Genesis Origo

ADVANCED AUDIT & ASSURANCE (AAA)

Mr Yap Wai Wing

ASSOCIATION OF CHARTERED CERTIFIED ACCOUNTANTS

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REGULATORY ENVIRONMENT

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CHAPTER 1: International regulatory frameworks for audit and assurance services

The need for laws, regulations, standards and other guidance relating to audit, assurance and related services.

US corporate scandals plagued the early 2000s, with Enron, Tyco, and WorldCom becoming notorious. The 2008 financial crisis bred Libor rate-fixing and other cases of serious misconduct. Loss-hiding at Japan's Olympus Corporation was exposed in 2011. In 2013 Shell, BP, Statoil and others came under investigation by the EU Commission for supposed oil price rigging. Fined, sued, disgraced and sometimes collapsed the consequences for organizations can be dire.

Corporate governance becomes more prominent after these corporate scandals had been introduced. Corporate governance is not just about complying with the letter of the law. It is also about directing and controlling a company through practices, structures and processes.

Even companies are subjected to the requirements of corporate governance, corporate scandals are still happening around us, those discovered and those remain undiscovered. Corporate scandals will lead to corporate collapses (like Enron) which gave rise to an adverse effect on various stakeholders. It affects employees who have lost their job, suppliers who have lost their collection, shareholders who have lost their investment and etc. All these had happened due to actions by a small group of people, i.e. the board of directors. All these high-profile corporate collapses have arisen despite the fact that the financial statements of these collapsed companies had been audited.

Reasons for the need for regulation of auditors: -

(a) To protect public interest.
Potential investors make decisions on whether to invest in equity shares of a company based on various factors which include the audited financial statements. Therefore the audited FS inadvertently being used by stakeholders for their own purpose. The work of auditors is regulated so that the public can believe that the audited FS are highly reliable.

(b) Monitoring
To ensure that public accountants base their audit opinions on appropriate work and sufficient evidence. Auditor's work are expected to be inspected by a regulatory body, such as ACCA or any local regulatory body. This is to ensure the auditors are carrying out the high quality audit to the public.

(c) Independence and competence of auditors
ACCA requires all members to adhere to the Code of Professional Conduct and Ethics, keep technically up to date through continuing professional education and have their audit work inspected.

(d) To maintain public confidence in the accountancy profession
Corporate scandals which involve both management and auditor have tarnished the image of the accountancy profession. Regulation for auditors is in place to ensure auditor's work are of high quality so as to prevent the loss of reputation in the accountancy profession.

Public oversight of audit and assurance practice

International:-
The Public Interest Oversight Board (PIOB)

The Public Interest Oversight Board (PIOB) is the global independent oversight body that seeks to improve the quality and public interest focus of the international audit and assurance, and ethics standards formulated by the International Standard Setting Boards.

- To ensure the activities of IFAC and the independent standard setting bodies supported by IFAC are responsive to public interest.

- provides oversight of the standards-setting bodies within the IFAC (IFAC supports the development, adoption and implementation of international standards for accounting education, ethics, and the public sector as well as audit and assurance. It also issues guidance to encourage high quality performance by professional accountants in business and small and medium accounting practices.)

USA:-
The Public Company Accounting Oversight Board (PCAOB) is a private-sector, non-profit corporation created by the *Sarbanes–Oxley Act* of 2002 to oversee the audits of public companies and other issuers in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. Since 2010, the PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

The PIOB oversees those committees of IFAC that have public interest responsibilities, namely:

(IAASB) International Auditing and Assurance Standards Board
(IAESB) International Accounting Education Standards Board
(IESBA) International Ethics Standards Board for Accountants
Their respective Consultative Advisory Groups
IFAC's Compliance Advisory Panel (CAP).

Basic principles of corporate governance

Corporate governance is the system by which organisations are directed and controlled. It encompasses the relationship between the board of directors, shareholders and other stakeholders, and the effects on corporate strategy and performance.

Many regulatory authorities, including the UK, use a code of best practice, often termed a **'comply or explain' approach** to corporate governance. Under this approach the regulatory authority issues a set of principles with which company directors of listed companies are expected to comply.

In some jurisdictions, such as the US, a more **prescriptive approach** is used, whereby corporate governance requirements are set by legislation. Both the principles and the legislative approaches are broadly similar in the matters they address. They both deal with the importance of the board of directors having a balanced structure, emphasising the need for non-executive directors, and for robust procedures in relation to the appointment of board members, and their remuneration. They both describe the merits of audit committees and the need to monitor the effectiveness of internal controls. They both demand disclosure about these and other matters in the annual report.

Prescriptive approach vs principles-based approach

Prescriptive auditing occurs in a regulatory framework which contains fixed rules which must be followed, with little or no consideration of whether or how the rules apply to a particular situation.

Principle-based auditing occurs in a regulatory framework which contains limited or no fixed rules, but instead is based on guiding principles which the auditor must consider how or whether to apply in a given situation.

Advantages of a prescriptive approach:

- Using prescriptive wording and rules should improve the clarity and understandability of auditing standards.
- It can be argued that having more precise requirements in auditing standards will then lead to uniformity in audit practice, and an improvement in audit quality, as the auditor will be in no doubt as to which procedures need to be performed.
- It could also be easier to monitor the quality of work, as it would be easier to spot missing procedures.

Ways in which liability may be restricted

The guidance for when an auditor may be liable, either under criminal or civil law, appears to be clear and largely uncontroversial. The same cannot be said of the nature of the fines and settlements, which remains a hotly debated issue. Before discussing this, it is worth making the point that auditors are only found liable in cases where they have breached their responsibilities to perform work with professional competence and due care and to act independently of their clients.

There is therefore little argument that they should face the penalties of their own failures and that parties that have suffered as a result should be able to seek adequate compensation. The main criticism of the current system is that the penalties incurred by the audit profession are unfairly high.

1. Audit firms may take the following steps to minimise their exposure to negligence claims:
   (i) Regulate the use of documents and restrict their use to their specific, intended purpose.
   (ii) Maintain quality of the audit: ensure sufficient training to staffs, adequate staffing and adequate time to carry out the engagement.
   (iii) Engage second partner review, especially for public listed entities and high risk assignment.
   (iv) Compliance with code of ethics, to avoid the objectivity and independence of the audit partner to be compromised (e.g. partners rotation)
   (v) Screening potential audit clients to accept only clients where the risk can be managed.
   (vi) Take specialist legal advice where appropriate
   (vii) Have adequate professional indemnity insurance (PII)
   (viii) Application of professional scepticism while evaluating audit evidence.
   (ix) Set a liability cap with client.

2. Disclaimers of liability

   One of the outcomes of the Bannerman case was the potential exposure of auditors to litigation from third parties to whom they have not disclaimed liability. As a result it became common to include a disclaimer of liability to third parties in the wording of the audit report.

   Disclaimers may not entirely eliminate liability to third parties but they do reduce the scope for courts to assume liability to them.

   In some exceptional cases, ACCA appreciates that its members would want to issue a specific (as opposed to a standard) disclaimer on or in respect of its audit report. An example of this would be where the auditor had identified the fact that the audited accounts would be used or relied on by third parties but, for various reasons, those third parties were not known to the firm. In these exceptional cases, ACCA suggests two examples of appropriate wording:-

I. Example where third party has been identified

Independent auditors report to the Shareholders of ABC Ltd

Respective responsibilities of directors and auditors
Under section 235(1) of the Companies Act 1985 (or "Under section 495(1) of Companies Act 2006") we have a duty as auditors to report on the annual accounts of the company. This duty only extends to a report to the members of the company as a whole and not to an individual shareholder or group of shareholders or to a third party. We are therefore responsible only to the shareholders as a whole for our audit opinion.

Normal audit report from this stage

PRACTICE MANAGEMENT

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CHAPTER 7: Quality Management

Purpose of quality management

The purpose of assurance services is to enhance the intended user's confidence in the subject matter they are using to make decisions.

For there to be confidence in the assurance process, engagements must be performed that are of satisfactory quality.

Quality management at Firm Level *(ISQM 1 Quality Management for Firms that Perform Audits and Reviews of Financial Statements, or Other Assurance or Related Services Engagements)*

The objective of the firm is to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance services engagements performed by the firm, that provides the firm with reasonable assurance that:

(a) The firm and its personnel fulfil their responsibilities in accordance with professional standards and applicable legal and regulatory requirements; and conduct engagements in accordance with such standards and requirements; and
(b) Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

The public interest is served by the consistent performance of quality engagements.

A system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. However, for the purposes of this ISQM, a system of quality management addresses the following eight components:

(a) The firm's risk assessment process

The firm shall design and implement a risk assessment process to establish quality objectives, identify and assess quality risks and design and implement responses to address the quality risks.

Also, additional quality objectives are to be established if they are considered necessary.

(b) Governance and leadership

The firm shall establish the following quality objectives that address the firm's governance and leadership, which establishes the environment that supports the system of quality management. Firm to reinforce the firm's role in serving the public interest, the importance of professional ethics, values and attitudes.

CHAPTER 8: Advertising, publicity, obtaining professional work and fees

Advertising

A professional accountant in public practice may inform the public of the services he/she is capable of providing by means of advertising or other forms of promotion subject to the general requirement that the medium **shall NOT reflect adversely** on the

- professional accountant
- ACCA or
- the accountancy profession.

ACCA rules:

> Advertisements and promotional material prepared or produced by a professional accountant shall not (either in content or presentation):
>
> (a) bring ACCA into disrepute or bring discredit to the professional accountant, firm or the accountancy profession;
> (b) discredit the services offered by others whether by claiming superiority for the professional accountant's own services or otherwise;
> (c) be misleading, either directly or by implication;
> (d) fall short of any local regulatory or legislative requirements, such as the requirements of the United Kingdom Advertising Standards Authority's Code of Advertising and Sales Promotion, notably as to legality, decency, clarity, honesty, and truthfulness.

Practice names and descriptions:-

Members' descriptions:
A member of ACCA may be either a Member or a Fellow and is entitled to use the professional designation "Chartered Certified Accountant" or "Certified Accountant". A professional accountant may use the designatory letters "ACCA" (for a Member) or "FCCA" (for a Fellow).

Practice descriptions:-
The descriptions "Chartered Certified Accountant(s)", "Certified Accountant(s)", "Statutory Auditor(s)" or "Registered Auditor(s)" shall **NOT** form part of the name of a firm, company or limited liability partnership. Similarly, the designatory letters "ACCA" or "FCCA" shall not form part of the name of a firm, company or limited liability partnership.

A firm in which all the partners are Chartered Certified Accountants may use the description "Members of the Association of Chartered Certified Accountants"

A firm (containing holders of practising certificates of whatever category or insolvency licences) may describe itself as a firm of "Chartered Certified Accountants", "Certified Accountants" or "an ACCA practice" only where:

(a) at least half of the partners are ACCA members; and
(b) the principals have above control at least 51 per cent of the voting rights under the firm's partnership agreements (or constitution).

Generally, members may practice under whatever name they want, but:-

- A practice name shall be consistent with the dignity of the profession
- A practice name shall not be misleading.
- A practice name should not run the risk of being confused with the name of another firm.

- A sole practitioner should not add ‘and partners’ to the name under which he practices.

The use of ACCA name and logo

A professional accountant is not permitted to do the following:

- form or incorporate a firm that consists of any confusingly similar term (i.e Certified Accountant); and/or
- register a domain name or trade mark incorporating or consisting of any of the confusingly terms (i.e Certified Accountant) .

A firm that has at least one ACCA member as a partner or director may use the ACCA logo on letterheads, other stationery and on an Internet site. The logo shall be used in an appropriate manner, so that it cannot be confused with the logo of the firm, The overriding design consideration is that the positioning, size and colour of the ACCA logo shall not compromise its recognition. The ACCA logo is square and shall not be cropped or altered in any way.

Basis of fees

Letters of engagement shall state the fees to be charged or the basis upon which the fees are calculated.

Where the letter of engagement is not explicit with regard to the basis on which fees are calculated, the professional accountant in public practice shall charge a fee which is **fair and reasonable**.

This may have regard to any or all of the following to the extent that they are not referred to in the letter of engagement:
(a) the seniority and professional expertise of the persons necessarily engaged on the work;
(b) the time expended by each;
(c) the degree of risk and responsibility which the work entails;
(d) the urgency of the work to the client; and
(e) the importance of the work to the client.

Contingent fees

Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. For the purposes of this section, a fee is not regarded as being contingent if established by a court or other public authority.

A contingent fee charged by a firm in respect of an audit engagement creates a self-interest threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm shall not enter into any such fee arrangement.

ISA 320 Materiality in Planning and Performing an Audit

Materiality and performance materiality

Materiality
Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole.

General benchmarks for materiality level: -
5% of profit before tax (often used for profit-oriented entities)
1% of total revenue / total assets

Materiality by nature (Qualitative misstatement)

Examples of items which are material by nature include:

- Misstatements that, when adjusted, would turn a reported profit into a loss for the year.
- Misstatements that, when adjusted, would turn a reported net-asset position into a net liability position
- Related party transactions including transactions with directors;
- Disclosures in the financial statements relating to possible future legal claims or going concern issues.

Three types of risks examinable in paper AAA are: -

- Risk of material misstatements
- Audit risk
- Business risk

Risk of material misstatements

Risk of material misstatements - The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

- Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

- Control risk – The risk that a misstatement that could occur in an assertion about a class of transactions, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's controls.

The financial statements may be materially misstated for 3 main reasons:-

- Financial information being materially misstated. E.g. Depreciation is not charged for tangible non-current assets.
- Disclosures in financial statements are inadequate or omitted. E.g. going concern disclosures being omitted.
- The basis of preparation is inappropriate. E.g. the use of going concern assumption where break up basis is seems to be more appropriate.

Audit risk

Audit risk is the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Audit risk model:

Detection risk - The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

PRACTICE QUESTION

You are a manager in the audit department of Dove & Co, responsible for the audit of the Sunshine Hotel Group (the Group), which has a financial year ending 31 December 2017. The Group operates a chain of luxury hotels and it is planning to expand its operations over the next three years by opening hotels in countries with increasingly popular tourist destinations.

You are about to start planning the Group audit for forthcoming year end, and the audit engagement partner has just sent the following email to you:

To: Audit manager

From: John Starling, audit engagement partner

Subject: Audit planning, the Sunshine Hotel Group

Hello

I attended a planning meeting last week for the Sunshine Hotel Group (the Group) with the finance director and a representative of the Group audit committee, at which we discussed business developments during the year and plans for the future. I have provided you with my notes from this meeting, as well as some background information about the Group, as I know this is the first time that you are managing the audit. I have also provided you with an extract from an email which I received this morning from the Group finance director.

Using the information provided you are required to prepare briefing notes for my use in which you:

(a) Evaluate the business risks facing the Group. (10 marks)

(b) Identify and explain the significant risks of material misstatement which should be evaluated as part of our audit planning. (10 marks)

(c) In respect of the email received from the finance director:

(i) Discuss the additional implications for planning the Group audit and explain any relevant actions to be taken by the firm, and (5 marks)

(ii) Recommend the planned audit procedures to be performed on the claim of $10 million, assuming that the audit team is given access to all relevant sources of audit evidence. (6 marks)

Thank you.

Background information

The Group owns 20 hotels, all located in popular beachside holiday resorts. The hotels operate on an 'all-inclusive' basis, whereby guests can consume unlimited food and drink, and take part in a variety of water sports including scuba diving as part of the price of their holiday. Each hotel has at least four restaurants and a number of bars. The 'Sunshine Hotel' brand is a market leader, with significant amounts spent each year on marketing to support the brand. The hotels are luxurious and maintained to a very high standard and are marketed as exclusive adult-only luxury holiday destinations.

When customers book to stay in the hotel, they are charged a deposit equivalent to 20% of the total cost of their stay, and a further 20% is payable eight weeks before arrival. The remaining 60% is settled on departure. If a booking is cancelled prior to a week before a guest's stay commences, then a full refund is given, but no refunds are given for cancellations within the week leading up to a guest's stay.

Notes from meeting with finance director and representative of Group audit committee

The Group has seen continued growth, with revenue for the year to 31 December 2017 projected to be $125 million (2016 – $110 million), and profit before tax projected to be $10 million (2016 – $9 million).

According to the latest management accounts, the Group's total assets are currently $350 million. The 'Sunshine Hotel' brand is not recognised as an asset in the financial statements because it has been internally generated. The Group has cash of $20 million at today's date. Most of this cash is held on short-term deposit in a number of different currencies. Based on the latest management accounts, the Group's gearing ratio is 25%.

In January 2017, the Group entered into an agreement with an internationally acclaimed restaurant chain, Moulin Blanche, to open new restaurants in its five most popular hotels. The agreement cost $5 million, lasts for 10 years, and allows the Group to use the restaurant name, adopt the menus and decorate the restaurants in the style of Moulin Blanche. The cost of $5 million has been recognised within marketing expenses for the year. After a period of refurbishment, the new restaurants opened in all five hotels on 1 July 2017.

Part of the Group strategy is to expand into new countries, and in July 2017 the Group purchased land in three new locations in Farland at a cost of $75 million. There are currently no specific plans for the development of these locations due to political instability in the country. In addition to the Farland acquisitions, an existing hotel complex was purchased from a competitor for $23 million. The hotel complex is located in a country where local legislation prohibits private ownership and use of beaches, so the Group's hotel guests cannot enjoy the private and exclusive use of a beach which is one of the Group's key selling points. For this reason, the Group has not yet developed the hotel complex and it is currently being used as a location for staff training. All of these assets are recognised at cost as property, plant and equipment in the Group statement of financial position. Due to the problems with these recent acquisitions, the Group is planning to invest in alternative locations, with capital expenditure on sites in new locations of $45 million budgeted for 2018. This will be funded entirely from an undrawn borrowing facility with the Group's bank which has a fixed interest rate of 3·5% per annum.

Two of the Group's hotels are located in an area prone to hurricanes, and unfortunately only last week, a hurricane caused severe damage to both of these hotels. Under the Group's 'hurricane guarantee scheme', customers who were staying at the hotels at the time of the hurricane were transferred to other Group hotels, at no cost to the customer. Customers with bookings to stay at the closed hotels have been offered a refund of their deposits, or to transfer their reservation to a different Group hotel, under the terms of the scheme. The hotels are closed while the necessary repair work, which will take two months, is carried out at an estimated cost of $25 million. The repair work will be covered by the Group's insurance policy, which typically pays half of the estimated cost of repair work in advance, with the balance paid when the repair work is completed. No accounting entries have been made as yet in relation to the hurricane.

Extract from email from the Group finance director to John Starling, audit engagement partner

John

The Group's lawyer has received a letter from Ocean Protection, a multi-national pressure group which aims to safeguard marine environments. Ocean Protection is claiming that our hotel guests are causing environmental damage to delicate coral reefs when scuba diving under the supervision of the Group's scuba diving instructors.

Ocean Protection is pressing charges against the Group, and alleges that our activities are in breach of international environmental protection legislation which is ratified by all of the countries in which the Group operates. Damages of $10 million are being sought, Ocean Protection suggesting that this amount would be used to protect the coral reefs from further damage.

The Group is keen to avoid any media attention, so I am hoping to negotiate a lower level of payment and an agreement from Ocean Protection that they will not make the issue public knowledge.

From an accounting point of view, we do not want to recognise a liability, as the disclosures will draw attention to the matter. We will account for any necessary payment when it is made, which is likely to be next year.

I understand that your audit team will need to look at this issue, but I ask that you only speak to me about it, and do not speak to any other employees. Also, I do not want you to contact Ocean Protection as this could impact on our negotiation.

Required:

Respond to the instructions in the partner's email. (31 marks)

Overall Group Audit Strategy and Group Audit Plan

<u>Considerations When Component Auditors Are Involved</u>

In establishing the overall group audit strategy and group audit plan, the group engagement partner shall evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor.

<u>Relevant Ethical Requirements, Including Those Related to Independence</u>

The group engagement partner shall take responsibility for component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement and, confirming whether the component auditors understand and will comply with the relevant ethical requirements. The group auditor may consider whether additional information or training for component auditors.

<u>Engagement Resources</u>

The group engagement partner shall determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component.

The group engagement partner may consider matters such as:
- Previous experience with or knowledge of the component auditor
- The component auditor's specialized skills (e.g., industry-specific knowledge)
- The degree of system of quality management use (e.g., audit methodologies, review and supervision)
- The consistency of laws and regulations, language and culture, education and training.

The procedures to determine the component auditor's competency and capability may include, for example:
- An evaluation of the information communicated by the group auditor's firm to the group auditor
- Discussing the assessed risks of material misstatement with the component auditor
- Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement
- Discussing the component auditor's competence and capabilities with colleagues in the group engagement partner's firm that have worked directly with the component auditor
- Obtaining published external inspection reports

<u>Engagement Performance</u>

The group engagement partner shall take responsibility for the nature, timing and extent of direction and supervision of component auditors and the review of their work:
- Areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified
- Areas in the audit of the group financial statements that involve significant judgment

Materiality

For purposes of planning and performing audit procedures, the group auditor shall determine component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality.

Extracted from paper AAA technical article

EXAMPLE 1

Imagine that financial statements materiality is taken to be 10% of profit or loss for each entity within a group and performance materiality is set at 0.5% of profit. Imagine that a group has a parent company and two components, one of which is profit making and one of which is loss making:

$'000s	Parent	Subsidiary 1	Subsidiary 2	Group
Proft	2,000	12,000	(8,000)	6,000
Component materiality @ 10%	200	1,200	800	600
Performance materiality @ 0.5%	10	60	40	30

ISRE 2400 (Revised), Engagements to Review Historical Financial Statements

The review of historical financial statements is a limited assurance engagement.

The Engagement to Review Historical Financial Statements

In a review of financial statements, the practitioner expresses a conclusion that is designed to enhance the degree of confidence of intended users regarding the preparation of an entity's financial statements in accordance with an applicable financial reporting framework. The practitioner's conclusion is based on the practitioner obtaining limited assurance.

The practitioner performs primarily inquiry and analytical procedures to obtain sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole, expressed in accordance with the requirements of this ISRE.

If the practitioner becomes aware of a matter that causes the practitioner to believe the financial statements may be materially misstated, the practitioner designs and performs additional procedures, as the practitioner considers necessary in the circumstances, to be able to conclude on the financial statements in accordance with this ISRE.

In all cases when limited assurance cannot be obtained and a qualified conclusion in the practitioner's report is insufficient in the circumstances, this ISRE requires that the practitioner either disclaim a conclusion in the report issued for the engagement or, where appropriate, withdraw from the engagement if withdrawal is possible under applicable law or regulation.

Comparison between a reasonable assurance and limited assurance

Reasonable assurance		*Limited assurance*
	Level of assurance	
	Opinion / Conclusion	
	Amount of work to be performed.	
	Cost to the client	
	Types of engagement	

Illustration 1: A practitioner's report on financial statements prepared in accordance with a fair presentation framework designed to meet the common financial information needs of a wide range of users

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

Report on the Financial Statements[15]

We have reviewed the accompanying financial statements of ABC Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's[16] *Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standard for Small and Medium-sized Entities,[17] and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements. We conducted our review in accordance with International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements.* ISRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

A review of financial statements in accordance with ISRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing. Accordingly, we do not express an audit opinion on these financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that these financial statements do not present fairly, in all material respects, (or *do not give a true and fair view of)* the financial position of ABC Company as at December 31, 20X1, and (*of)* its financial performance and cash flows for the year then ended, in accordance with the International Financial Reporting Standard for Small and Medium-sized Entities.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the practitioner's report will vary depending on the nature of the practitioner's other reporting responsibilities.]

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

Illustration 2: A practitioner's report containing a **qualified conclusion** due to an apparent material misstatement of the financial statements. Financial statements prepared in accordance with a compliance framework designed to meet the common information needs of a wide range of users.

Basis for Qualified Conclusion

The company's inventories are carried in the statement of financial position at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from the requirements of the Financial Reporting Framework (XYZ Law) of Jurisdiction X. The company's records indicate that, had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Conclusion

Based on our review, except for the effects of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements of ABC Company are not prepared, in all material respects, in accordance with the Financial Reporting Framework (XYZ Law) of Jurisdiction X.

Illustration 3: A practitioner's report containing a qualified conclusion due to the practitioner's inability to obtain sufficient appropriate evidence.

Basis for Qualified Conclusion

ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the statement of financial position as at December 31, 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain access to the relevant financial information of XYZ concerning the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year. Consequently, we were unable to perform the procedures we considered necessary.

Qualified Conclusion

Based on our review, except for the possible effects of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not present fairly, in all material respects, (or *do not give a true and fair view of)* the financial position of ABC Company as at December 31, 20X1, and (*of*) its financial performance and cash flows for the year then ended in accordance with [name of applicable financial reporting framework, including a reference to the jurisdiction or country of origin of the financial reporting framework when the financial reporting framework used is not International Financial Reporting Standards].

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

PRACTICE QUESTION

Question 1

You are a manager in the audit department of Nidge & Co, a firm of Chartered Certified Accountants, responsible for the audit of Darren Co, a new audit client operating in the construction industry. Darren Co's financial year ended on 31 January 20X5, and the draft financial statements recognise profit before tax of $22·5 million (20X4 – $20 million) and total assets of $370 million, including cash of $3 million. The company typically works on three construction contracts at a time.

The audit is nearly complete and you are reviewing the audit working papers. The audit senior has brought several matters to your attention:

(a) Darren Co is working on a major contract relating to the construction of a bridge for Flyover Co. Work started in July 20X4, and it is estimated that the contract will be completed in September 20X5. The contract price is $20 million, and it is estimated that a profit of $5 million will be made on completion of the contract. The full amount of this profit has been included in the statement of profit or loss for the year ended 31 January 20X5. Darren Co's management believes that this accounting treatment is appropriate given that the contract was signed during the financial year, and no problems have arisen in the work carried out so far. (8 marks)

(b) A significant contract was completed in September 20X4 for Newbuild Co. This contract related to the construction of a 20-mile highway in a remote area. In November 20X4, several large cracks appeared in the road surface after a period of unusually heavy rain, and the road had to be shut for ten weeks while repair work was carried out. Newbuild Co paid for these repairs, but has taken legal action against Darren Co to recover the costs incurred of $40 million. Disclosure on this matter has been made in the notes to the financial statements. Audit evidence, including a written statement from Darren Co's lawyers, concludes that there is a possibility, but not a probability, of Darren Co having to settle the amount claimed. (6 marks)

(c) For the first time this year, the financial statements are presented as part of an integrated report. Included in the integrated report are several key performance indicators, one of which states that Darren Co's profit before tax has increased by 20% from the previous year. (6 marks)

Required:
Discuss the implications of the matters described above on the completion of the audit and on the auditor's report, recommending any further actions which should be taken by the auditor.

Note: The mark allocation is shown next to each of the matters above. **(20 marks)**

Question 2

Your firm has been engaged to perform a separate assurance engagement on Faster Jets Co's corporate social responsibility (CSR) report. This engagement will be performed by Brown & Co's specialist social and environmental assurance department and there are no ethical threats created by the provision of this service in addition to the audit. An extract from the draft CSR report is shown below:

CSR objective	CSR target	Performance in 2014
Continue to invest in local communities and contribute to charitable causes	Make direct charitable cash donations to local charities	Donations of $550,000 were made to local charities
	Build relationships with global charities and offer free flights to charitable organisations	800 free flights with a value of $560,000 were provided to charities
	Develop our Local Learning Initiative and offer free one day education programmes to schools	$750,000 was spent on the Local Learning Initiative and 2,250 children attended education days
Reduce environmental impact of operations	Reduce the amount of vehicle fuel used on business travel by our employees	The number of miles travelled in vehicles reduced by 5%, and the amount spent on vehicle fuel reduced by 7%

Required:

(i) Discuss the difficulties in measuring and reporting on social and environmental performance; and
(4 marks)

(ii) Recommend the procedures to be used to gain assurance on the validity of the performance information in Faster Jets Co's CSR report. (6 marks)

CHAPTER 24: Other Current Issues

Big data and data analytics

Big data is a broad term for the larger, more complex datasets that can be held by modern computers. The terms refer to a qualitative shift in the amount of data that is available in comparison with the past.

Data analytics is the examination of data to try to identify patterns, trends or correlations. As the quantity of data has increased, it has become more and more necessary to evolve ways of processing and making sense of it.

Big data consisted of 5 characteristics, which are referred to as 5Vs.

- Volume
- Velocity
- Variety
- Veracity
- Value

How does big data may affect audit?

Proposed Revisions Pertaining to Safeguards in the Code—Phase 2

This Exposure Draft (ED) includes enhanced requirements and application material pertaining to the application of the conceptual framework in the *Code of Ethics for Professional Accountants* (the Code), including safeguards.

Key enhancements proposed in the Safeguards ED, which is presented in accordance with the new structure and drafting conventions, include:

- More robust and prominent requirements related to the application of the conceptual framework, including a required overall assessment of the judgments made and conclusions reached;
- A clearer and more robust description of the concept of safeguards, and clarified and streamlined examples of safeguards; and
- New guidance regarding the application of the concept of a “reasonable and informed third party” that is essential to properly applying the conceptual framework.

Phase 2 proposals address safeguards-related provisions in the independence sections of the Code of Ethics. The document also explains the rationale for some revisions to the non-assurance services section of the extant Code, and the proposed conforming amendments arising from the project.

Exposure Draft, Improving the Structure of the Code of Ethics for Professional Accountants—Phase I and Phase II

This Exposure Draft (ED) represents the first application of proposed new structure and drafting conventions for the *Code of Ethics for Professional Accountants* (the Code), covering both a number of the provisions of the Code dealing with its general application and selected sections addressing professional accountants in public practice. In addition to the use of clearer language, key features in the ED include:

- Requirements clearly distinguished from application material;
- Increased clarity of responsibility for compliance with the Code's requirements;
- A reorganization of the content of the Code; and
- A new Guide to the Code.

Phase 2 moved on to consider the following issues:

- Accountants' response to non-compliance with laws and regulations.
- Long association of firm personnel with an audit or assurance client; and
- Ethical issues that professional accountants in Business often face.

As of September 2017, the IESBA is considering on analysis of responses to the second ED.

Toward Enhanced Professional Skepticism *(Currently still on-going)*

Professional skepticism lies at the heart of a quality audit.

Key observations:

1) Increased attention to business acumen is central to the exercise of professional skepticism.

   In today's complex and rapidly changing business environment, strong business acumen is essential. For example, a sufficient knowledge of the client's business model and strong professional competencies, in addition to a strong understanding of relevant standards, laws, and regulations, enable robust professional skepticism. Education and continuing, effective training remain vital.

2) Environmental factors can influence the ability to exercise professional skepticism.

   Professional skepticism can be impeded by factors from tight financial reporting deadlines and resource constraints, to a firm's tone at the top and incentive systems, to local culture and groupthink. Heightening awareness of these and other factors is the first step to mitigate their impact.

3) Awareness of personal traits and biases is essential.

   Personal traits play a role in the exercise of professional skepticism. These include, for example, confidence; an inquisitive nature; an individual's response to stress, time pressures, or conflict; knowledge; practical experience; and cultural background.

4) Building in professional skepticism from the outset is key.

   Instilling professional skepticism starts at the beginning of one's career. For auditors, some have said it needs to be "part of their DNA." Education and training can raise awareness and develop the needed attitude.

5) There is more that the three standard-setting boards can do, both in the immediate term and the longer term

   The Working Group provided recommendations to all three boards outlining actions that they may take individually as well as collectively. These included immediate actions, which are being acted on with priority attention, as well as considerations requiring further study

6) Beyond audit, aspects of the concepts underlying professional skepticism may be relevant to all professional accountants.

   There are questions about whether and how aspects of the concepts underlying professional skepticism should apply more broadly to all professional accountants, and not just auditors.

7) Standard setting alone will not be enough.

   All stakeholders with an interest in professional skepticism have a role to play to help cultivate a skeptical mindset.