for in those consolidated financial statements. Hence, as governments corporatize and privatize government entities, maintaining influence or interests on them, going concern issues will become increasingly relevant to the public sector;
- In addition, when auditing those public sector entities having funding arrangements backed by a central or local government that may be withdrawn, their existence may also be at risk, and thus **ISSAI 1570** provides useful guidance when auditing them.

6.32 Where there is significant uncertainty in the entity's ability to continue as a going concern and this has been disclosed in the entity's financial statement, the auditor will include wording in the Emphasis of Matter paragraph to direct users' attention to the applicable note in the financial statement. If the auditor does not agree with management's assumption regarding going concern, it shall modify its opinion in the audit report.

Written representations

6.33 Written representation often referred to as management representation is one form of audit evidence on its own, or one, which corroborates other audit evidence, obtained by the auditor.

6.34 **ISSAI 1580** also requires the auditor to perform certain audit procedures by the end of the audit. The auditor should ensure that the date of written representations should be as near as possible to, but not after the auditor's report date. As explained under Paragraph 34 above, written representations are necessary audit evidence, and therefore the auditor cannot express an opinion on the financial statements, and as such the auditor's report cannot be dated before the date of the written representations.

6.35 A sample of written representations is provided as **AWP 6.4**, which should be adopted according to the needs of the SAI Bhutan. The sample provides an overview of what needs to be included in the written representations. Depending on the governance structure of the entities audited by SAI Bhutan, the management should decide and communicate to the entity as to who should sign the written representations.

Legal Inquiry

6.36 In accordance with **ISSAI 1700** (Revised), the auditor is required to date the auditor's report 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. Audit evidence about the status of litigation and claims up to the date of the auditor's report may be obtained by inquiry of management, including in-house legal counsel, responsible for dealing with the relevant matters. In some instances, the auditor may need to obtain updated information from the entity's external legal counsel.

Communicating deficiencies in internal control to those charged with governance and management

6.37 In accordance with **ISSAI 1260**, the auditor is required to communicate with those charged with governance or management on significant deficiencies observed in internal controls relevant to financial reporting process on the basis of audit work performed (refer control testing section in Chapter 5). This communication needs to be in a written form. The communication with the management and those charged with governance is a continuous process in an audit. **ISSAI 1260.A13** states that in determining when to issue the written communication, the auditor may consider whether receipt of such communication would be an important factor in enabling those charged with governance to discharge their oversight responsibilities in relation to financial reporting process, that includes approval of the financial statements. SAIs may have policies as to when such matters need to be communicated to those charged with governance and management for taking appropriate action.

Documentation of the review process

6.38 The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of audit procedures performed, the result of audit procedures performed and audit evidence obtained, significant matters arising during the audit, the conclusions reached thereon, and professional judgments made in reaching those conclusions.

6.39 **ISSAI 1230** "Audit Documentation" requires that the documentation of the review process include who reviewed the completed audit work and the date and extent of that review. In the working papers suggested in this Manual as various AWPs, designated rows and columns were created to record 'who performed the audit work' and 'who reviewed the work completed'. The evidence of review at different levels also ensures that the due process for quality control of ISSAI financial audit has been followed in the audit.

6.40 The documentation of Audit working papers with specific numbering is suggested in **AWP 6.7**.

Audit Completion Report

6.41 The Engagement Team should document the Audit Completion Report as suggested in **AWP 6.5**

Audit Exit Meeting

6.42 Audit exit meeting though not a specific requirement of ISSAIs, however, it is practised in compliance with the Auditor General's Standing Instructions. This is to ensure that the preliminary audit findings, the management's response and the financial statements are discussed and agreed with the management, and where relevant with those charged with governance. It also reduces the risks of misunderstanding between the management and the auditor on issues reflected in the final audit report.

6.43 Other matters relevant to an audit can also be discussed such as difficulties encountered during the audit process so that it may be addressed in the next audit, details of ethical matters if any that may be clarified with the management and identification of officials accountable for deficiencies and lapses, etc.

6.44 The auditor and the management should maintain the minutes of the exit meeting detailing the discussions on auditor's report and the specific audit findings and the decisions arrived on each discussion points. The minutes should then be dated and signed by representatives of the audit team and the management. The minutes of the audit exit meeting also become audit evidence, which is used as the basis to finalise the audit report. The engagement team should document the minutes of the audit exit meeting as suggested in **AWP 6.6.**

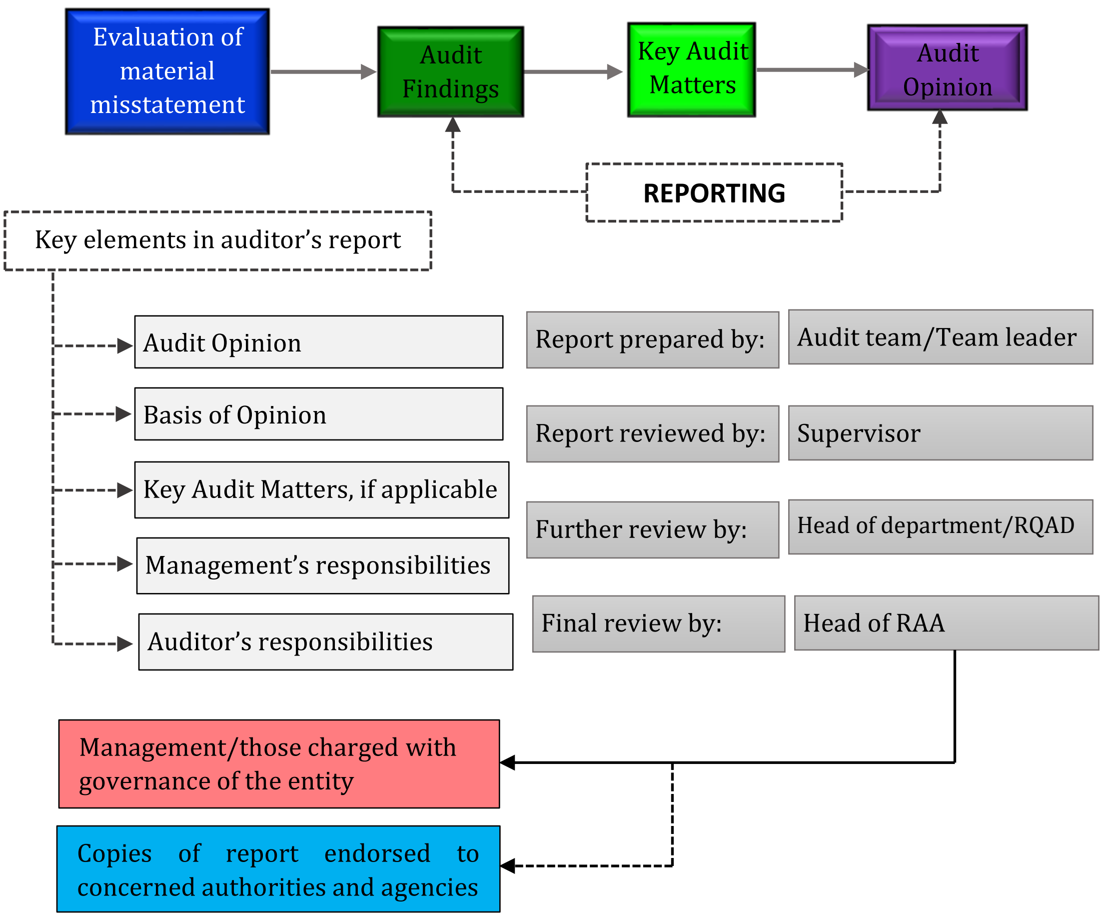
6.45 Upon conducting the audit exit meeting, the audit team prepares the audit report considering the response provided by management and those charged with governance.

Chapter 7: Audit Reporting

7.1 The Audit Report is the final product of the entire audit process, which is prepared based on sufficient appropriate audit evidence gathered by auditors through performing audit procedures. In this regard, the objectives of the auditor are (**ISSAI 1700**): (a) to form an opinion on the financial statements, based on an evaluation of the conclusions drawn from the audit evidence obtained; and (b) to express clearly that opinion through a written report that also describes the basis for that opinion.

7.2 Based on the evaluation of the effect of uncorrected misstatements and conclusion drawn from the audit evidence, the auditors prepare and issue the audit report. The reporting process of financial audit is illustrated in **Figure- 7.1** below:

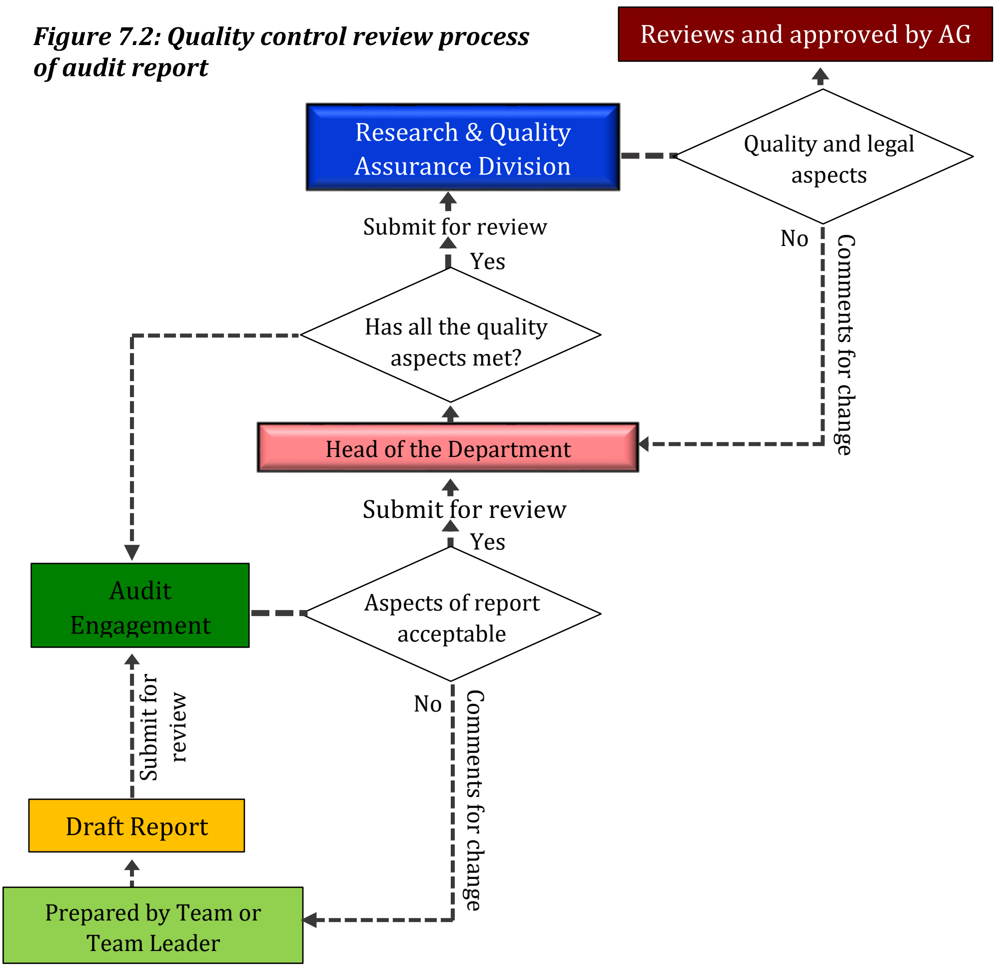
Figure 7.1: Snapshot of Audit Reporting



7.3 The reporting requirements are provided in ISSAI 1700 - Forming an Opinion and reporting on Financial Statements; ISSAI 1701 - Communicating Key Audit Matters in the Independent Auditor's Report; ISSAI 1705 - Modifications to the Opinion in the Independent Auditor's Report; ISSAI 1706 - Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report; ISSAI 1710 – Comparative Information – Corresponding Figures and Comparative Financial Statements; and ISSAI 1720 – The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements. Besides these requirements, additional reporting responsibilities maybe determined by relevant laws and regulations. These additional reporting responsibilities are emphasized in respective ISSAIs and its practice notes.

7.4 For maintaining consistency and to achieve high quality audit report, it should go through quality review process as highlighted in **Figure 7.2**. The figure is self-explanatory, and the structure would depend on how the review process is established within the SAI.

Figure 7.2: Quality control review process of audit report



Forming an Opinion on the Financial Statements

7.5 The wording of audit opinion would depend on the financial reporting framework used for preparing the financial statements; i.e. the fair presentation framework or compliance framework as explained under **ISSAI 1200:13**. As highlighted in the Manual, the auditor would have already assessed the type of reporting framework used by the entity. In the public sector environment, the reporting framework is usually the one prescribed by the government that is followed throughout for preparing the financial statements.

7.6 The financial reporting framework broadly determines the form, content and structure of the financial statements.

7.7 The auditor considers or evaluates the following conditions while forming an Opinion on the financial statements such as:

- Whether the financial statements are prepared in all material respects, in accordance with the applicable financial reporting framework;
- Whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. This conclusion should be based on the following (**ISSAI 1700:11**):
  - Whether sufficient appropriate evidence has been obtained as required by **ISSAI 1330**; and
  - Whether uncorrected misstatements are material individually or in aggregate in accordance with **ISSAI 1450**.
- Consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements (**ISSAI 1700:12**);

The **Illustration 7.1** given below will help with the above evaluation to form auditor's opinion.

Illustration 7.1 Auditor's consideration while forming an opinion

Audit Evidence	**Sufficient appropriate**			**Information presented in the Financial Statements**	**Relevant**	
	Yes	No			Yes	No
Uncorrected misstatements	Material				Reliable	
	No	Yes			Yes	No
Significant accounting policies	Disclosed adequately				Comparable	
	Yes	No			Yes	No
Accounting policies	Consistent with FRF[2]				Understandable	

[2] Financial Reporting Framework

	Yes	No			Yes	No
	Appropriate			FS Disclosures	Adequate	
	Yes	No			Yes	No
Accounting estimates	Reasonable			Terminology used	Appropriate	
	Yes	No			Yes	No

Forms of Opinion

7.8 The financial audit is an independent assessment of the financial statements, wherein the auditor expresses an opinion providing reasonable assurance (*high level of assurance but not an absolute assurance*) There are broadly two types of opinion:

- Unmodified Opinion; and
- Modified Opinion

Unmodified Opinion

7.9 The auditor expresses an unmodified audit opinion when the auditor concludes that the financial statements are prepared in all material respects, in accordance with the applicable financial reporting framework.

7.10 The wording of the opinion paragraph of the auditor's report will depend on the type of reporting framework used by the entity in preparing the financial statements i.e. either fair presentation framework or compliance framework. The examples extracted from illustrations provided in **ISSAI 1700** are reproduced below:

Illustration 7.2: Applicable FRF and auditor's opinion

Auditor's opinion under fair presentation framework
a) In our opinion, the accompanying financial statements present fairly, in all material respects the financial position of the entity as at 31 December 20X1, the financial performance and its cash flows for the year then ended in accordance with (the applicable financial reporting framework); or   ***b) In our opinion, the accompanying financial statements give a true & fair view of the financial position of the entity as at 31 December 20X1, the financial performance and its cash flows for the year then ended in accordance with (the applicable financial reporting framework)***
Auditor's opinion under compliance framework
In our opinion, the accompanying financial statements are prepared, in all material respects, in accordance with XYZ law of Jurisdiction X.

The description of what the financial statements are designed to present (e.g. financial position, results of operations) in the above illustrative examples will vary depending on the financial reporting framework being applied (IFRS, IPSAS, Cash Basis, etc.).

7.11 The applicable financial reporting framework adopted by the audited entity may be IFRSs issued by the International Accounting Standards Board (IASB) or IPSASs issued by the International Public Sector Accounting Standards Board (IPSASB). However, some entities may prepare the financial statements based on the national accounting standards which are either consistent with IFRS or IPSAS, or are not based on either of them. Typically, the financial statements of the government entities are based on law enacted by the Parliament or rules and regulations issued by the government (Ministry of Finance).

7.12 The financial reporting framework such as IFRS and IPSAS are deemed to be a fair presentation framework. When the financial statements are prepared in accordance with the fair presentation framework, the auditor should evaluate whether those statements achieve fair presentation. As per **ISSAI 1700:14**, the auditor's evaluation as to whether the financial statements achieve fair presentation framework should include the following:

- The overall presentation, structure and content of the financial statements; and
- Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

7.13 When the financial statements are prepared in accordance with compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation (**ISSAI 1700:19**).

7.14 Examples of unmodified audit report where the reporting framework is fair presentation framework is provided as **Appendix 7.1** and compliance framework in **Appendix 7.2**.

Modified Opinion

7.15 **ISSAI 1700:17** states that the auditor shall modify the opinion in the auditor's report in accordance with **ISSAI 1705** if the auditor;

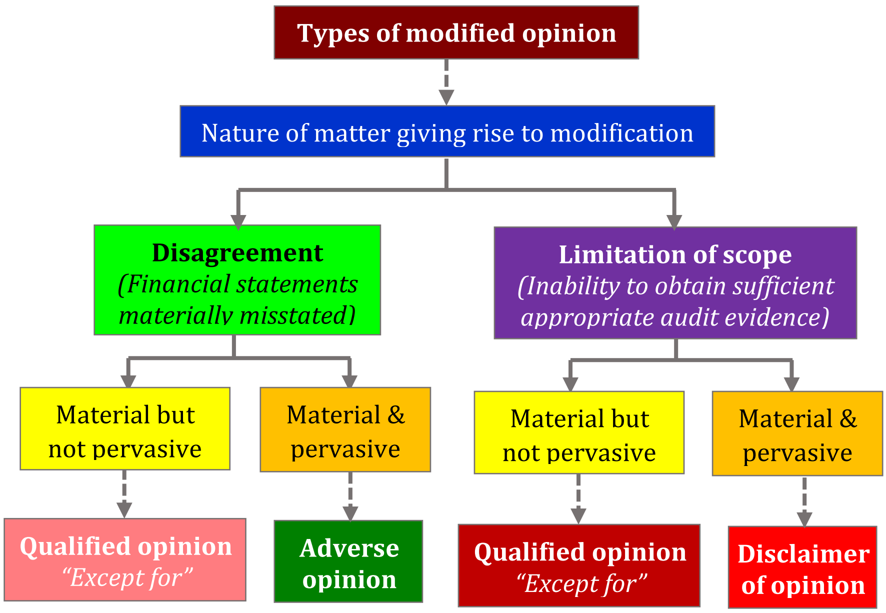
- Concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement (disagreement). For example, disagreeing on the accounting policies used by the entity, or the accounting transactions made in the books of accounts; or
- Is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (limitation of scope). For example, a limitation such as not allowing access to certain areas of accounting transaction documents or failure of the management to produce documents to the auditor.

7.16 The extent of the modification in the auditor's opinion will depend on the circumstances and the pervasiveness of the effects, or possible effects, of the matter on the financial statements. **ISSAI 1705** provides the requirements on modifications to the opinion in the independent auditor's report, which should be read in conjunction with requirements of **ISSAI 1700**, as they are interrelated.

Determining types of modification to the Auditor's Opinion

7.17 While determining the types of modification of the auditor's opinion, the '*Auditor's professional judgment*' plays a crucial role in determining the pervasiveness of the effects or possible effects of nature giving rise to modification of auditor's opinion on the financial statements. This will determine the types of modified audit opinion to be issued on the financial statements. In doing so the materiality on the financial statements as a whole determined at the planning stage plays a critical role. **Figure 7.3** provides a decision tree to arrive at different types of modified audit opinion. Further a list of possible misstatements or errors that would impact the overall audit opinion is provided under **Annexure 7.1** for guidance purpose.

Figure 7.3: Judgment analysis to form different types of modified audit opinion



7.18 As can be seen from the above decision tree, the matter giving rise to modified audit opinion could be as a result of financial statements being materially misstated or due to inability to obtain sufficient appropriate audit evidence. In other words, the basis of modification could be as a result of disagreement on certain matters in the financial statements with the management or limitation of scope limiting the auditor to perform further audit procedures to gather sufficient appropriate audit evidence.

7.19 If the matter giving rise to modification is as a result of financial statements being materially misstated, the auditor needs to assess whether the misstatement either individually or in aggregate is material or pervasive. If the matter is material and not pervasive, the auditor can express qualified audit opinion with “except for” paragraph (the illustration is provided in **Appendix 7.3** for General-Purpose Fair Presentation Framework and **Appendix 7.4** for General-Purpose Compliance Framework).

7.20 If the matter giving rise to modification as a result of financial statement being materially misstated is both material and pervasive, the auditor should express adverse opinion. This type of opinion is very rare.

7.21 Similarly, if the matter giving rise to modification is due to inability of auditor to gather sufficient appropriate audit evidence, the auditor should assess whether such matter is material or pervasive. If the matter giving rise to modification is material but not pervasive, the auditor can express qualified opinion with “except for” paragraph.

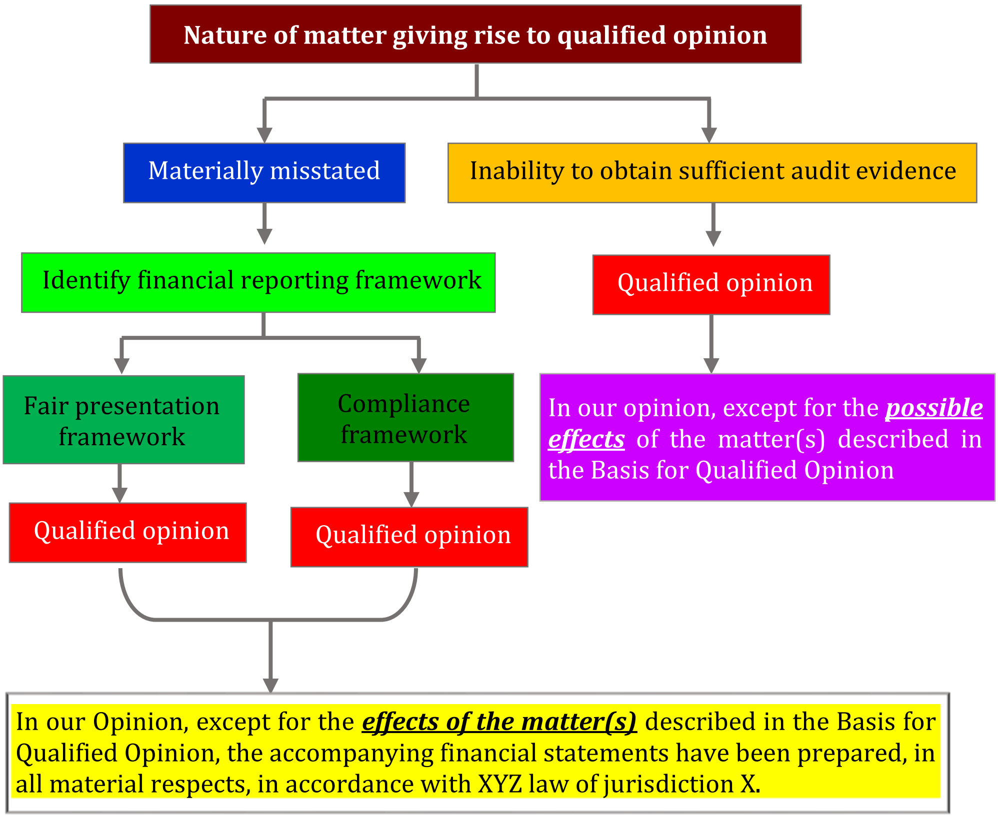
7.22 If the auditor’s inability to obtain sufficient appropriate audit evidence is both material and pervasive, the auditor should then disclaim the opinion on the financial statements. In this situation, the auditor is unable to perform further audit procedures to obtain the sufficient appropriate audit evidence that forms the basis for providing an opinion on the financial statements.

7.23 The summary of auditor’s judgement about the nature of the matter-giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements affecting the types of opinion to be expressed as explained above are further illustrated in **Figure 7.4**.

Qualified opinion

7.24 The wording and phrases used in Qualified Opinion Paragraph of the Auditor’s Report is to be determined by the nature of the applicable financial reporting framework as to whether it is a fair presentation framework or compliance framework. In case of inability to obtain sufficient appropriate audit evidence, the auditor is required to amend the Auditor’s responsibility paragraph in the auditor’s report. The form and content of Qualified Opinion is illustrated in **Figure 7.4** below:

Figure 7.4: Form and content of auditor's qualified opinion

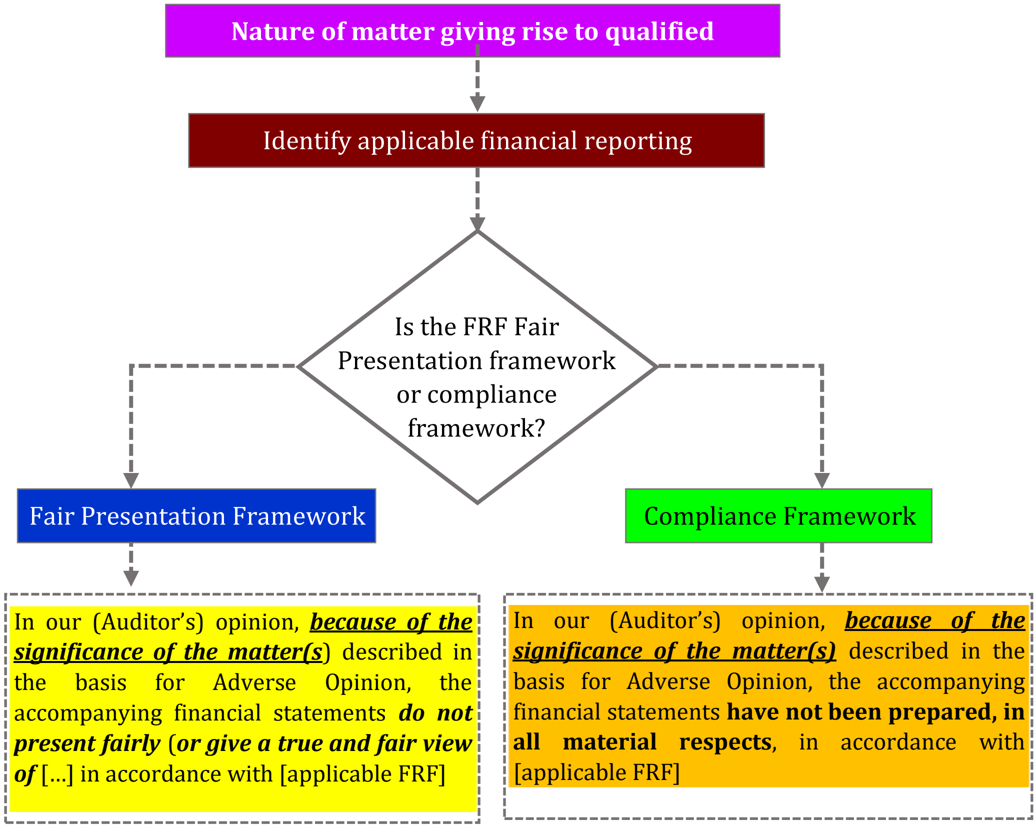


7.25 **Appendix 7.3** provides an illustration of Qualified Opinion due to misstatement of the financial statements of a government entity prepared in accordance with a general-purpose fair presentation framework. Similarly, **Appendix 7.4** provides an illustration of Qualified Opinion due to misstatement of the financial statements of a government entity prepared in accordance with a general-purpose compliance framework. **Appendix 7.5** provides an illustration of Qualified Opinion due to auditor's inability to obtain sufficient appropriate audit evidence on an item(s) recognized in the financial statements.

Adverse Opinion

7.26 The adverse opinion paragraph under either fair presentation framework or compliance framework is illustrated below:

Figure 7.5: forming adverse opinion on the financial statements



7.27 An illustration of Adverse Opinion due to misstatement of the financial statements of a government entity prepared in accordance with a general-purpose fair presentation framework is provided in **Appendix 7.6**.

Disclaimer of Opinion

7.28 When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the wording of Disclaimer of Opinion will be as prescribed under **ISSAI 1705**. This would also require modifying the standard formulation and wording of auditor's responsibility paragraph as compared to other forms of opinion (refers **ISSAI 1705.28**).

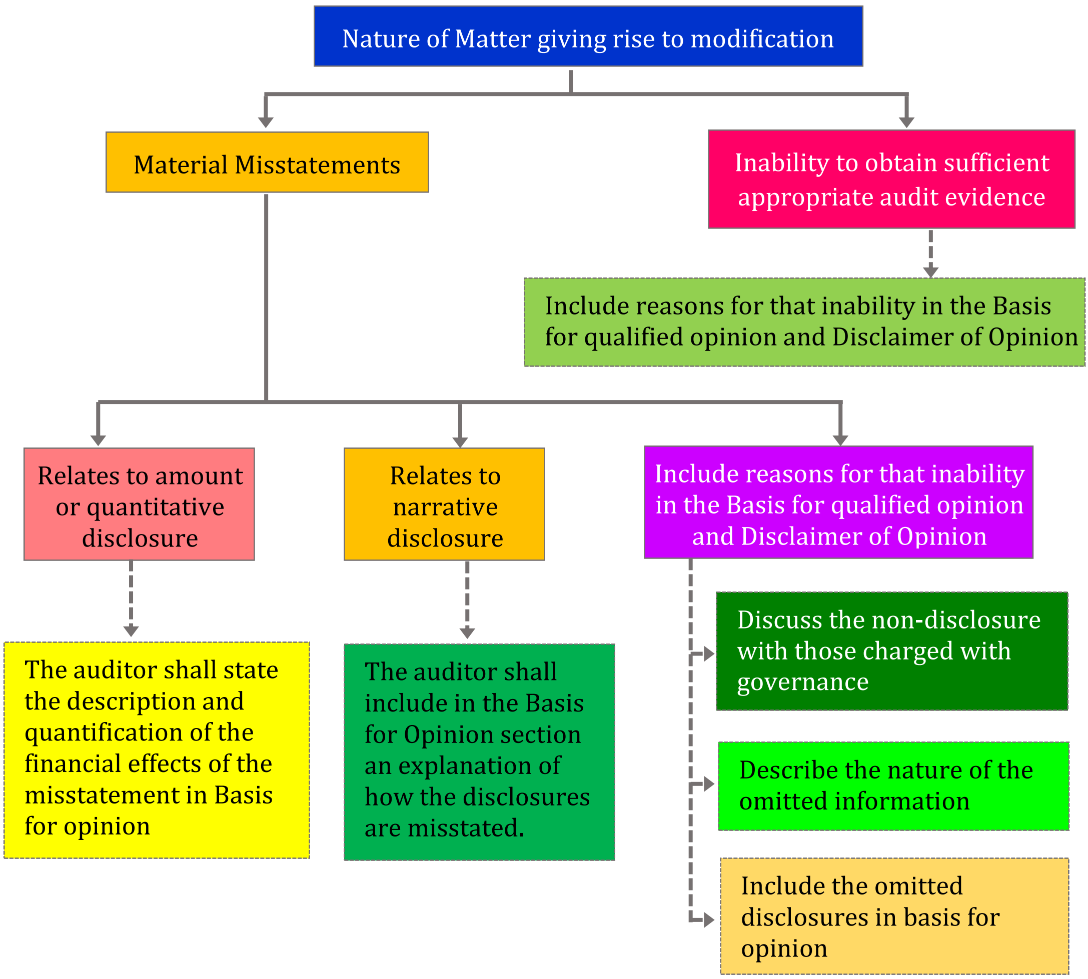
> ***Disclaimer of Opinion***
> *We do **not express an opinion** on the accompanying financial statements. Because of the **significance of the matter(s)** described in the 'Basis for Disclaimer of Opinion' section, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.*

7.29 An illustration of Disclaimer of opinion due to auditor's inability to obtain sufficient appropriate audit evidence is provided in **Appendix 7.7**.

Amending the basis of opinion

7.30 As required under **ISSAI 1705.20**, the auditor should amend the heading of the basis for opinion as "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," including description of the matter-giving rise to the modification. In the case of inability to obtain sufficient appropriate audit evidence, the auditor is required to amend the Auditor's Responsibility paragraph in the auditor's report. The requirements given under Paragraph 21-27 of **ISSAI 1705** are further illustrated in **Figure 7.6** below:

Figure 7.6: Conditions required to describe in basis of opinion



7.31 Examples of auditor's report having both qualified and adverse opinion as a result of material misstatements are provided as **Appendix 7.5** and **Appendix 7.6**. An example of auditor's report having qualified opinion as a result of inability to obtain sufficient appropriate audit evidence is given as **Appendix 7.7**.

Basis for Disclaimer of Opinion

7.32 When auditor disclaims an opinion on the financial statements, the auditor is required to amend the description of the auditor's responsibility paragraph to include the following as required by **ISSAI 1705:28**:

- A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with International Standards of Supreme Audit Institutions and to issue an auditor's report;
- A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- The statement about auditor independence and other ethical responsibilities required by **ISSAI 1705:28 (C)**.

7.33 If it is **material and pervasive**, the auditor should then disclaim the opinion on the financial statements. In both the situations, the auditor is unable to perform further audit procedures to obtain sufficient and appropriate audit evidence, which forms the basis for providing an opinion on the financial statements.

In case of inability to obtain sufficient appropriate audit evidence, the auditor is required to amend the Auditor's responsibility paragraph in the auditor's report. When the auditor disclaims an opinion, due to an inability to obtain sufficient appropriate audit evidence, the wording of Disclaimer of Opinion and auditor's responsibility paragraph will be as follows, under **ISSAI 1705**:

Basis for Disclaimer of Opinion:
*«We do **not express an opinion** on the accompanying financial statements. Because of the **significance of the matter(s)** described in the 'Basis for Disclaimer of Opinion' section, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements»*.

Auditor's Responsibilities for the Audit of the Financial Statements:

Our responsibility is to conduct an audit of the entity's financial statements in accordance with ISSAI and issue an Auditor's Report. However, because of the matters described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Emphasis of Matter Paragraphs

7.34 An Emphasis of Matter paragraph reflected in the auditor's report emphasizes a matter already presented or disclosed in the financial statements. The purpose is to draw the attention of users of the financial statement to those matters that, in the auditor's judgment, are fundamental to the user's understanding of the financial statement. **ISSAI 1706** provides the requirements related to the Emphasis of Matter Paragraph. An Emphasis of Matter example is, for instance:

«We draw attention to note X to the financial statements which describes the uncertainty regarding the future outcome of an outstanding litigation against Hospital Y. Our opinion is not qualified in respect of this matter».

7.35 The emphasis of matter paragraph does not affect the audit opinion, i.e. whether the opinion to be expressed is unmodified or modified opinion. Emphasis of Matter is reflected as a separate paragraph in the auditor's report after the basis of opinion paragraph. Because this paragraph does not affect the opinion on the financial statements, it should be clearly indicated that the auditor's opinion is not modified in respect of the matter emphasized (**ISSAI 1706:9 (C)**). An example of auditor's report having Emphasis of Matter paragraph is given as **Appendix 7.7**. Additional examples that may be relevant to report in an Emphasis of Matter paragraph, if properly disclosed in the financial statements may, in addition to paragraph A1 of the ISSAI include:

- Legislative actions on programs or the budget;
- Contradictive laws, regulations or directives with a significant effect on the entity;
- Fraud, abuse or losses;
- Significant transactions;
- Significant internal control deficiencies;
- Questionable business practices;
- Transactions entered into without due regard for economy;
- Prior period restatements;

- Lack of fiscal sustainability;
- Environmental issues;
- Corporate social responsibility issues;
- Ethical issues (proper behavior by public officials); or
- Ineffective and uneconomical use of public assets.

Other Matter Paragraphs in the Auditor's Report

7.36 Other Matter paragraph is different from Emphasis of Matter paragraph. Other Matter paragraph in the auditor's report include a matter other than those presented or disclosed in the financial statements that, in the auditor's judgement is relevant to user's understanding of the audit, the auditor's responsibilities or the auditor's report (**ISSAI 1706:10**).

7.37 The auditor while including Other Matter paragraph in the auditor's report should confirm that inclusion of such paragraph is not prohibited by law or regulation.

The Other Matter's paragraph is reported immediately after the Opinion paragraph and Emphasis of Matter paragraph, if any. ISSAI 1706 provides the requirements related to Other Matter paragraphs. Hence, the need for inclusion of an Other Matter's paragraph in the auditor's report may arise when:

- The auditor is unable to withdraw from an engagement, even though the possible effect of an inability to obtain sufficient appropriate audit evidence, due to a limitation on the scope of the audit imposed by management, is pervasive (**ISSAI 1706:A5**);
- Law, regulation or generally accepted practice in a jurisdiction require, or permit, the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statement or of the auditor's report thereon;
- An entity prepares one set of financial statement in accordance with a general purpose framework (for example, the national framework) and another set of financial statement in accordance with another general purpose framework (for example, **IFRS**), and the auditor is engaged to report on both sets of financial statement: if the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statement has been prepared by the same entity, in accordance with another general purpose framework and that the auditor has issued a report on those financial statement;

- Financial statement are prepared for a specific purpose are prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statement meet their financial information needs: since the auditor's report is intended for specific users, the auditor may consider it necessary, in the circumstances, to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

7.38 An illustration of auditor's report having an Emphasis of Matter Paragraph, and Other Matter Paragraph is given in **Appendix 7.8**. An independent Auditor's report containing a qualified opinion due to departure from applicable financial reporting framework and that includes Emphasis of Matter Paragraph, and Other Matter Paragraph is illustrated in **Appendix 7.9**.

Communicating Key Audit Matters in the independent Auditor's Report

7.39 **ISSAI 1701** defines Key Audit Matters (KAM) as those matters that, in auditor's judgement were of most significance in the audit of current period financial statements.

7.40 As per **ISSAI 1701**, it is mandatory for auditor to communicate KAM in an audit of listed companies, and can apply voluntarily for audit of entities other than listed entities. As stated in Paragraph P3 of practice note of **ISSAI 1701**, *given that the public sector is a significant participant of any economy and is responsible for maintaining and providing important functions that affect citizens, public sector auditors should also consider reporting KAM for auditees other than listed entities*.

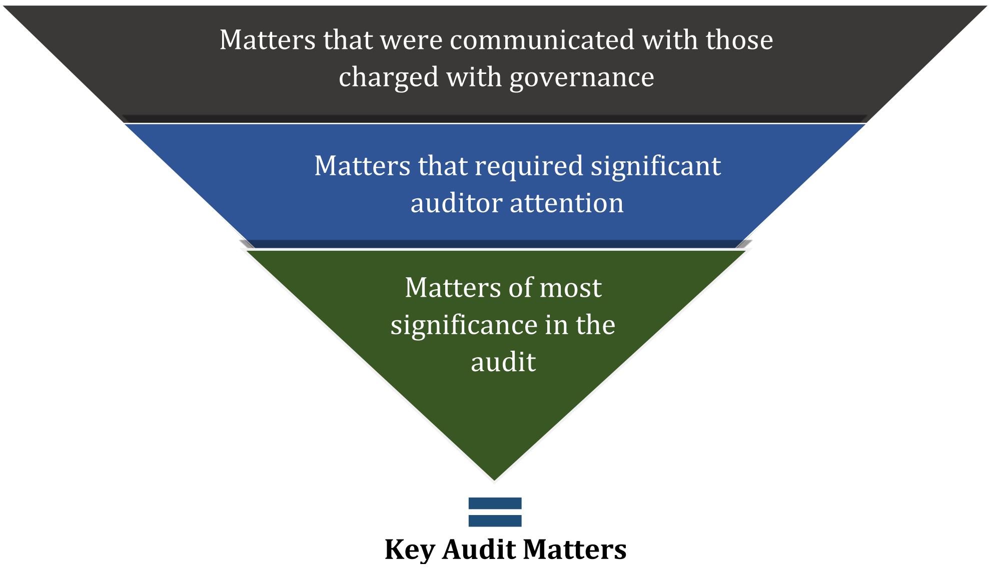
7.41 Key Audit Matters (KAM) are abstracted from matters communicated to the management and those charged with governance, which are considered most significant in the audit of the financial statements of the current period. The decision-making process for KAM is shown in **Figure 7.7**.

7.42 The intent of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit performed. It also provides additional information to intended users of the financial statements.

7.43 **ISSAI 1705** (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation. A matter giving rise to a modified opinion in accordance with **ISSAI 1705** (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with **ISSAI 1570** (Revised), are by their nature key audit matters. However, in such circumstances, these matters shall not be described in the Key Audit Matters section of the auditor's report. Rather, the auditor shall:

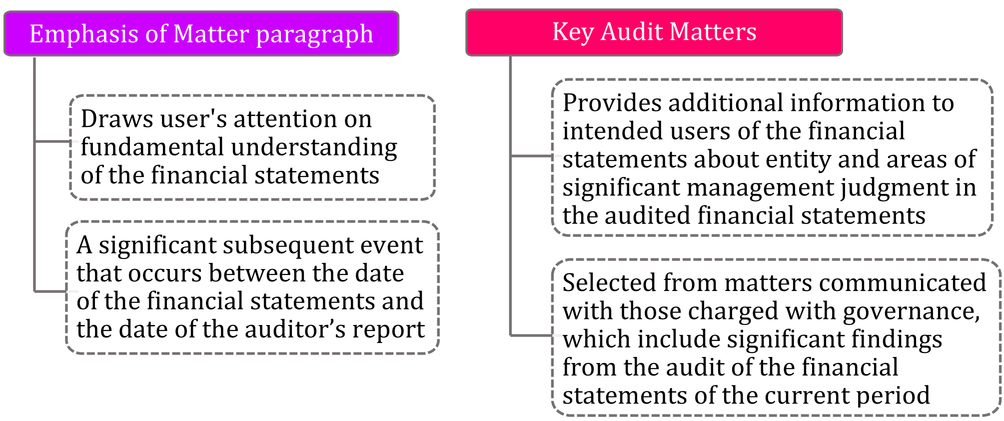
- Report on these matter(s) in accordance with the applicable ISA(s); and
- Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section.

Figure 7.7: The Decision-making Framework for Key Audit Matters (KAM)



7.44 In the auditor's report, the key audit matter paragraph is placed after the Emphasis of Matter Paragraph and before Other Matter Paragraph.

Figure 7.8: Relationship between Emphasis of Matter Paragraphs and Key Audit Matters in the Auditor's Report



Form and content of auditor's report on financial statements

7.45 The auditor's report should include the following elements:

- Title
- Addressee
- Auditor's Opinion
- Basis for Opinion
- Going Concern (If applicable)
- Emphasis of Matter Paragraph (if applicable)
- Key Audit Matters only when it is relevant and applicable
- Other Information (if applicable in accordance with ISSAI 1720)
- Responsibilities of Management for the Financial Statements
- Auditors Responsibilities for the Audit of the Financial Statements
- Other Reporting Responsibilities (If applicable)
- Name of the supervisor/line manager/engagement partner
- Signature of the supervisor/line manager/engagement partner
- Auditor's Address
- Date of the Auditor's Report

7.46 The form and content of auditor's report will change depending on the types of opinion being issued in the auditor's report.

Report on other legal and regulatory requirements

7.47 In the context of financial audits carried out by SAIs and also considering the environment within which the public sector operates, the SAIs may have other reporting responsibilities to report on matters that are supplementary to the auditor's responsibilities under the ISSAIs. As per **ISSAI 1700.43**, these other reporting responsibilities can be addressed in a separate section in the auditor's report with the heading titled "Report on Other Legal and Regulatory Requirements". If the report contains this section, the auditor's report on the financial statements needs to have a clear heading title "Report on the Audit of Financial Statements" (**ISSAI 1700.45**). The format of presenting the report when it contains "Report on Other Legal and Regulatory Requirements" is suggested in **Appendix 7.9**.

Reporting of identified or suspected non-compliance

7.48 **ISSAI 1250** prescribes three levels of reporting of identified or suspected non-compliance as given below:

- Reporting non-compliance to those charged with Governance (Para 22 to 24);
- Reporting non-compliance in the auditor's report on the financial statements (Para 25-27); and
- Reporting non-compliance to regulatory and enforcement authorities (Para 28).

7.49 Instances observed by the auditor of non-compliance with laws and regulations can be reported to management and those charged with the governance, and to other concerned authorities depending on the line of authorities within the entity. The need to report to concerned authorities would depend on the significance and severity of non-compliance that cannot be dealt with at the entity level.

7.50 The instances of non-compliance that need to be reported in the auditor's report on the financial statements would depend on whether those non-compliances have material effect on the financial statements. 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 is required to express either a qualified opinion or adverse opinion in accordance with **ISSAI 1705**. Similarly, if there is a limitation of scope to evaluate whether the non-compliance may have material effect on the financial statement, the auditor is required express either a qualified opinion or disclaim an opinion on the financial statements in accordance with **ISSAI 1705**.

7.51 If an instance of non-compliance warrants the attention of the concerned higher authorities (for e.g.; the parliament), the auditor is required to determine whether the auditor has the responsibility to report to such authorities and may act accordingly. **ISSSAI 1250.A20** (Considerations specific to Public Sector Entities) provides an explanatory note that the public sector auditor may be obliged to report on instances on non-compliance to the legislature or other governing body or to report them in the auditor's report.

Chapter 8: Quality Assurance at the engagement level

8.1 The RAA should establish at the engagement level quality control measures specifically taken to ensure the high quality of each audit product. High quality is achieved when the auditors comply with professional standards and applicable legal and regulatory requirements and that the auditor's report is appropriate in the circumstances (**ISSAI 1220:6**);

8.2 However, to be effective, those measures should be subject to ongoing monitoring (**ISSAI 1220:23**) to provide independent and reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and are operating effectively.[3]

8.3 In this regard, **IDI** has developed a Quality Assurance Guidance and Tool to help SAIs to implement a quality assurance system. The QA tool prescribes a set of questions and statements, the replies to which would indicate the extent of the SAI's compliance with the appropriate level of ISSAI. The replies thus obtained can be validated through the documents provided by the SAI that must be inspected during the QA review, since they provide an insight into the quality of the processes undertaken by the SAI and its personnel in general, and the quality of the financial audits and issuance of the corresponding audit reports in particular. The QA referred in this chapter relates to conducting QA review after audit is completed and report issued.

8.4 Institutionally, an independent quality assurance function should be established within the SAIs. The quality assurance function may be performed by an office (in bigger SAIs) or by a professional (in smaller SAIs) within the SAIs or alternatively, by a peer SAI. The quality assurance review team should consist of a mix of professionals who have either extensive knowledge of applicable standards and experienced in conducting financial audit.

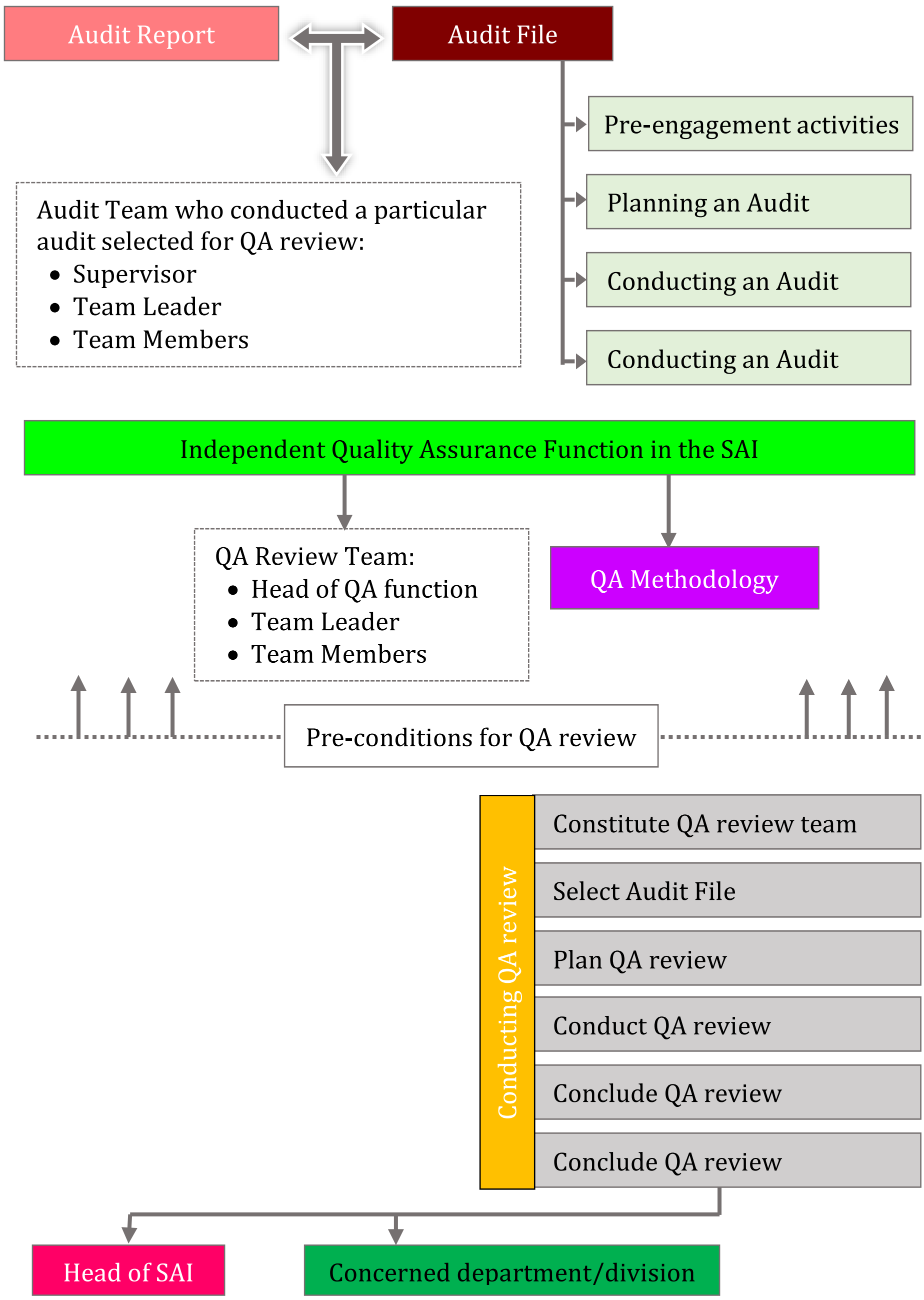
8.5 Most SAIs have established (either formally or informally) QA practices that can be strengthened through the above-mentioned tools developed by IDI. Initially, the SAI can create an ad hoc team to assess the extent to which a QA function needs to be created. The results of the assessment will be the basis for drafting a QA policy, which would include, among others, the purpose of the QA policy; establishment of the QA office; nature and frequency of QA reviews; criteria for QA object's selection; and reporting and follow-up requirements. In establishing the QA office, care must be taken to be

[3] At an **institutional level**, for a system to be effective it needs to be part of an SAIS's strategy, culture, policies and procedures. As for quality, at this level, SAIS shall develop a quality policy probably comprised of a quality mission statement and SAIS's quality objectives.

adequately staffed. A QA manual should also be developed to guide the conduct of the QA function, particularly reviewing financial audit's processes and outputs.

8.6 At the financial audit function level, a typical QA review would briefly take the following steps (Figure 8.1):

Figure 8.1: Snapshot of Quality Assurance Review in Financial Audit



8.7 After the selection of the financial audits for QA, the QA tool can be used to check/inspect the audit documentation compliance with the ISSAI requirements. The questionnaires cover the financial audit methodology, the different phases of the audit and the quality control procedures. In gathering evidence, the following methods are used, among others: document review; physical observation; focus group; interview or external confirmation (i.e. audit evidence obtained as a direct written response to the auditor from a third party (the confirming party); in paper form or by electronic or other medium).

Information obtained from the QA questionnaires are analysed and deficiencies observed along with the corresponding recommendations.

8.8 The results of the QA review are discussed first with the audit team concerned, in an exit meeting to ensure that the findings are clearly understood by all concerned. The QA team should obtain the agreement of the audit team to the QA observations and recommendations. Should there be any disagreement between the QA team and the audit team, especially on a high-risk issue, the SAI may establish policies and procedures for dealing with and resolving disagreements within the audit team, with those consulted and, where applicable between the audit team supervisor and QA reviewer (adapted from ISQC1.43). The QA results may also indicate some competency gap in the auditors. Therefore, it may also provide a basis for determining the training needs of auditors to address those competency gaps.

8.9 Then, QA results (observations and recommendations) are to be reported to the Head of the SAIs, who then ensures that the deficiencies are addressed so as to improve the SAIs quality control system.

8.10 Implementation of the QA recommendations is aimed at enhancing or correcting the practices of the SAIs to comply with ISSAIs requirements and best practices (as the yardstick). This will enable the SAIs to evolve into a credible and professional organization (**ISSAI 12**).

Chapter 9: Follow up of Audit Report

9.1 The audit report as discussed in Chapter 7 may contain qualified audit opinion on the financial statements, key audit matters, and audit findings covering deficiencies in internal controls and non-compliances to laws and regulations, that may or may not have direct effect on the financial statements. The report would also contain audit recommendations suggesting further course of action to be taken by the management or those charged with governance, (say recommended to improve internal control related to payment of travel claims – in this auditor suggests different measures to prevent excess payment of travel claims) and for that matter by concerned authorities if the case was of fraud, or indication of fraud.

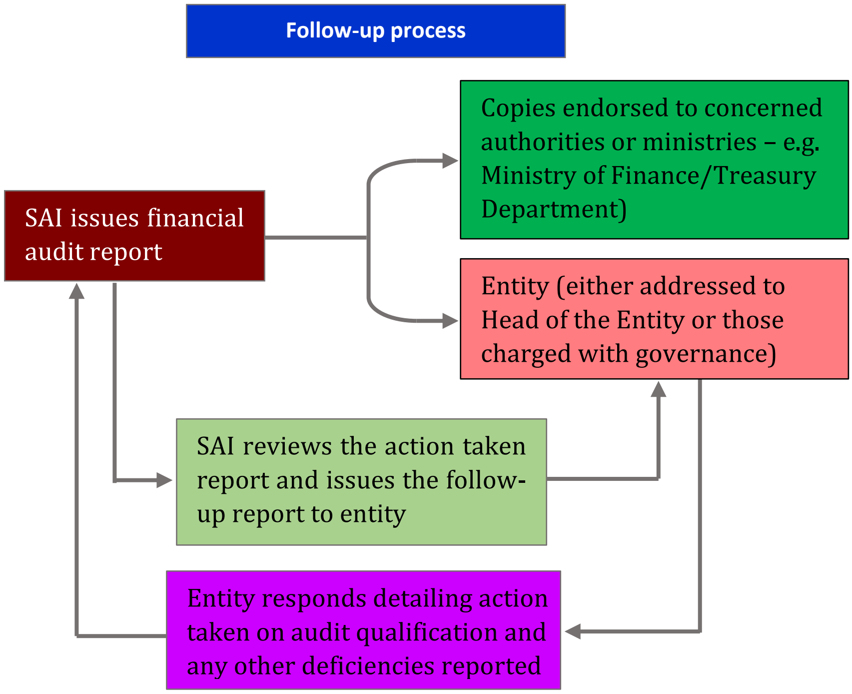
9.2 Unless there is a follow-up mechanism put in place, the RAA will not be in a position to ascertain the action taken by the management on audit findings and recommendations. Further, it may so happen that even the management and those charged with governance may not have a motivation to take action on the audit report.

9.3 Follow-up is not the requirement of ISSAIs, but is considered as a best practice and in accordance with the AG Standing Instructions so that the audit becomes effective, and that the desired impact is created in the entities being audited in particular and the public sector environment in general.

9.4 Besides statutory requirement, one of the purposes of conducting the audit is to help improve the systems and procedures including the financial reporting process in the entity. By conducting the follow-up, the SAI would also be able to establish the value addition created by the financial audit if there had been improvement in the system. Unless this follow-up is put in practice, the SAI cannot gauge whether the desired impact of audit has been effective or not. Therefore, a follow-up audit is one of the important components of the audit process, and that process cannot be complete without it. Further, even management and those charged with governance may not be motivated to take action if there is no follow-up system in the SAI.

9.5 Different SAIs may have different follow-up process depending on the models they follow (Court model, Westminster model, Board model, etc.). **Figure 9.1** provides a snapshot of suggested follow-up process.

Figure 9.1: Snapshot of follow-up process



9.6 The SAI issues audit report to the entity – usually addressed to the Head of the Entity or those charged with governance. Depending on the issues reflected in the audit report, and also as required by a law in which the SAI functions, the SAI may also be required to endorse copies of audit reports to the concerned authorities or government ministries – e.g. Ministry of Finance. However, it should be the responsibility of the Head of the entity or those charged with governance to take action on outstanding audit issues in the audit report.

9.7 Depending on the time period defined in the respective laws, rules and regulations, the SAI may indicate the deadline for responding to the audit report detailing the action taken by the entity. Respective laws and regulations may also require the audited entity to take action on audit reports issued by the SAI.

9.8 Upon receiving audit report from the SAI, the management or those charged with governance take corrective action, implement recommendations, and submit response to the SAI detailing the action taken on each issues and recommendations provided in the audit report (suggested as Action Taken Report on audit findings). The entity is expected to submit the action taken report along with supporting documents evidencing the action taken on audit findings.

9.9 The SAI reviews the action taken report and prepare a follow-up report. The follow-up can be done either as a desk review, or visit the entity premises for factual confirmation of the response provided by the management or those charged with governance. The follow-up of action taken report should also go through the due process of quality control.

9.10 It may be appropriate to have an independent follow-up function in the SAI to carry out objective assessment of the action taken by the management, and exercise their professional judgement. If for instance the follow-up is done by the same functional division/Unit or audit team who conducted the audit, they may tend to defend their audit findings and audit qualification, even if the management or those charged with governance have taken an appropriate action on those audit issues.

9.11 Based on different SAIS's model and the Parliamentary structure prevalent in SAIS's jurisdiction, the Public Accounts Committee play an active role in the review and follow up of the audit reports tabled to the Parliament. Therefore, there could be two levels of follow-up of audit findings and recommendations, i.e. one at SAIS level, and another one at Public Accounts Committee/Parliamentary level.

9.12 The formats below are to be adopted for preparing summary and detailed follow-up report.

Illustration 9.1: Summary of follow-up report on action taken by the entity

Fiscal Year/Accounting year	Total number of audit observations/ Recommendations	No. of observations/ recommendations implemented	No. of observations/ recommendations partially implemented	Balance observations/ recommendations to be implemented
20…				
20…				
20…				

Detailed Follow-up Report for the year ended 31 December 20…..

Obs./ Rec. No.	Observations/ recommendations in brief	Management's response – current status	SAI's further comments
			Indicate as implemented, not implemented, partially implemented within the (bracket against each observation and recommendation)

Note: *This should also include audit qualification if any on the financial statements Obs. Observation, Rec. Recommendation*

9.13 A follow-up of audit report could be for just one accounting year/fiscal year for which the audit was conducted and report issued and also there could be outstanding issues of earlier years' audit reports, which also may have to be followed-up.

9.14 The follow-up should be a continuous process until such time the outstanding audit findings are resolved based on appropriate action taken by the management or those charged with governance. After issuance of the initial audit report and upon receiving first response from the management or those charged with governance, the frequency of the follow-up thereafter may be decided by the SAI, or the SAI may have certain regulation or law, which guides this process. However, it is in the best interest of both SAI and the entity to resolve outstanding audit issues including qualified opinion on the financial statements if any at the earliest possible.

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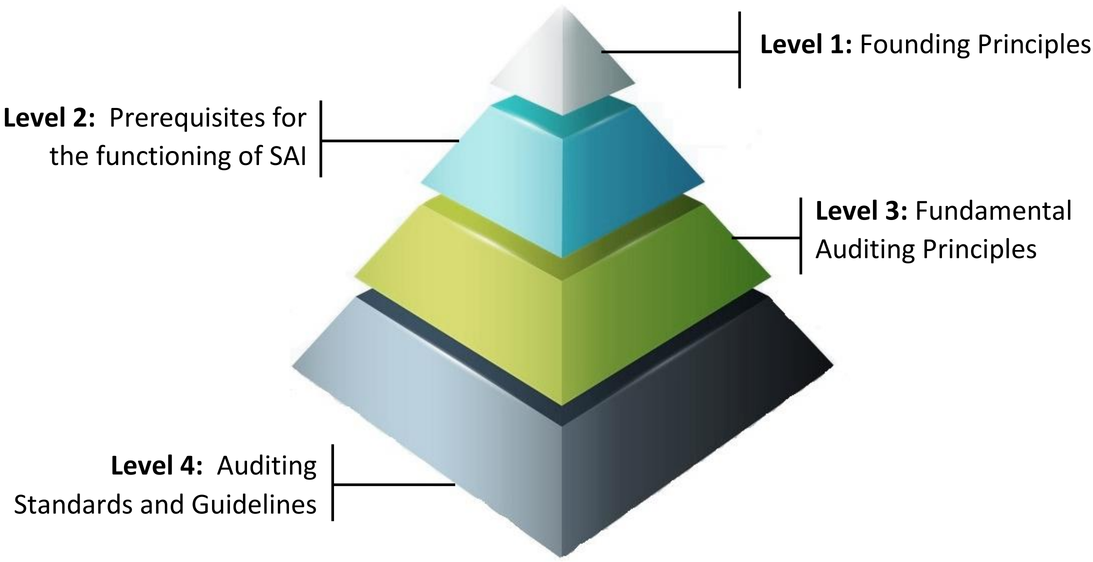
ISSAI Framework



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ANNEXURE

AUDIT WORKING PAPERS (AWP) TEMPLATES

Reporting on Economy, Efficiency & Effectiveness in the use of Public Resource