Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs)

2018

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President's Message

I am pleased to issue this message to the publication of the Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs) - 2018 published by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs) is a principles based, stand-alone auditing standard, tailored specifically to audits of the financial statements of small entities.

The standard is applicable for audits of small entities (that do not have public accountability and publish general purpose financial statements for external users) which are non-Specified Business Entities that follow the cost model for measurement of assets and liabilities. The financial reporting frameworks that could be applied for the purpose of this Standard are either the Sri Lanka Accounting Standard for Small and Medium- Sized Entities (SLFRS for SMEs) or SLFRS for Smaller Entities.

I would like to thank the immediate Past President Mr. Lasantha Wickremasinghe for initiating this project during his term. This publication would not have been possible without the untiring contributions of the Sub-Committee to develop the Audit Framework for SME Audits and Auditing Standards Committee of CA Sri Lanka, as well as the commitment of the technical division.

Jagath Perera
President
The Institute of Chartered Accountants of Sri Lanka

Auditing Standards Committee Chairman's Message

As the chairman of the Auditing Standards Committee, I am pleased to be associated with this publication of Sri Lanka Auditing Standard (SLAuS) simplifying the Audits of Non – Specified Business Enterprises (Non-SBEs) - 2018 published by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

In this complex environment, simplifying procedures to assist auditors is a challenge. However, with the purpose of simplification in mind, the Auditing Standards Committee approved this Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs) developed with the assistance of a sub-committee.

The Standard is applicable for audits of small and medium sized entities (that do not have public accountability and publish general purpose financial statements for external users). These entities are also non-Specified Business Entities that follow the cost model for measurement of assets and liabilities. The financial reporting framework that could be applied for the purpose of this Standard are either Sri Lanka Accounting Standard for Small and Medium-Sized Entities (SLFRS for SMEs) or SLFRS for Smaller Entities.

I would like to thank the members of the Auditing Standards Committee and the members of the sub-committee for their honorary effort in assisting the professionals involved in auditing Non SBEs which will reduce the complexity and also cost of audit while improving quality and documentation. My sincere thanks to the technical division of the Institute for their untiring contributions in implementing this project to simplify audits of Non SBEs.

Suren Rajakarier
Chairman
Auditing Standards Committee

Sub-Committee to Develop an Audit Framework for SME Audits Chairman's Message

Auditing of financial statements aims to add credibility to the reported financial position and performance of an organisation. It has been identified that some of the Sri Lanka Auditing Standards are not relevant for smaller entities and hence, some standards may not need to be applied in full. Therefore, the Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs) serves as a principle based, stand-alone auditing standard, tailored specifically to audits of the financial statements of small entities. In other words, it is made to facilitate quality auditing that is scalable for smaller entities.

The SLAuS can be applied for audits of general-purpose financial statements published by small and medium sized entities that do not have public accountability which are Non-Specified Business Entities that follow the cost model for measurement of assets and liabilities. The financial reporting frameworks that could be applied for the purpose of this Standard are either the Sri Lanka Accounting Standard for Small and Medium- Sized Entities (SLFRS for SMEs) or SLFRS for Smaller Entities.

In developing this Standard, a public consultation process was followed and the valuable comments directed to CA Sri Lanka have been included in this publication.

We are grateful for the guidance of the immediate Past President, Mr. Lasantha Wickremasinghe and the incumbent President, Mr. Jagath Perera for their passion towards this initiative. I would like to thank the Auditing Standards Committee and the members of the Sub-Committee, which consisted of the members of the SMP Capacity Development Task Force and the Audit Faculty for the honourable contribution and valuable input. In addition, special thanks goes to the Technical Division as well for it's untiring commitment.

Sanath

Sanath Fernando
Chairman
Sub-Committee to Develop an Audit Framework for SME Audits

Preface

This Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs) is a principles based, stand-alone auditing standard, tailored specifically to audits of the financial statements of small entities.

The standard is applicable for audits of small and medium sized entities (that do not have public accountability and publish general purpose financial statements for external users) which are non-Specified Business Entities that follow the cost model for measurement of assets and liabilities. The financial reporting frameworks that could be applied for the purpose of this Standard are either Sri Lanka Accounting Standard for Small and Medium- Sized Entities (SLFRS for SMEs) or SLFRS for Smaller Entities.

For this purpose, the companies categorised under the "Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995 and subsequent amendments thereto as "Specified Business Enterprises" will not fall into this SLAuS.

This SLAuS is effective for audits of financial statements for periods ending on or after 31 March 2018.

Sri Lanka Framework for the Engagements to Audit Non – Specified Business Enterprises (Non-SBEs)

Financial statements are ordinary prepared and presented annually and are directed toward the common information needs of a wide range of users. Many of those users rely on the financial statements as their major source of information because they do not have the power to obtain additional information to meet their specific information needs. Thus financial statements need to be prepared in accordance with Sri Lanka Accounting Standards.

The Framework does not apply to services other than audit services provided by auditors such as taxation, consultancy and financial accounting advice.

Assurance in the context of this Framework refers to the auditor's satisfaction as to the reliability of an assertion being made by one party for use by another party. To provide such assurance, the auditor assesses the evidence collected as a result of procedures conducted and expresses a conclusion. The degree of satisfaction achieved and therefore, the level of assurance which may be provided is determined by the procedures performed and their results.

In an audit engagement, the auditor provides a high, but not absolute, level of assurance that the information subject to audit is fee of material misstatement. This is expressed positively in the audit report as reasonable assurance.

The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. The phrases used to express the auditor's opinion are "give a true and fair view" or "present fairly, in all material respects," which are equivalent terms. A similar objective applies to the audit of financial or other information prepared in accordance with appropriate criteria.

In forming the audit opinion, the auditor obtains sufficient appropriate audit evidence to be able to draw conclusions on which to base that opinion.

The auditor's opinion enhances the credibility of financial statements by providing a high, but not absolute, level of assurance. Absolute assurance in auditing is not attainable as a result of such factors as the need for judgement, the use of testing, the inherent limitations of any accounting and internal control systems and the fact that most of the evidence available to the auditor is persuasive, rather than conclusive, in nature.

Assurance engagement involve three separate parties: a practitioner, a responsible party and intended users.

When applying this standard, the auditor shall comply with relevant ethical requirements.

Content

Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs)

CHAPTER 01 - OBJECTIVES, GENERAL PRINCIPLES AND RESPONSIBILITIES GOVERNING AN AUDIT OF FINANCIAL STATEMENTS

1.1 Overall Objectives

The overall objectives of the auditor when conducting an audit of financial statements are:

- to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- to report on the financial statements, and communicate, in accordance with the auditor's findings.

1.2 Requirements

1.2.1 Ethical Requirements Relating to an Audit of Financial Statements

When applying this standard, the auditor shall comply with relevant ethical requirements, including those pertaining to independence. Relevant ethical requirements ordinarily comprise Parts A and B of the *Code of Ethics for Professional Accountants* issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka Code) related to an audit of financial statements together with national requirements that are more restrictive.

1.2.2 Professional Skepticism

The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.

1.2.3 Professional Judgment

The auditor shall exercise professional judgment in planning and performing an audit of financial statements.

1.2.4 Sufficient Appropriate Audit Evidence and Audit Risk

To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

1.2.5 Conduct of an Audit in Accordance with SLAuS

The auditor shall conduct the audit in complying with the SLAuS for Non-SBEs relevant to the Audit. Whether the auditor has performed an audit in accordance with SLAuS is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

1.3 Scope of the Audit

The term scope of the audit refers to the audit procedures deemed necessary in the circumstances to achieve the objectives of the audit. The procedures required to conduct an audit in accordance with this SLAuS shall be determined by the auditor having regard to the requirements of this SLAuS, applicable legislation, regulations and where appropriate the terms of the audit engagement and reporting requirements.

1.4 Reasonable Assurance

An audit in accordance with SLAuS is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.

However, there are inherent limitations in an audit that affect the auditor's ability to detect material misstatement. These limitations result from factors such as:

- The use of testing
- The inherent limitations of any accounting and internal control

system (for example, the possibility of collusion).

- The fact that most audit evidence is persuasive rather than conclusive.

Also the work undertaken by the auditor form an opinion is permeated by judgement, in particular regarding;

(a) the gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and

(b) the drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

Further, other limitations may affect persuasiveness of evidence available to draw conclusions on particular financial statement assertions (for example, transactions between related parties). In these cases, certain auditing standards identify specified procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:

(a) unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or

(b) any indication that a material misstatement has been occurred.

1.5 Acceptance or Continuance of an Audit Engagement

1.5.1 Objective

The objective of the auditor is to evaluate whether to accept or continue an audit engagement considering whether preconditions for an audit are present and upon agreeing the terms of the audit engagement with management or those charged with governance as appropriate. One of the purposes of agreeing the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor.

1.5.2 Preconditions for an Audit

The auditor shall consider whether the preconditions for an audit are present. In making this consideration the auditor evaluates whether:

- the financial reporting framework to be applied in the preparation of the financial statements is acceptable;

- management acknowledges its responsibility for the preparation of the financial statements in accordance with the applicable laws and regulations;
- management will provide the auditor with:
    - o all information of which management is aware that is relevant;
    - o any additional information that the auditor may request from management; and
    - o unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence:
- the terms of engagement is acceptable;
- management or those charged with governance impose a limitation on the scope of the auditor's work; and
- there are other factors that may affect the engagement acceptance.

On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

1.5.3 Agreement on Audit Engagement Terms

Unless management's responsibilities for the financial statement and the scope of the audit is clearly defined in applicable law or regulation, the auditor shall obtain from management or those charged with governance, as appropriate, a written agreement:

- that it acknowledges and understands its responsibility;
    - o for the preparation of the financial statements in accordance with the applicable financial reporting framework; and
    - o to provide the auditor with:
        - access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

- additional information that the auditor may request from management for the purpose of the audit; and
- unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence;

- of the terms of the audit engagement, including:
  - the objective and scope of the audit;
  - the responsibilities of the auditor;
  - the responsibilities of management;
  - identification of the applicable financial reporting framework; and
  - reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of financial statements prepared in accordance with Sri Lanka Accounting Standards for SMEs or Smaller Entities. It will need to be varied according to individual requirements and circumstances, would require adaptation if intended or expected to apply to recurring audits.

To the appropriate representative of management or those charged with governance of ABC Company:

[*The objective and scope of the audit*]

You have requested that we audit the financial statements of ABC Company, which comprise the Balance Sheet as at December 31, 20X1, and the Income Statement and [Cash Flow Statement] for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

[*The responsibilities of the auditor*]

We will conduct our audit in accordance with SLAuS for the Audits of non-SBEs. That standard require that we comply with ethical requirements. As part of an audit in accordance with SLAuS for the Audits of non-SBEs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations;

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.; and

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

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SLAuS for the audits of non SBEs.

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance] acknowledge and understand that they have responsibility:

(a) For the preparation and fair presentation of the financial statements in accordance with SLFRS for SMEs or Smaller Entities;

(b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide us with:

   (i) Access to all information of which [management] is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

   (ii) Additional information that we may request from [management] for the purpose of the audit; and

   (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate*.]

[Reporting]

[*Insert appropriate reference to the expected form and content of the auditor's report*].

The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

....
Name and Title

Date

1.6 Supervision and Quality Control for Audit Work

The engagement partner shall take responsibility for the overall quality on each audit engagement. Throughout the engagement, the engagement partner shall remain alert, through observation, inspection of audit documentation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements and professional standards.

The engagement partner shall take responsibility for:

- the direction, supervision and performance of the audit engagement in compliance with this standard, relevant ethical requirements and applicable legal and regulatory requirements;
- reviews being performed in accordance with the firm's policies and procedures;
- satisfying that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued;
- satisfying that consultations being made by the members of the engagement team on difference of opinions, difficult or contentious matters and the resulting conclusions being implemented as agreed with the party consulted;
- an engagement quality control review being performed in accordance with the firm's policies and procedures wherever it is required; and
- the auditor's report being appropriate in the circumstances.

The engagement partner shall include the following, in the audit documentation:

- Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

1.7 Documenting the Audit Engagement

1.7.1 Scope

The auditor shall prepare documentation that provides:

- a sufficient and appropriate record of the basis for the auditor's report; and
- evidence that the audit was planned and performed in accordance with this standard and applicable legal and regulatory requirements.

For the purpose of this SLAuS;

- Audit documentation means the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "work papers" are also sometimes used).
- Audit file is one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

1.7.2 Form, content and extent of audit documentation

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 the audit procedures performed to comply with the SLAuS and applicable legal and regulatory requirements;

- The results of the audit procedures performed (including alternative audit procedures performed, whenever required), and the audit evidence obtained; and

- Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

(a) The identifying characteristics of the specific items or matters tested;

(b) Who performed the audit work and the date such work was completed; and

(c) Who reviewed the audit work performed and the date and extent of such review.

When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its internal control, the audit plan, materiality, assessed risks, significant matters noted during the audit, and conclusions reached.

Working papers ordinarily include;

- Information concerning the legal and organizational structure of the entity
- Extracts or copies of important legal documents, agreements and minutes
- Information concerning the industry, economic environment and legislative environment within which the entity operates.
- Evidence of the planning process including audit programs

and any changes thereto.

- Evidence of the auditor's understanding of the accounting and internal control system.
- Evidence of inherent and control risk assessments and any revisions thereof
- Evidence of the auditor's consideration of the work of internal auditing and conclusions reached.
- Analyses of transactions and balances.
- Analyses of significant ratios and trends.
- A record of the nature, timing and extent of audit procedures performed and the results of such procedures.
- Evidence that the work performed by assistants was supervised and reviewed.
- An indication as to who performed the audit procedures and when they were performed.
- Details of procedures applied regarding components whose financial statements are audited by another auditor.
- Copies of communications with other auditors, experts and other third parties.
- Details of discussions with discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.
- Copies of letters or notes concerning audit matters communicated to or discussed with the entity, including the terms of the engagement and material weaknesses in internal control.
- Letters of representation received from the entity.
- Conclusions reached by the auditor concerning significant aspects of the audit, including how exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated.

- Copies of the financial statements and auditor's report.

1.7.3 Timely Preparation, assembly of the Final Audit File, safe custody and retention of Audit Documentation

Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

The auditor shall adopt appropriate procedures for maintaining the confidentiality and safe custody of working papers in which the ownership lies with the auditor.

After the assembly of the final audit file, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period. The retention period for audit documentation ordinarily is no shorter than five years from the date of the auditor's report.

The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

In the case of recurring audits, some working paper files may be classified as "permanent" audit files which are updated with new information of continuing importance as distinct from current audit files which contain information relating primarily to the audit of a single period.

If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

If the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document: the specific reasons for making them; and when and by whom they were made and reviewed.

1.8 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

The auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

1.8.1 Responsibility

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. An auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

1.8.2 Requirements

The auditor shall:

- maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance;

- have a discussion among the engagement team members placing a particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur;

- obtain an understanding of the entity and its environment, including the entity's internal control;

- inquire of management and others within the entity as appropriate;

- evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, that may indicate risks of material misstatement due to fraud;

- evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present;

- identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures, particularly based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks along with the required documentation where the auditor concludes that the presumption is not applicable in the circumstances of the engagement;

- determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level;

- if there are any material misstatements, express a qualified, an adverse or disclaim an opinion on the financial statements as appropriate.

In many of the small entities, all of those charged with governance are involved in managing the entity. This may be the case in a small entity where a single owner manages the entity and no one else has a governance role.

In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a small entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. However, domination of management by a single individual can be a potential deficiency in internal control since there is an opportunity for management override of controls.

1.9 Consideration of Laws and Regulations in an Audit of Financial Statements

When planning and performing audit procedures and in evaluating and reporting the results thereof, the auditor should recognize that non – compliance by the entity with laws and regulations may materially affect the financial statements. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

For this purpose, non-compliance means acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

1.9.1 The Auditor's Consideration of Compliance with Laws and Regulations

The auditor shall:

- obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and how the entity is complying with that framework;
- obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations

generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;

- perform the audit procedures (i.e. inquiring of management and where appropriate those charged with governance as to whether the entity is in compliance with such laws and regulations and inspecting correspondence, if any, with the relevant licensing or regulatory authorities) to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements;

- remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention;

- request management and, where appropriate, those charged with governance, to provide written representations that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor;

1.9.2 Audit Procedures When Non-Compliance is Identified or Suspected

- If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:

  - an understanding of the nature of the act and the circumstances in which it has occurred; and

  - further information to evaluate the possible effect on the financial statements.

- If management or as appropriate those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

- If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.
- The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.

1.9.3 Reporting Non-Compliance with Laws and Regulations

- Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance, matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential.
- If there are any material misstatements, the auditor shall express a qualified, an adverse or disclaim an opinion on the financial statements as appropriate.
- If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

1.10 Communication with Management and Those Charged with Governance

The auditor shall communicate the matters relating to the audit with management and those charged with governance on a timely basis which include;

- responsibilities of the auditor;
  - The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
  - the audit of the financial statements does not relieve

management or those charged with governance of their responsibilities;

- significant findings from the audit;
- modifications to, emphasis of matter and other matters in the auditor's report;
- communication requirements in laws and regulation;
- other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the financial statements and the financial reporting process.

The auditor shall use professional judgment in determining the appropriate form of communicating with management and those charged with governance. Communication is preferred to be done in writing and if oral, it need to be documented.

CHAPTER 02 - PLANNING

2.1 Planning the Work

Planning an audit involves establishing the overall audit plan for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways.

- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor identify and resolve potential problems on a timely basis.
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by auditors of components and experts.

2.2 Developing an Audit Plan

Here, the work is focused at the assertion level and specific audit procedures are determined on an assertion-by-assertion basis.

The auditor shall develop an audit plan that shall include a description of:

(a) The nature, timing and extent of planned risk assessment procedures; and

(b) The nature, timing and extent of planned further audit procedures at the assertion level.

2.3 Documentation

The auditor shall include in the audit documentation:

(a) The audit plan; and

(b) Any significant changes made during the audit engagement to the audit plan, and the reasons for such changes.

CHAPTER 03 - IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement 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.

3.1 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment

The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

The risk assessment procedures shall include the following:

(a) Inquiries of management, and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.

(b) Analytical procedures.

(c) Observation and inspection.

3.2 The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

The Entity and Its Environment

The auditor shall obtain an understanding of the following:

(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework.

(b) The nature of the entity, including:

- (i) its operations;
- (ii) its ownership and governance structures;
- (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities;

and

(iv) the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

(e) The measurement and review of the entity's financial performance.

The Entity's Internal Control

The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Certain characteristics of a small entity — such as the concentration of decision-making power, limited segregation of duties and management override — may lead to an increased risk of misstatement in the financial statements due to fraud. On the other hand, management may be able to exercise more effective oversight than in a larger entity, thereby compensating for the generally more limited opportunities for segregation of duties. The auditor would need to evaluate the approach and attitude of management on a case-by-case basis in identifying the risks of material misstatement due to fraud. If, for example, management insists on authorizing key transactions, this may compensate for otherwise weak controls and reduce the risk of employee fraud.

Since small entities tend to take a less formal approach to internal control than large organizations, it may be difficult to distinguish these components in a small entity. The requirement, however, still applies, so the auditor must do what is possible to identify and understand them.

The control environment represents the collective effect of such factors as management philosophy and operating style, organizational structure, personnel policies and practices on establishing, enhancing or reducing the effectiveness of specific policies and procedures. The control environment reflects management's overall attitude, awareness, commitment and actions concerning the importance of internal control and its emphasis in the entity.

Factors affecting the control environment that have particular relevance to small entity audits and require particular attention, are:

- the entity's organizational structure;
- the competence of personnel; and
- the control consciousness of management.

The control activities are the policies and procedures that help ensure that management directives are carried out. An auditor must obtain an understanding of these activities to the extent considered necessary to assess the risk of material misstatement at the assertion level. The auditor does not have to obtain an understanding of all control activities, nor even all those carried out in important areas, but rather controls in areas that have the highest risk of material misstatement. The purpose of obtaining this understanding is to help in designing tests of controls where there is an expectation that the controls are effective.

In many cases in small entities, division of duties is often problematic, because of the limited numbers of people available. In these situations, however, the control objectives may sometimes be met through management oversight, which the auditor can assess as to its effectiveness. This is often the case for not-for-profit organizations.

Documentation

The auditor shall include in the audit documentation:

(a) The discussion among the engagement team, and the significant decisions reached;

(b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;

(c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level

(d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements

3.3 Audit Materiality

3.3.1 Introduction

This deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. The determination of materiality is a matter of professional judgement. In determining the materiality of an item, the auditor considers not only the nature of the item and the amount relates to the financial statements, but also the needs of the users of financial statements.

When establishing the overall audit plan, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

The calculation of materiality is needed at an early stage in audit planning so that effective substantive tests can be designed. Factors an auditor should consider when calculating materiality for the audit of a small entity include.

Often benchmarks could be used in determining for the financial statements as a whole based on the nature of the entity and relative volatility of that benchmarks. In case of a smaller entity, the materiality might be a percentage of revenue, assets, net assets or profit before tax.

Example

Revenue	0.5 – 1%
Net Assets	0.25 – 1%
Assets	0.5 – 1%
Profit before tax	10%

Source: from the Industry practices

If the auditor becomes aware of information during the audit that would have caused the auditor to determine a different materiality level, the materiality level shall be revised.

3.3.2 Documentation

The auditor shall include in the audit documentation the following amounts and the factors considered in their determination

(a) Materiality for the financial statements as a whole;

(b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;

(c) Performance materiality; and

(d) Any revision of (a)–(c) as the audit progressed.

CHAPTER 04 - THE AUDITOR´S RESPONSE TO ASSESSED RISKS

4.1 Overall Responses to Address the Assessed Risks of Material Misstatements at the Financial Statement Level

The auditor shall design and implement overall responses to address the assessed risks of material misstatements at the financial statement level and may include:

- emphasizing to the engagement team the need to maintain professional skepticism.
- assigning more experienced staff or those with special skills or using experts.
- providing more supervision.
- incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- making general changes to the nature, timing or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.

The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end. Deficiencies in the control environment, however, have the opposite effect; for example, the auditor may respond to an ineffective control environment by:

- Conducting more audit procedures as of the period end rather than at an interim date.
- Obtaining more extensive audit evidence from substantive procedures.
- Increasing the number of locations to be included in the audit scope.

4.2 Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

The auditor shall 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. This forms the basis for designing further audit procedures. When performing further audit procedures at an interim date, the auditor shall consider additional procedures for the remaining period.

In designing the further audit procedures, the auditor shall:

- consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:
    - the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (that is, the inherent risk); and
    - whether the risk assessment takes account of relevant controls (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (where the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures).
- obtain more persuasive audit evidence the higher the auditor's assessment of risk.

4.2.1 Tests of Controls

When the auditor plan to rely on controls, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of those controls that the auditor intends to rely on.

In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.

Considerations when performing test of controls:

- nature and extent of the controls
    - the period covered and how often the control has been performed

    - significant changes in the controls in the period
    - determine whether the controls to be tested depend upon other controls (indirect controls)

- timing of the test of controls
    - test controls for a selected period, or throughout the whole period
    - if only testing for a selected period, determine additional procedures for the period that are not tested

- evaluating the operating effectiveness of controls
    - the cause and potential consequences of any deviations detected
    - whether misstatements detected while performing substantive procedures indicate that controls are not operating effectively
    - the need for additional test of controls or other procedures to obtain appropriate audit evidence
    - whether the tests of controls that have been performed provide an appropriate basis for reliance on the controls

There may not be many control activities that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of control activities or of other components of control may make it impossible to obtain sufficient appropriate audit evidence.

If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

(a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;

(b) Additional tests of controls are necessary; or

(c) The potential risks of material misstatement need to be addressed using substantive procedures.

4.2.2 Substantive procedures

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level. Based on the auditor's judgment, substantive procedures are performed by testing the details of the transaction, disclosure or account balance, substantive analytical procedures or a combination of those.

Substantive procedures are designed and performed in response to assessed risks in order to obtain sufficient and appropriate audit evidence at the assertion level. Irrespective of the assessed risks, substantive procedures shall be performed for each material class of transactions, account balance, and disclosure.

Substantive procedures in response to identified significant risks shall be specifically designed to respond to that risk and those procedures shall include tests of details. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.

Further audit procedures in response to assessed risks shall always include substantive procedures:

- to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements;
- to address the risks of management override of controls;
- to address the risk caused by any identified events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, including:
    - evaluating management's plans for future actions in relation to its going concern assessment;
    - evaluate managements cash flow forecast, and analyze significant factors affecting management's plans for future action;
    - consider whether any additional facts or information have

    become available since the date on which management made its assessment; and

    - request written representations from management and, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans;

- as a retrospective review of management judgments and assumptions in relation to significant accounting estimates reflected in prior years financial statements; and
- in relation to the financial statement closing process for:
    - agreeing or reconciling the financial statements with the underlying accounting records;
    - examining material journal entries and other adjustments made during the course of preparing the financial statements; and
    - evaluating whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework.

Considerations when designing substantive procedures to address risks identified:

- Fraud risk;
    - the appropriateness of journal entries in the general ledger and other adjustments made in the preparation of the financial statements;
    - whether there is a need to test journal entries in the general ledger and other adjustments made throughout the period; and
    - the business rationale for significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.
- Going concern;
    - management's assessment as to the entity's ability to continue as a going concern;

  - covenants or other circumstances that may affect management in their assessment; or whether any additional facts or information have become available since the date on;
  - which management made its assessment; and
  - when material uncertainty exist, the effect this may have on fraud risk, including managements involvement in the preparation of accounting estimates and in applying accounting policies.

- Laws and regulations;
  - applicable laws and regulations.

- Accounting estimates;
  - the method used and consistency in the method used by management in preparing the accounting estimate, input and assumptions on which it is based, including estimation uncertainty;
  - historical accuracy in estimates made by management in prior periods;
  - potential biases in the estimates and an evaluation whether the circumstances producing the bias, if any, represents a risk of material misstatement due to fraud;
  - whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate; and
  - In obtaining audit evidence, the auditor may need to focus on inquiries and discussion with the owner-manager early in the audit process about the nature of any accounting estimates, the completeness of the required accounting estimates, and the adequacy of the estimating process may assist the owner-manager in determining the need to use an expert.

- Related parties;
  - arrangements or information suggesting the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor;
  - the business rationale for significant transactions involving related parties; and
  - the terms of transactions.

4.2.2.1 Substantive Analytical Procedures

The objectives of the auditor are:

(a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and

(b) To 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.

When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures, the auditor shall:

(a) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;

(b) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;

(c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and

(d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Analytical Procedures that Assist When Forming an Overall Conclusion

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.

Investigating Results of Analytical Procedures

If analytical procedures performed in accordance with this ISA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(a) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

(b) Performing other audit procedures as necessary in the circumstances.

There are a number of possible techniques that can be used to perform the analytical procedures. The objective is to select the most appropriate technique to provide the intended levels of assurance and precision. Techniques include: Ratio analysis, Trend analysis, Break-even analysis, Pattern analysis and Regression analysis.

4.2.2.2 Test of details

When performing test of details to address assessed risks at assertion level the auditor shall, using professional judgment, design the nature, timing and the extent of the procedure to identify the misstatements and reduce the audit risk to an acceptable level. A test of details can be performed by inspections, recalculation or external confirmations. When selecting items for a test of details the auditor can either select all items, specific items or base the selection of items on audit sampling techniques.

When performing audit sampling the auditor shall determine the sample size sufficient to reduce the risk to an acceptably low level and select items in a way that each sampling unit in the population has a chance of selection. Identified misstatements in the sample shall be investigated as to their nature and cause, and their effect on the audit. Misstatements in the sample, excluding misstatements that do not affect the remaining population, shall be projected to the population.

When performing external confirmations, the auditor shall determine the extent of confirmations, select the confirming parties, send the requests and receive the responses directly from the confirming party. The auditor shall maintain control over the external confirmations and follow up on the confirming party when applicable.

4.3 Evaluation

When the auditor has performed the audit procedures designed to respond to the assessed risks of material misstatement at the assertion level, evaluations shall be made as to the whether sufficient appropriate audit evidence is obtained to be able to draw reasonable conclusions on which to base the auditor's opinion for relevant assertions, including evaluation of identified misstatements.

When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

4.3.1 Evaluation of misstatements identified during the audit

Throughout the audit, the auditor shall accumulate misstatements identified, other than those that are clearly trivial. The auditor shall determine the nature and cause of each identified misstatement, including whether the misstatements may indicate fraud, and their potential effect on the risk assessment and the audit plan.

The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, and where appropriate, those charged with governance, and request those misstatements to be corrected. If some or all of the misstatements are not corrected, the auditor shall obtain an understanding of the reasons for not making the corrections and shall consider that understanding when evaluating whether the financial statements as a whole are free from material misstatement.

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

- the size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence;
- the potential reaction of the misstatements form the users of the financial statement; and
- the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

The auditor shall communicate with management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.

4.3.2 Evaluating the Sufficiency and Appropriateness of Audit Evidence

Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate.

The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. When evaluating the sufficiency of the audit evidence the auditor shall consider if the nature and cause of identified misstatements indicate that other misstatements may exist that when aggregated could be material.

In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.

If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain additional audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or issue a disclaimer on the financial statements.

CHAPTER 05 - AUDIT EVIDENCE

The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

5.1 Information to be Used as Audit Evidence

When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

(a) Evaluate the competence, capabilities and objectivity of that expert;

(b) Obtain an understanding of the work of that expert; and

(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary in the circumstances:

(a) Obtaining audit evidence about the accuracy and completeness of the information; and

(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

5.2 Selecting Items for Testing to Obtain Audit Evidence

When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure.

Inconsistency in, or Doubts over Reliability of, Audit Evidence, if:

(a) audit evidence obtained from one source is inconsistent with that obtained from another; or

(b) the auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

5.3 Audit Evidence—Specific Considerations for Selected Items

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

(a) Existence and condition of inventory;

(b) Completeness of litigation and claims involving the entity; and

(c) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

5.3.1 Inventory

If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

  (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

  (ii) Observe the performance of management's count procedures;

  (iii) Inspect the inventory; and

  (iv) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

5.3.2 Litigation and Claims

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;

(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and

(c) Reviewing legal expense accounts.

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other ISAs, seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.

If:

(a) management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and

(b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor shall modify the opinion in the auditor's report

5.4 Initial Audit Engagements—Opening Balances

Objective

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

(a) Opening balances contain misstatements that materially affect the current period's financial statements; and

(b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

5.4.1 Audit Procedures on Opening Balances

The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;

(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

(c) Performing one or more of the following:

   (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;

   (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or

   (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

5.5 Confirmations

Confirmation of the year's transactions can occasionally be obtained from third parties, for example, purchases from major suppliers or grants received from major agencies. This procedure is particularly useful in small entities that have purchase or sale transactions with one or a few major suppliers or customers. Direct confirmation of transactions with the supplier or customer would provide the best evidence of completeness.

5.6 Written Representation

The auditor shall evaluate the need to obtain written representations to confirm certain matters or to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements. When evaluating the need for written representation, the auditor considers;

- the extent of audit evidence obtained by oral representation;
- existence of material uncertainty for going concern;
- estimates with high degree of estimation uncertainty;
- existence of related parties and related party transactions; and
- if managements responsibility for the preparation of the financial statement in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation is defined in law or covered in other ways.

Unless the responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation is clearly defined in law or covered in other way, for example by managements signature on the financial statements, the auditor shall obtain written representation on this matter.

The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.

5.7 Going Concern

The size of an entity affects its ability to withstand adverse conditions. Small entities can respond quickly to exploit opportunities, but may lack reserves to sustain operations.

Auditor should considers whether there are any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Conditions of particular relevance to small entities include the risk that banks and other lenders may cease to support the entity, the possibility of the loss of a principal supplier, major customer or key employee, and the possible loss of the right to operate under a license, franchise or other legal agreement.

Auditor may require to perform audit procedures that may be relevant when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern. Such procedures may include a review of documentation such as cash flows and profit forecasts. In the audit of a small entity, the auditor does not ordinarily expect to find detailed forecasts relevant to the consideration of going concern. Nevertheless, the auditor discusses with the owner-manager the going concern status of the entity and, in particular, the financing of the entity in the medium and long-term. The auditor considers these discussions in the light of corroborative documentation and the auditor's knowledge of the business. The auditor seeks written representation from the owner-manager of the matters identified.

Where the small entity is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. For example, the continuance of a small entity in financial difficulty may be dependent on the owner-manager subordination his loan to the entity in favor of banks or other financial institutions. In such circumstances the auditor inspects appropriate, documentary evidence of the subordination of the owner-manager's loan. Where an entity is dependent on additional support from the owner-manager, the auditor considers the owner-manager's ability to meet the obligation under the support arrangement. In addition, the auditor may ask for a written representation confirming the owner-manager's intention or understanding.

CHAPTER 06 - CONCLUDING AND REPORTING

6.1 Introduction

This section deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.

6.1.1 Objectives

The objectives of the auditor are:

i. To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and

ii. To express clearly that opinion through a written report.-

6.1.2 Basic Elements of the Auditors Report.

The Auditors report shall be in writing

i. ***Title*** - *The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor*

ii. ***Addressee*** - *The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement.*

iii. ***Basis for Opinion***

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

(a) States that the audit was conducted in accordance with Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs).

(b) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

iv. ***Auditor’s opinion** - The Opinion section of the auditor’s report shall also:*

(a) Identify the entity whose financial statements have been audited;

(b) State that the financial statements have been audited;

(c) Identify the title of each statement comprising the financial statements;

(d) Refer to the notes, including the summary of significant accounting policies; and

(e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

(f) When expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the auditor’s opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- In our opinion, the accompanying financial statements present fairly, in all material respects, […] in accordance with Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities). *(as applicable)* ; or
- In our opinion, the accompanying financial statements give a true and fair view of […] in accordance with Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities). *(as applicable)*

(g) When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor’s opinion shall be that the accompanying financial statements give a true and fair view of *(or present fairly, in all material respects)* in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities). *(as applicable))*

v. ***Auditor's and the management Responsibilities for the Financial Statements***

The Management is responsible for preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*. Our responsibility is to express an opinion on these financial statements, based on our Audit.

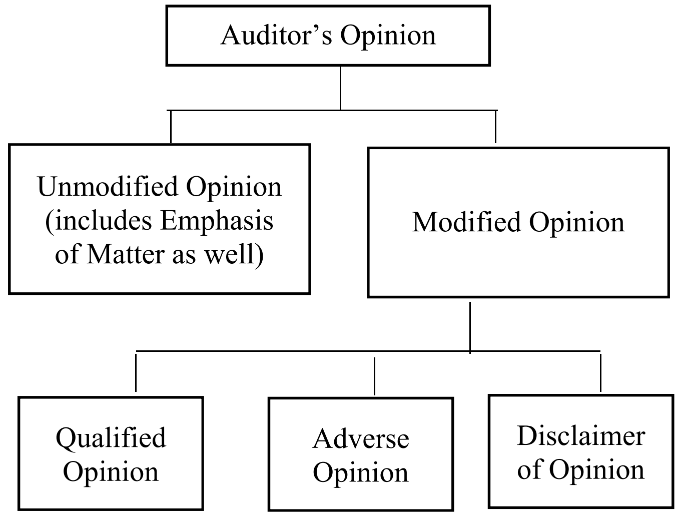
vi. ***Report on Other Legal and Regulatory Requirements*** (This section applies only for the Companies registered under the Companies Act No: 07 of 2007)

vii. ***Signature of the Auditor***

viii. ***Auditor's Address***

ix. ***Date of the Auditor's Report***

6.2 Auditor's Opinion



6.2.1 Unmodified Opinion

Emphasis of Matter or other matter paragraph

(a) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

(b) Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Including an Emphasis of Matter Paragraph in the Auditor's Report

The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for:

(a) A modified opinion when required by the circumstances of a specific audit engagement;

(b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or

(c) Reporting a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

Including an Other Matter Paragraph in the Auditor's Report

The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other professional standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.

Illustration 1 – Unmodified Audit Opinion

Report on the Audit of the Financial Statements

To the Shareholders of ABC Company [or Other Appropriate Addressee]

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of income, statement of changes in equity and (statement of cash flows) for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Basis for Opinion

We conducted our audit in accordance with Sri Lanka Auditing Standard

(SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs), which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An Audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the management, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the accompanying financial statements give a true and fair view of *(or present fairly, in all material respects)* the financial position of the Company as at December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable).*

Respective Responsibilities of Management and Auditors.

The Management is responsible for maintaining proper accounting records, preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*. Our responsibility is to express an opinion on these financial statements, based on our Audit.

Report on Other Legal and Regulatory Requirements[1]

As required by section 163 (2) of the Companies Act No. 07 of 2007, and as far as appears from our examination, proper accounting records have been kept by the Company.

[*Signature in the name of the audit firm*] [*Audit Firm Address*]
[*Date*]

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1 This section applies only for the Companies registered under the Companies Act No: 07 of 2007.

6.2.2 Types of Modified Opinions

The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	*Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements*	
	Material but Not Pervasive	*Material and Pervasive*
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

6.2.2.1 Qualified Audit Opinion

Illustration 2 – Qualified Audit Opinion

Report on the Audit of the Financial Statements

To the Shareholders of ABC Company [or Other Appropriate Addressee]

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of income, statement of changes in equity and (statement of cash flows) for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Basis for qualified Opinion

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. 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.

We conducted our audit in accordance with Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs), which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An Audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the management, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our qualified audit opinion. As far as appears from the examination of them, we believe that our audit provides a reasonable basis for our opinion.

Qualified Opinion

In our opinion, except for the effects for the matter described in the Basis for qualified opinion section of our report the accompanying financial statements give a true and fair view of *(or present fairly, in all material respects)* the financial position of the Company as at December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable).*

Respective Responsibilities of Management and Auditors.

The Management is responsible for maintaining proper accounting records, preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable))*. Our responsibility is to express an opinion on these financial statements, based on our Audit.

Report on Other Legal and Regulatory Requirements[1]

As required by section 163 (2) of the Companies Act No. 07 of 2007, except for the matter referred in basis for qualified audit opinion paragraph we have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Company.

[*Signature in the name of the audit firm*] [*Audit Firm Address*]

[*Date*]

[1] This section applies only for the Companies registered under the Companies Act No: 07 of 2007.

6.2.2.2 Modified Opinion (Adverse Opinion)

Illustration 3 – Adverse Audit Opinion

Report on the Audit of the Financial Statements

To the Shareholders of ABC Company [or Other Appropriate Addressee]

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of income, statement of changes in equity and (statement of cash flows) for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Basis for Adverse Opinion

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. 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.

We conducted our audit in accordance with Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs), which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An Audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the management, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the basis for adverse opinion section of the report, the accompanying financial statements do not give a true and fair view of *(or do not present fairly, in all material respects)* the financial position of the Company as at December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities). *(as applicable).*

Respective Responsibilities of Management and Auditors

The Management is responsible for maintaining proper accounting records, preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*. Our responsibility is to express an opinion on these financial statements, based on our Audit.

Report on Other Legal and Regulatory Requirements[1]

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

[*Signature in the name of the audit firm*] [*Audit Firm Address*]

[*Date*]

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[1] This section applies only for the Companies registered under the Companies Act No: 07 of 2007

6.2.2.3 Modified Opinion (Disclaimer of Opinion)

Illustration 4 – Disclaimer of Audit Opinion

Report on the Audit of the Financial Statements

To the Shareholders of ABC Company [or Other Appropriate Addressee]

We were engaged to audit the accompanying financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of income, statement of changes in equity and (statement of cash flows) for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Basis for Disclaimer of Opinion

We were initially appointed auditors on (date) which was subsequent to the end of the Company's financial year. In consequence we were unable to carry out auditing procedures necessary to obtain adequate assurance regarding the quantities and condition of inventories and work in progress, appearing in the balance sheet at Rs. xxxx. There were no other satisfactory audit procedures that we could adopt to obtain sufficient evidence regarding the existence of inventories and work in progress. Accordingly, we have not been able to obtain sufficient appropriate audit evidence to provide a basis.

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of the company, because of the significance of the matter discussed in the basis for disclaimer of opinion section of the report. We have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Respective Responsibilities of Management and Auditors.

The Management is responsible for maintaining proper accounting records, preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) *(as applicable)*.

Our responsibility is to express an opinion on these financial statements, based on our Audit. We conducted our audit in accordance with Sri Lanka Auditing Standard (SLAuS) for the Audits of Non – Specified Business Enterprises (Non-SBEs), which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An Audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the Management, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standard for Small and Medium-sized Entities (or Sri Lanka Accounting Standard for Smaller Entities) (as applicable).

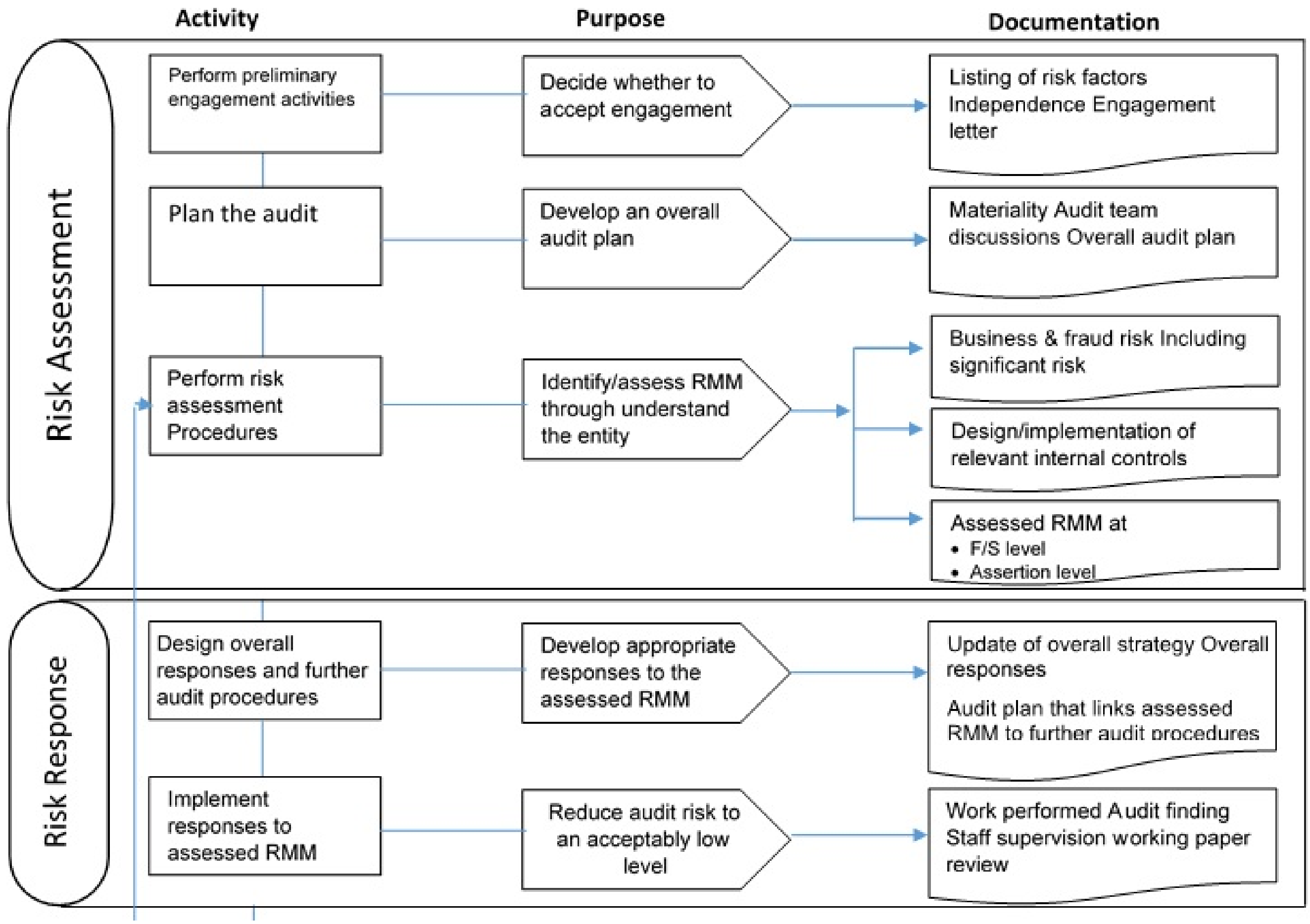
Report on Other Legal and Regulatory Requirements[1]

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

[*Signature in the name of the audit firm*] [*Audit Firm Address*]

[*Date*]

[1] This section applies only for the Companies registered under the Companies Act No: 07 of 2007


Activity
Purpose
Documentation
Risk Assessment
Perform preliminary engagement activities
Decide whether to accept engagement
Listing of risk factors Independence Engagement letter
Plan the audit
Develop an overall audit plan
Materiality Audit team discussions Overall audit plan
Perform risk assessment Procedures
Identify/assess RMM through understand the entity
Business & fraud risk Including significant risk
Design/implementation of relevant internal controls
Assessed RMM at
F/S level
Assertion level
Risk Response
Design overall responses and further audit procedures
Develop appropriate responses to the assessed RMM
Update of overall strategy Overall responses
Audit plan that links assessed RMM to further audit procedures
Implement responses to assessed RMM
Reduce audit risk to an acceptably low level
Work performed Audit finding Staff supervision working paper review

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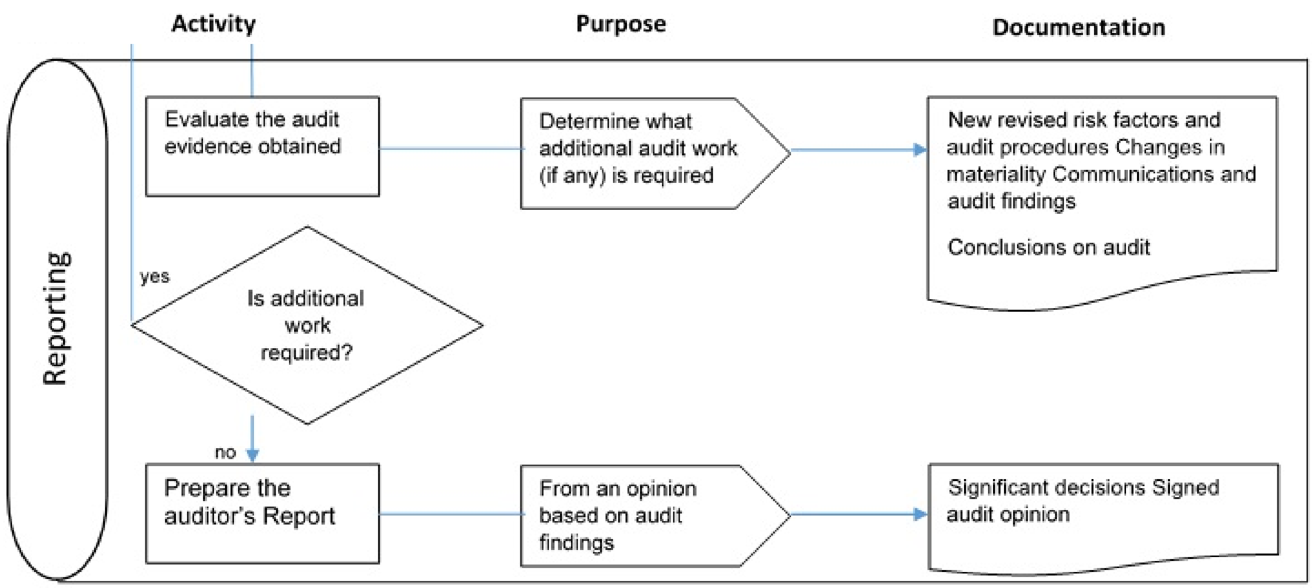

Activity
Purpose
Documentation
Reporting
Evaluate the audit evidence obtained
Determine what additional audit work (if any) is required
New revised risk factors and audit procedures Changes in materiality Communications and audit findings
Conclusions on audit
yes
Is additional work required?
no
Prepare the auditor's Report
From an opinion based on audit findings
Significant decisions Signed audit opinion

Appendix 2 - Glossary

Accounting estimate: An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation.

Accounting records: The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

Analytical procedures: 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.

Applicable financial reporting framework: 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 that is required by law or regulation.

Appropriateness (of audit evidence): The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

Assertions: Representations 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. Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms:

a) Assertions about classes of transactions and events for the period under audit:

   i. *Occurrence*—transactions and events that have been recorded have occurred and pertain to the entity;

ii. *Completeness*—all transactions and events that should have been recorded have been recorded;

iii. *Accuracy*—amounts and other data relating to recorded transactions and events have been recorded appropriately;

iv. *Cutoff*—transactions and events have been recorded in the correct accounting period;

v. *Classification*—transactions and events have been recorded in the proper accounts.

b) Assertions about account balances at the period end:

i. *Existence*—assets, liabilities, and equity interests exist;

ii. *Rights and obligations*—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity;

iii. *Completeness*—all assets, liabilities and equity interests that should have been recorded have been recorded;

iv. *Valuation and 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 and disclosure:

i. *Occurrence and rights and obligations*—disclosed events, transactions, and other matters have occurred and pertain to the entity.

ii. *Completeness*—all disclosures that should have been included in the financial statements have been included.

iii. *Classification and understandability*—financial information is appropriately presented and described, and disclosures are clearly expressed.

iv. *Accuracy and valuation*—financial and other information are disclosed fairly and at appropriate amounts.

Audit documentation: The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “work papers” are also sometimes used).

Audit evidence: Information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Appropriateness (of audit evidence): The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based.

Sufficiency (of audit evidence): The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor’s assessment of the risks of material misstatement and also by the quality of such audit evidence.

Audit file: One or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

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

Audit sampling (sampling): The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

Business risk: A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

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.

Emphasis of Matter paragraph: A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Engagement partner- The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Engagement team: All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.

Exception: A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

Experienced auditor: An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:

a. Audit processes;

b. Auditing standards and applicable legal and regulatory requirements;

c. The business environment in which the entity operates; and

d. Auditing and financial reporting issues relevant to the entity's industry.

External confirmations: 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.

Estimation uncertainty: The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

Financial statement level risk: 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.

Fraud: An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Internal control: The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.

Management: The person(s) with executive responsibility for the conduct of the entity's operations.

Management's expert: An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

Management bias: A lack of neutrality by management in the preparation of information.

Misstatement: A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.

Misstatements can arise from error or fraud. To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgmental misstatements and projected misstatements.

Factual misstatements: are misstatements about which there is no doubt.

Judgmental misstatements: are differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate.

Projected misstatements: are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.

Modified opinion: A qualified opinion, an adverse opinion or a disclaimer of opinion.

Non-compliance: Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

Opening balances: Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

Other matter paragraph: A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Pervasive: A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

a) Are not confined to specific elements, accounts or items of the financial statements;

b) If so confined, represent or could represent a substantial proportion of the financial statements; or

c) In relation to disclosures, are fundamental to users' understanding of the financial statements.

Population: The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

Preconditions for an audit: The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

Professional judgment: The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional skepticism: An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence.

Public Accountability: An entity has public accountability if:

(a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

Reasonable assurance: A high, but not absolute, level of assurance.

Related party: A party that is either:

a) A related party as defined in the applicable financial reporting framework; or

b) Where the applicable financial reporting framework establishes minimal or no related party requirements:

    i. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;

    ii. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or

iii. Another entity that is under common control with the reporting entity through having:

a) Common controlling ownership;

b) Owners who are close family members; or

c) Common key management.

However, entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

Risk assessment procedures: The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Risk of material misstatement: 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 transaction, 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 internal control.

Sampling unit: The individual items constituting a population.

Significant risk: An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Subsequent events: Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

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.

Tests of controls: An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Those charged with governance: The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

Uncorrected misstatements: Misstatements that the auditor has accumulated during the audit and that have not been corrected.

Unmodified opinion: The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Written representation: A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.