ISSAI 200

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INTOSAI

Fundamental Principles of Financial Auditing

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INTOSAI Professional Standards Committee

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INTRODUCTION

1. Professional standards and guidelines are essential for the credibility, quality and professionalism of public sector auditing. The International Standards of Supreme Audit Institutions (ISSAIs) developed by the International Organisation of Supreme Audit Institutions (INTOSAI) aim to promote independent and effective auditing and support the members of INTOSAI in the development of their own professional approach in accordance with their national laws and regulations and mandate.

2. ISSAI 100, Fundamental Principles of Public Sector Auditing, includes the fundamental principles for public sector auditing in general. ISSAI 200, Fundamental Principles of Financial Auditing, have been developed to address the key principles related to an audit of financial statements in the public sector and builds on the fundamental principles of ISSAI 100 and develops some of them further to suit the specific context of audits of financial statements. ISSAI 200 constitutes the basis for auditing standards related to audits of financial statements. ISSAI 200 has to be read and understood in conjunction with ISSAI 100. The principles of ISSAI 100, including specifically those relating to ethics, independence and quality control, also apply to financial auditing.

3. ISSAI 200 contributes to enhance confidence in the public sector by promoting good governance and sound management of the execution of public budgets and the reporting thereof.

4. This ISSAI provides detailed information on the following:
   - The purpose and authority of the Fundamental Principles of Financial Auditing
   - Framework for Auditing Financial Statements in the Public Sector
   - The elements of an audit of Financial Statements
   - The principles of an audit of Financial Statements.

PURPOSE AND AUTHORITY OF THE FUNDAMENTAL PRINCIPLES OF FINANCIAL AUDITING

5. ISSAI 200 Fundamental Principles of Financial Auditing represent the core of the detailed auditing standards contained on level 4 of the ISSAI framework (e.g., ISSAIs 1000 to 1810). The principles in ISSAI 200 can be used in two ways:
   - To form the basis on which standards are developed or consistent national standards are adopted.
   - To form the basis for adoption of the Financial Auditing Guidelines (ISSAI 1000-1810) as the authoritative standards.

6. Accordingly, ISSAI 200 provides the basic principles for adoption of, or development of, standards and guidelines relevant to financial audits in the public sector. ISSAI 200 constitutes principles and should not be applied as authoritative standards. SAIs may choose to develop or adopt national standards based on or consistent with these fundamental auditing principles. However, ISSAIs 1000 – 1810 represents how the Fundamental Auditing Principles can be applied and SAIs are encouraged to adopt them as authoritative standards.

7. Reference to ISSAI 200 in audit reports or auditor’s reports should only be made if auditing standards are in place and only if the standards developed or adopted fully comply with all relevant principles of ISSAI 200. A principle is considered relevant when it deals with the type of audit or combinations of audit types and the circumstance or procedure is applicable. The

principles do not override national laws, regulations or mandates. SAIs adopting the ISSAIs on level 4[1] as their authoritative standards makes reference to these in their reports.

8. The ISSAIs on Financial Audit on level 4 are intended to support the application of auditing standards based on the fundamental principles in providing more detailed guidance supporting the principles in the Fundamental Principles of Financial Auditing. They include the International Standards of Auditing (ISA) and together with the additional public sector application guidance they reflect best practice.

9. When adopting or developing audit standards based on the Fundamental Principles reference to these in the auditor's report may be done by stating;
... We conducted our audit in accordance with [national standards] based on (or consistent with) the INTOSAI Fundamental Auditing Principles (ISSAI 100-999) of the International Standards of Supreme Audit Institutions.

10. Auditors in some jurisdictions may choose to apply the Financial Audit Guidelines as the authoritative standards on which they conduct their audits. Reference to the use of them as standards can, depending on the standards applied and the SAI's mandate, be done in two ways:

(a) In accordance with the ISSAIs (1000-1810); this means full compliance with all relevant ISAs and the additional guidance set out in the INTOSAI Practice Notes to the ISAs

(b) In accordance with the ISAs; this includes compliance with all relevant ISAs

11. When the ISSAIs on the level 4 are used as authoritative standards, auditors of public sector entities also respect the authority of the ISAs. SAIs are encouraged to strive to full adoption of the guidelines on level 4 as their authoritative standards. They have been developed to reflect best practice. INTOSAI recognizes that in some environments this might not be possible due to lack of basic requirements in government structure or due to laws or regulations that will not allow for the premises attached to an audit of financial statements in accordance with level 4. In such cases, SAIs in such environments have the option to develop authoritative standards based on the Fundamental Principles of Financial Auditing.

12. Public sector auditors who state in their auditor's report on a set of financial statements that the audit has been conducted in accordance with the ISAs are also encouraged to apply the additional public sector guidance in ISSAIs 1000-1810. Where public sector auditors have additional audit and reporting responsibilities, references to other applicable standards will also be necessary.

13. When the ISSAIs on level 4 are used as authoritative standards for an audit of financial statements conducted together with a compliance audit, auditors of public sector entities respect the authority of both the Financial Audit Guidelines and the Compliance Audit Guidelines[2].

[1] ISSAI 1000-1810, The Financial Audit Guidelines.

[2] ISSAI 4000 General Introduction to Guidelines on Compliance Audit, and ISSAI 4200 Compliance Audit Guidelines Related to Audit of Financial Statements.

14. The main purpose of the ISSAIs on financial audits is to provide INTOSAI members with a comprehensive set of principles, standards and guidelines for the audit of financial statements of public sector entities. The ISSAIs on financial audit includes ISSAI 200 and 1000 to 1810. ISSAI 1000 to 1810 include Practice Notes developed by INTOSAI in addition to the International Standards on Auditing (ISAs) developed by the International Auditing and Assurance Standards Board (IAASB). The Practice Note and ISA together constitute a guideline in the ISSAI standards framework.

15. ISSAIs 1000 to 1810 provides guidance for audits of financial statements as defined in ISSAI 1200 and address additional public sector audit considerations. The audit and reporting responsibilities of SAIs related to financial audits may include additional aspects of legality and regularity. In the public sector, audits of financial statements will often be combined with audits of compliance with authorities. The ISSAIs on Compliance Audit[3] addresses such additional auditing and reporting responsibilities. Audit of compliance is the independent assessment of whether a particular subject matter is in compliance with applicable authorities identified as criteria. Compliance auditing is performed by obtaining assurance as to whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the audited entity.

16. ISSAI 200 provides the fundamental principles relevant for an audit of financial statements prepared in accordance with a Financial Reporting Framework. The principles are also applicable for circumstances when SAIs are engaged or have responsibilities to audit single financial statements and specific elements, accounts, or items of a financial statement and financial statements prepared in accordance with special purpose financial frameworks as well as summary financial statements. When reference are made in ISSAI 200 to audits of financial statements this includes such responsibilities.

17. ISSAIs 1000 to 1810 for financial audits may be applied as appropriate to such responsibilities. However, auditors are prohibited from making reference to the use of the ISSAIs if:
    - the preconditions for an audit in accordance with the ISSAI[4]s for financial audit not are in place
    - the auditor is not able to comply with the authority attached to the ISAs[5]and ISSAIs

18. The scope of financial audits for a public sector auditing function may be further defined by the mandate as a range of objectives that are to be audited, including not only financial statements prepared in accordance with a Financial Reporting Framework but also include objectives such as:
    - States' or entities' accounts or other financial reports not necessary prepared in accordance with a Financial Reporting Framework;
    - Budgets, budget sections, appropriations and other decisions on allocation and the implementation thereof;
    - Policies, programmes or activities defined by their legal basis or source of financing;
    - Legally defined areas of responsibility, such as the responsibilities of ministers; and
    - Categories of income or payments or assets or liabilities.

[3] ISSAI 400 Fundamental Principles of Compliance Auditing, ISSAI 4000 General Introduction to Guidelines on Compliance Audit, and ISSAI 4200 Compliance Audit Guidelines Related to Audit of Financial Statements.
[4] ISSAI 1210 Agreeing the Terms of Audit Engagements, paragraphs 6-8.
[5] ISSAI 1000 – paragraphs 37-43.

19. When mandate defines such objectives SAIs may also need to consider development or adoption of standards based on the general fundamental principles on public sector auditing in ISSAI 100 and the fundamental principles on compliance and performance auditing.. The guidance in the ISSAIs on level 4 that apply to special purpose frameworks[6], audits of single financial statements and specific elements, accounts, or items of a financial statement[7], and reports on summary financial statements[8], may also be relevant for parts of such purposes.

FRAMEWORK FOR AUDITING FINANCIAL STATEMENTS IN THE PUBLIC SECTOR

Objective

20. The purpose of an audit of financial statements is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with the framework. Laws or regulations for public sector audit organizations may prescribe the use of other wordings for expressing the opinion. An audit conducted in accordance with standards based on INTOSAI Fundamental Principles for Financial Auditing and relevant ethical requirements enables the auditor to express such an opinion.

21. ISSAI 200 is based on the objective as defined in ISSAI 1200[9] as follows:

In conducting an audit of financial statements, the overall objectives of the auditor are:

(a) 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

(b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

Public Sector Applications covered by ISSAI 200

[6] ISSAI 1800 Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks .

[7] ISSAI 1805 Special Considerations – Audits of single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement.

[8] ISSAI 1810 Engagements to Report on Summary Financial Statements .

[9] ISSAI 1200 paragraph 11 of ISA 200.

Premises for an audit of financial statements in accordance with the ISSAIs

22. **The auditor should respect the premise on which an audit of financial statements is conducted.**

23. A financial audit conducted in accordance with ISSAIs is premised on the following conditions:
    - The financial reporting framework used for preparation of the financial statements is deemed to be acceptable by the auditor.
    - Management of the entity acknowledges and understands its responsibility:
        - For the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;
        - For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
        - To provide the auditor with unrestricted access to all information of which management is aware that is relevant to the preparation of the financial statements.

24. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements and the auditor does not have suitable criteria for auditing the financial statements. Suitable criteria can be formal, for example in the preparation of financial statements; the criteria may be International Public Sector Accounting Standards (IPSASs), the International Financial Reporting Standards (IFRSs), or other national financial reporting frameworks for use in the public sector.

25. A complete set of financial statements for a public sector entity prepared in accordance with a financial reporting framework for the public sector normally comprise:
    - A statement of financial position;
    - A statement of financial performance;
    - A statement of changes in net assets/equity;
    - A cash flow statement;
    - A comparison of budget and actual amounts either as a separate additional financial statement or as a reconciliation;
    - Notes, comprising a summary of significant accounting policies and other explanatory information
    - In certain environments a complete set of financial statements according to the financial reporting framework may also include other reports such as reports on performance and appropriation reports.

    If the financial statements are prepared on cash basis of accounting, in accordance with a framework for cash basis of accounting, a complete set of financial statements may not comprise all these statements.

26. For environments that do not have authorized or recognized standard-setting organizations or financial reporting frameworks prescribed by law or regulation, appendix 2 to ISSAI 1210[10], may provide assistance for the auditor in determining whether the financial reporting framework is acceptable. Reference to the ISSAIs, in accordance with the authority of this

[10] ISSAI 1210 Agreeing the Terms of Audit Engagements.

ISSAI, should not be made in the auditor's report if the auditor assesses the reporting framework as not being acceptable. In such cases, the auditor may use the ISSAIs on financial audits as guidance for the audit process, but may not make reference to them in the report.

27. Acceptable financial reporting frameworks normally exhibit the following attributes that result in information provided in financial statements that is useful to the intended users:
- Relevance, in that the information provided in the financial statements is relevant to the nature of the audited entity and the purpose of the financial statements.
- Completeness, in that transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are not omitted.
- Reliability, in that the information provided in the financial statements:
  (i) Where applicable, reflects the economic substance of events and transactions and not merely their legal form; and
  (ii) Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances.
- Neutrality and objectivity, in that it contributes to information in the financial statements that is free from bias.
- Understandability, in that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretation.

28. In some public sector audit environments, financial audits are referred to as budget execution audits, which often include the examination of transactions against the budget for compliance and regularity issues. Such audits may be undertaken on a risk basis or with the ambition to cover all transactions. In such audit environments there is often a lack of an acceptable financial reporting framework. The result of financial transactions may be presented in the format of expenditure amounts compared to budgetary figures. In environments where such audits are undertaken and there are no financial statements presented in accordance with a general purpose financial reporting framework, auditors need to determine whether the financial statements is prepared on the basis of an acceptable special purpose financial reporting framework. If that is not the case, the underlying premises of an audit in accordance with the ISSAIs on financial audit are not in place. Auditors in such environments may consider developing standards using the fundamental principles on financial auditing as guidance to suit their specific needs. In such cases reference should not be made to the Fundamental Principles of Financial Auditing.

29. The type of audit carried out in environments where compliance with authorities is the main focus of the audit would normally be considered a compliance audit. ISSAI 400, Fundamental Principles on Compliance Auditing may be a relevant source of information for the development or adoption of standards for the audit work. If on the other hand, the audit mandate allows for a change in audit procedures and the use of acceptable financial reporting frameworks is introduced, with financial statements being prepared in accordance with such acceptable financial reporting framework, the ISSAIs on financial auditing may be adopted in the future.

30. In cases where the audit mandate refers to financial audit not directed to financial statements prepared in accordance with a financial reporting framework, it is suggested that the ISSAIs are considered best available practice and the spirit of those are implemented in specific

standards that apply for the specific environment. ISSAIs 1805[11] may be relevant to consider for audits of elements of financial statements.

Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

31. The principles of ISSAI 200 are applicable to audits of financial statements prepared in accordance with both general purpose frameworks and special purpose frameworks. A special purpose framework is a framework designed to meet the financial information needs of specific users. In addition to preparing general purpose financial statements, a public sector entity may prepare financial statements for other parties (such as governing bodies, the legislature or other parties that perform an oversight function) that can demand financial statements tailored to meet their specific information needs. In some environments such financial statements are the only financial statements prepared by the public sector entity. Even when such financial statements are the only financial statements prepared by the public sector entity, they are considered to be special purpose financial statements. Auditors, therefore, need to carefully examine whether the financial reporting framework is designed to meet the financial information needs of a wide range of users ("general purpose framework") or the financial information needs of specific users or the requirements of a standard setting body.

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

33. The principles of ISSAI 200 are relevant for audits of financial statements prepared in accordance with such frameworks. In addition to the principles, SAIs may find it useful to consider the requirements and guidance in ISSAI 1800, which deals with special considerations in the application of ISSAIs and ISAs to an audit of financial statements prepared in accordance with a special purpose framework, when developing or adapting standards based on ISSAI 200 principles.

Audits of Single Financial Statements, Specific Elements, Accounts or Items of a Financial Statement

34. The principles of ISSAI 200 are also applicable for audits of public sector entities preparing financial information, including single financial statements, specific elements, accounts or items of a financial statement for other parties (such as governing bodies, the legislature or other parties that perform an oversight function). Such information may fall under the audit mandate of a public sector audit organization. Auditors may also be engaged to audit single

[11] ISSAI 1805 Special Considerations – Audits of single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement.

financial statements, specific elements, accounts or items such as to audit projects financed by the government in organizations in which they are not engaged to audit the complete set of financial statements with the legislature or those with responsibility to direct the audit organization.

35. In addition to consideration of the principles of ISAI 200, SAIs may find it useful to consider the requirements and guidance in ISSAI 1805 when developing or adapting standards based on the principles in ISSAI 200. ISSAI 1805 deals with special considerations in the application of the requirements of the ISAs to an audit of a single financial statement or of a specific element, account or item of a financial statement. The single financial statement or the specific element, account or item of a financial statement may be prepared in accordance with either a general or a special purpose framework.

ELEMENTS OF AN AUDIT OF FINANCIAL STATEMENTS

36. An audit of financial statements is defined as an assurance engagement. Assurance engagements involve at least three separate parties: an auditor or auditor, a responsible party and intended users. The elements of public sector auditing are described in ISSAI 100[12]. ISSAI 200 provides some additional aspects of the elements relevant for an audit of financial statements.

Responsible Party

37. In an assertion-based engagement, such as an audit of financial statements, the responsible party is responsible for the subject matter information, normally the financial statements, and may also be responsible for the underlying subject matter (the financial activities undertaken and reflected in the financial statements). The responsible party is normally the executive branch of government and/or its underlying hierarchy of public sector entities responsible for the management of public funds and the exercise of authority under the control of the legislature as well as the financial statements. Their responsibility is to manage funds and exercise authority in accordance with the decisions and premises of the legislature.

[12] ISSAI 100 Fundamental Principles of Public Sector Auditing.

Intended Users

38. Legislators represent the citizens, who are the ultimate users of the financial statements in the public sector. The “intended user” is primarily the parliament, as representative of the citizens in making decisions and fixing priorities concerning the amounts of spending and income of public finance, but also on the purpose and contents of spending and income as a part of a public democratic process. Such decisions and premises of the legislature may form the basis of the broader perspective of financial audit in the public sector. For public sector entities, legislators and regulators are often the primary users of their financial statements.

39. The responsible party and the intended users may be from different public sector entities or the same. As an example of the latter case, in a governmental structure, a supervisory board may seek assurance about information provided by the management board of that public sector entity. The relationship between the responsible party and the intended users needs to be viewed within the context of the specific engagement and may differ from more traditionally defined lines of responsibility.

Subject Matter

40. The recognition, measurement, presentation and disclosure represented in the financial statements (outcome) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure (criteria) to an public sector entity’s financial position, financial performance and cash flows (subject matter). The term “subject matter information” is the outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the auditor gathers sufficient appropriate audit evidence to provide a reasonable basis for expressing an opinion in the auditor’s report. Subject matter information can fail to be properly expressed in the context of the subject matter and the criteria, and can therefore be misstated, potentially to a material extent. This occurs when the subject matter information does not properly reflect the application of the criteria to the subject matter, for example, when an entity’s financial statements do not give a true and fair view of (or present fairly, in all material respects) its financial position, financial performance and cash flows.

Reasonable Assurance Engagement

41. Financial audit is an assurance engagement, where the auditor expresses an opinion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome or evaluation or measurement of a subject matter against criteria.

42. An audit of financial statements in accordance with the ISSAIs is a reasonable assurance engagement. Reasonable assurance is high, but not absolute, assurance because there are inherent limitations of an audit, which result in most of the audit evidence to be obtained by the auditor being persuasive rather than conclusive. In general, reasonable assurance audits are designed to result in a positive form of expressing a conclusion, such as… “in our opinion the financial statements presents fairly, in all material respects (or give a true and fair view of) the financial position of…and its financial performance and cash flows…”.

43. Engagements to provide limited assurance, such as in a review engagement are currently not covered by the ISSAIs on financial audits. Such engagements provides a lower level of assurance than a reasonable assurance engagement, and is designed to result in a negative form of expression of a conclusion, such as “nothing has come to our attention that would

indicate that the subject matter is not in compliance, in all material respect". Auditors engaged to perform such engagements may need to apply guidance outside the ISSAIs.

44. In assurance engagements such as an audit of financial statements, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users. Such engagements are called "assertion-based engagements." The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the auditor's opinion.

Suitable Criteria

45. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria in the preparation of financial statements are normally formal; the criteria may be IPSASs, IFRS or other national financial reporting frameworks for use in the public sector.

PRINCIPLES OF AN AUDIT OF FINANCIAL STATEMENTS

Prerequisites for conducting financial audits

Ethical requirements

46. **The auditor should comply with relevant ethical requirements, including those pertaining to independence, relating to audits of financial statements.**

47. Auditors who perform assurance engagements in accordance with the ISSAIs are subject to ethical requirements in accordance with INTOSAI Code of Ethics[13] applied in the national context. For SAIs that either adopt the ISSAIs on level 4 as their authoritative standards or apply the ISAs, auditors are required to comply with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) (the IESBA Code), which establishes fundamental ethical principles for professional accountants, or adopt national requirements that are at least as demanding; the INTOSAI Code of Ethics (ISSAI 30) applied in the national context may be such an relevant ethical code. SAIs and each auditor doing work for the SAI therefore need to adopt ISSAI 30 or the IESBA Code in their environment in order to make reference in the auditor's report to the audit been conducted in accordance with the ISSAIs or the ISAs.

[13] ISSAI 30 Code of Ethics.

Quality Control requirements

48. **The auditor should implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that the audit complies with professional standards and applicable legal and regulatory requirements and that the auditor's report issued is appropriate in the circumstances.**

49. As stated in ISSAI 100 SAIs should adopt quality control procedures in accordance with ISSAI 40[14]. It provides the context of the IAASB's International Standards on Quality Control (ISQC) 1 in a public sector environment. ISQC 1 establishes standards and provides guidance on an organization's system of quality control. Although the general purpose and key principles of ISSAI 40 are consistent with ISQC 1, the requirements of ISSAI 40 have been adapted to ensure they are relevant to SAIs.

50. Public sector auditors who perform audits of financial statements in accordance with standards based on or consistent with the principles of ISSAI 200 are subject to quality control requirements at the engagement level. SAIs developing standards based on ISSAI 200 or adapting standards consistent with ISSAI 200 consider the need to formulate requirements related to:
    - The need for the responsible auditor to take responsibility for the overall quality on each audit engagement.
    - The need for the responsible auditor to ensure that members of the engagement team comply with relevant ethical requirements.
    - The need for the responsible auditor to form a conclusion on compliance with independence requirements that applies to the audit engagement.
    - The need for the responsible auditor to be satisfied that the engagement team and any auditor's experts collectively have the appropriate competence and capabilities.
    - The need for the responsible auditor to take responsibility for the performance of the engagement, specifically:
        - The direction, supervision and performance of the engagement and;
        - Ensuring that reviews are performed in accordance with the SAIs review policies and procedures.

51. In SAIs, an Auditor General, or the equivalent, has overall responsibility for introducing and maintaining quality control procedures, although the day-to-day operational responsibility may be delegated to others. For example, all those with engagement auditor responsibility in a SAI with an Auditor General System would, because of the hierarchical structure, ultimately report to the Auditor General.

[14] ISSAI 40 Quality Control for SAIs.

Engagement team management and skills

52. **The responsible auditor should be satisfied that the entire engagement team, and any experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:**
(a) Perform the audit in accordance with applied standards and applicable legal and regulatory requirements; and
(b) Enable the auditor to issue a report that is appropriate in the circumstances.

53. When considering the appropriate competence and capabilities expected of the team as a whole, the responsible auditor may consider the following matters, such as the team's:
- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and applicable legal and regulatory requirements.
- Technical expertise, including expertise with relevant information technology and specialized areas of accounting or auditing.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the SAI's quality control policies and procedures.
- Skills that are necessary to discharge the terms of the audit mandate in a the relevant environment, including an understanding of the applicable reporting arrangements, and reporting to the legislature or other governing body or in the public interest
- Some aspects of performance auditing or a comprehensive assessment of compliance with law, regulation or other authority and preventing and detecting fraud and corruption if relevant.

Principles related to basic Audit Concepts

54. ISSAIs 1000 – 1810 are the best example of how the Fundamental Principles of Financial Auditing can be applied. For SAIs that choose to develop standards based on the fundamental auditing principles or adopt national standards that are consistent with the principles the areas dealt with in this and the following section are matters that should be addressed.

Engagement Risk

55. **The auditor should reduce engagement risk to an acceptably low level in the circumstances of the engagement to obtain reasonable assurance as the basis for a positive form of expression of the auditor's opinion.**

56. Engagement risk for assurance engagements such as an audit is the risk that the auditor expresses an inappropriate conclusion when the subject matter information is materially misstated. The auditor reduces the assurance engagement risk to an acceptably low level in the circumstances of the engagement to obtain reasonable assurance as the basis for a positive form of expression of the auditor's conclusion. To be meaningful, the level of assurance obtained by the auditor is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential.

57. In general, engagement risk in an audit, relates to whether the risk that the subject matter information is materially misstated, and can be represented by the following components:
   a) Inherent risk: the susceptibility of the subject matter information to a material misstatement, assuming that there are no related controls; and
   b) Control risk: the risk that a material misstatement that could occur and will not be prevented, or detected and corrected, on a timely basis by related controls. When control risk is relevant to the subject matter, some control risk will always exist because of the inherent limitations of the design and operation of internal control; and

58. In addition to the risk that the subject matter information is materially misstated the auditor also considers the risk that the auditor will not detect that a material misstatement that exists. The degree to which the auditor considers each of these components is affected by the engagement circumstances.

Professional Judgment and professional skepticism

59. **The auditor should plan and perform the audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. When planning, performing, concluding and reporting an audit of financial statements, the auditor should exercise professional judgment.**

60. The terms "professional judgment" and "professional skepticism" are to be used when formulating requirements relating to the auditor's decisions about the appropriate course of action and to express the attitude of the auditor that includes a questioning mind. The concept of professional skepticism enhances and broadens the concept of due care and is fundamental for planning and performance of the audit. These concepts are included in the ISSAIs on financial audit. The term "professional judgment" has the following meaning: *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*[15].

61. The concept of professional judgment is applied by the auditor in all stages of the audit process. Professional skepticism is fundamental to all audit engagements. The auditor plans and performs an assurance engagement with an attitude of professional skepticism recognizing that circumstances may exist that cause the subject matter information to be materially misstated. An attitude of professional skepticism means that the auditor makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations by the responsible party. For example, an attitude of professional skepticism is necessary throughout the engagement process for the auditor to reduce the risk of overlooking suspicious circumstances, of over generalizing when drawing conclusions from observations, and of using faulty assumptions in determining the nature, timing and extent of evidence gathering procedures and evaluating the results thereof.

[15] ISSAI 1200 paragraph 13.

62. Professional judgment is necessary in particular regarding decisions about:
- Materiality and audit risk.
- The nature, timing, and extent of audit procedures used to meet the requirements of the ISSAIs and the ISAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the overall objectives of the auditor.
- The evaluation of management's judgments in applying the audited organization's applicable financial reporting framework.
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

Materiality

63. **The auditor should apply the concept of materiality appropriately when planning and performing the audit.**

64. When establishing the audit strategy, the auditor should determine materiality for the financial statements as a whole. If 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 decisions of users taken on the basis of the financial statements, the auditor should also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

65. The auditor should also determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements. Performance materiality is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds the materiality set for the financial statements as a whole. The determination of performance materiality involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures; and the nature and extent of misstatements identified in previous audits and thereby the auditor's expectations in relation to misstatements in the current period.

66. In a financial statement audit, a misstatement is material, individually or when aggregated with other misstatements, when it could reasonably be expected to influence the economic decisions users take based on the financial statements. Materiality has both quantitative and qualitative aspects. In the public sector, materiality is not limited to economic decisions of users, also decisions about whether to continue certain government programs or grant funding may be based on the financial statements. The qualitative aspects of materiality generally play a greater role in the public sector than in other types of entities. The assessment of materiality and the consideration of sensitivity and other qualitative factors in a particular engagement are matters for the auditor's judgment.

67. When determining levels of materiality, auditors may also consider aspects such as the sensitive nature of certain transactions or programs, the public interest, the need for effective legislative oversight and regulation, and the nature of the misstatement or deviation (e.g., if it is related to fraud or corruption). Such considerations by the auditor may result in

determination of materiality levels at a lower level than based on only quantitative or qualitative factors.

68. The broad audit mandate in the public sector may require audits of certain aspects related to compliance and internal control. While misstatements of small monetary amounts may be deemed trivial, even small deviations related to compliance or internal control are, by their nature, generally not seen as trivial. Even if a transaction – regardless of size – is correctly recorded in the financial statements, the transaction represents an instance of non-compliance or a control deviation if it is illegal or fraudulent or if the control was not followed. Some auditors also have a responsibility to report all (not only non-trivial) identified misstatements or compliance and control deviations to management or those charged with governance. Such misstatements or deviations may also have implications in a broader context. Based on their mandates, some SAIs may also order that any instances of non-compliance be corrected. Auditors with such broader responsibilities may use a combination of ISSAI 200 and ISSAI 400[16] for the adoption of relevant standards.

69. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of the financial statements. The auditor's opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.

70. The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. Although it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.

Documentation

71. **The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, with no previous connection with the audit, to understand the nature, timing and extent of the audit procedures performed to comply with the standards applied and applicable legal and regulatory requirements, the results of the audit procedures performed, and the audit evidence obtained. The audit documentation should be prepared on a timely basis.**

The auditor should include significant matters arising during the audit, conclusions reached, and significant judgments made in reaching the conclusions in the documentation.

[16] ISSAI 400 Fundamental Principles of Compliance Auditing.

72. Adequate audit documentation is important for several reasons. It will:
- confirm and support the auditor's opinions and reports;
- increase the efficiency and effectiveness of the audit;
- serve as a source of information for preparing reports or answering any enquiries from the audited organization or from any other party;
- serve as evidence of the auditor's compliance with the auditing standards;
- facilitate planning and supervision;
- help the auditor's professional development;
- help to ensure that delegated work has been satisfactorily performed; and
- provide evidence of work done for future reference.

73. Auditing standards based on the fundamental principles needs to include further requirements on the auditor in the following areas:
- The timely preparation of audit documentation.
- The form, content and extent of audit documentation.
- Documentation requirements where the auditor judges it necessary to depart from a relevant requirement in the applied auditing standards.
- Documentation requirements where the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor’s report.
- The assembly of the final audit file.

74. For auditors with a judicial role, such as a Court of Accounts, documentation forms part of the basis of the official ruling. In such an environment, due process of law may establish specific and strict requirements to be adhered to in regard to confidentiality of documentation in connection with the proceedings of a case. Additionally, as decisions may result in a legally binding public credit, there may be additional documentation retention requirements to which public sector auditors adhere.

75. Auditors familiarize themselves with policies and procedures describing additional requirements relating to audit documentation and that are designed to ensure compliance with applicable rules of evidence. The following matters may affect documentation and are considered by the auditor:
- Legislation imposing additional requirements on audit documentation;
- The scope of such requirements (i.e., are they to be imposed on every document from the audit assignment or on specific documents relating to certain audit issues);
- Additional processing, formalities or requirements to which audit documents are subject;
- The purpose of each additional requirement as regards due process of law in following the steps of the audit; and
- Any further impairment that may be placed upon audit documentation due to specific ways it has been collected and/or produced.

76. The auditor should 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. Audit documentation of any nature should not be deleted or discarded before the end of its retention period. Quality control procedures in accordance with ISSAI 40 and ISQC 1, or national requirements that are at least as demanding, requires SAIs to establish policies and procedures for the timely completion of the assembly of audit files. In the public sector such requirements for documentation and retention may be governed by legislative requirements related to confidentiality on the one hand, and access by third parties on the other hand. The ISSAIs on level 4 provides additional guidance for adopting requirements and guidance related to audit documentation.

Communication

77. **The auditor should, after determining the appropriate person(s) within the audited entity's governance structure with whom to communicate, communicate with those persons regarding the planned scope and timing of the audit and significant findings from the audit.**

78. In addition to communication with those having management responsible within the entity auditors should also communicate with the persons having governance responsibilities. In the public sector, identifying those charged with governance may be a challenge. The audited entity may be part of a larger or broader structure with governance bodies at several organizational levels as well as in several functions (i.e. vertically or horizontally). As a result, there may be instances where there are several distinct groups that are identified as those charged with governance. Furthermore, an audit in the public sector might involve both financial statement objectives as well as compliance objectives and in some cases that may involve separate governance bodies.

79. Communication should be in writing, if the auditor determines that is not adequate to communicate orally. Auditors may also have additional responsibilities to communicate with other parties than those within the organization, such as the legislature, appropriate regulators, or relevant funding agencies.

80. Written communications need not include all matters that arose during the course of the audit. However, written communication is needed for significant findings from the audit that the auditor is and auditors are required to communicate those findings to those charged with governance.

81. Auditors in the public sector are often the mandated auditors of the whole, or the major parts, of the government and its administration. In this situation, auditors may have access to information from other audited organizations and their audits, which might be of relevance to those charged with governance. Examples of this might include material errors in transactions with the audited organization that also affect other audited organizations, or designs of relevant controls which have provided efficiency gains in other audited organizations. Communicating this type of information to those charged with governance may add value to the audit when circumstances permit. However, laws, regulations or ethical requirements may prohibit communicating this type of information.

Principles related to the Audit Process

Agreeing the Terms of the Engagement

82. **The auditor should agree or, if the terms of the engagement are clearly mandated, establish a common understanding, of the terms of the audit engagement with management or those charged with governance, as appropriate.**

83. The terms of an audit engagement in the public sector are normally mandated and therefore not subject to requests from, and agreement with, management. Instead of agreeing the terms formally, public sector auditors may instead chose to establish a common, formal understanding of the respective roles and responsibilities of management and the auditor. Since the public sector auditor is normally engaged by and reports to the legislature, agreements often need to be reached with both the legislature and management.

84. The auditor should communicate with relevant representatives of those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that 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.

85. If law or regulation prescribes in sufficient detail the terms of the engagement, it may not be necessary to record them in an audit engagement letter or other suitable form of written agreement. An exception may be for the agreement by management and, where appropriate, those charged with governance, that they acknowledge and understand the responsibilities set out in the specific auditing standards, such as the ISSAIs and the ISAs. Such engagements often exist in the public sector and written agreements on the terms of engagements may not be used, however the use of such agreements may assist in clarifying the responsibilities of the parties involved.

86. An overview of the planned scope and timing of the audit should also be communicated with those charged with governance. In communicating with those charged with governance the auditor includes views about significant qualitative aspects of the audited organization's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor may need to explain why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the audited organization. Such communication may also address:
    - Significant difficulties, if any, encountered during the audit;
    - Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management;
    - Written representations the auditor is requesting from management; and
    - Other matters, if any, arising from the audit that, in the auditor's professional judgment, is significant to the oversight of the financial reporting process.

87. SAIs are normally required to carry out an audit as stated in their mandate. They do not normally have the option to reject an assignment if the required circumstances are not met. Standards developed based on the fundamental principles needs to provide guidance on suitable actions in such circumstances. ISSAI 1210 includes guidance for such situation.

<u>Planning</u>

88. **The auditor should develop an overall audit strategy that includes the scope, timing and direction of the audit, and assists the auditor in the development of an audit plan.**

89. An overall audit strategy guides the auditor in the development of the audit plan. When developing the overall audit strategy, the auditor needs to:
    - Identify the characteristics of the engagement that define its scope;
    - Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
    - Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
    - Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement auditor for the audited organization is relevant; and
    - Ascertain the nature, timing and extent of resources necessary to perform the engagement.

- Consider the results and knowledge obtained from performance audits and other audit activities relevant to the audited organization, including the implications of previous recommendations;
- Consider and assess the expectations of the legislature and other relevant users of the auditors' report.

90. **The auditor should properly plan the audit to ensure that it is conducted in an effective and efficient manner.**

91. The auditor should establish an audit plan. The audit plan should include a description of:
    - The nature, timing and extent of planned risk assessment procedures.
    - The nature, timing and extent of planned further audit procedures at the assertion level.
    - Other planned audit procedures that are required to be carried out so that the engagement complies with the applicable standards.

92. Both the overall strategy and the audit plan needs to be documented. They also need to be updated as necessary during the course of the audit.

<u>Understanding the audited organization</u>

93. **The auditor should have an understanding of the audited organization and its environment, including internal control procedures that are relevant to the audit.**

94. Understanding the different aspects of the organization and its environment enables the auditor to effectively plan and perform the audit and includes an understanding of:
    - Relevant environment, regulatory, and other external factors including the applicable financial reporting framework.
    - The nature of the audited organization, including how it operates, the governance structure, 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, the selection and application of accounting policies, including the reasons for changes thereto.
    - The measurement and review of the audited organization's financial performance.
    - Decisions initiated outside the audited organization as a result of political processes such as new programs or budget constraints.
    - Specific laws and regulations to which the audited organization is subject and the potential impact of non-compliance with these.
    - Program objectives and strategies may include public policy elements and therefore may have implications for the risk assessment.
    - Governance structures affected by the legal structure of the audited organization, for example whether the audited entity is a ministry, department, agency or other type of public sector entity.

95. The understanding of internal control relevant to the audit is a matter of professional judgment. Although most controls relevant for 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. Auditors also need to consider that additional reporting responsibilities may widen the need for understanding the internal control beyond those controls relevant to the financial reporting.

96. Public sector entities may be part of a wider internal control structure than those of the audited organization, and such government-wide controls may need to be considered as

relevant to the audit. When obtaining an understanding of controls that are relevant to the audit, the auditor considers the need to evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to inquiry of the audited organization's personnel.

97. **When obtaining the understanding of the control environment the auditor should evaluate whether management has created and maintained a culture of honesty and ethical behavior; and whether the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.**

98. Elements of the control environment that may be relevant when obtaining an understanding of the control environment may include consideration of the audited organization's communication and enforcement of integrity and ethical values, commitment to competence, participation by those charged with governance, management's philosophy and operating style, organizational structure, assignment of authority and responsibility and human resource policies and practices.

99. Relevant audit evidence may be obtained through a combination of inquiries and other risk assessment procedures such as corroborating inquiries through observation or inspection of documents. For example, through inquiries of management and employees, the auditor may obtain an understanding of how management communicates to employees its views on business practices and ethical behavior. The auditor may then determine whether relevant controls have been implemented by considering, for example, whether management has a written code of conduct and whether it acts in a manner that supports the code.

100. As part of the understanding process the auditor also needs to consider whether the audited organization has a process for identifying business risks relevant to financial reporting objective and estimating the significance of those risks assessing the likelihood of their occurrence. If such a process has been established the auditor needs to obtain an understanding of it, and the results thereof. If the auditor identifies risks of material misstatement that management failed to identify, the auditor should evaluate whether there was an underlying risk of a kind that the auditor expects would have been identified by the audited organization's risk assessment process. If there is such a risk, the auditor should obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the audited organization's risk assessment process. Some public sector environments require such processes to be established by the audited organizations.

101. The auditor's understanding of internal control relevant to financial reporting may include the following areas:
    - The classes of transactions in the audited organization's operations that are significant to the financial statements;
    - The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
    - The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;
    - How the information system captures events and conditions, other than transactions, that are significant to the financial statements;

- The financial reporting process used to prepare the audited organization's financial statements, including significant accounting estimates and disclosures;
- Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments;
- Relevant controls that relate to compliance with authorities;
- Controls related to monitoring performance against the budget;
- Controls related to transferring budgetary funds to other audited organizations;
- Controls of classified data related to national security and sensitive personal data, such as tax and health information; and
- Supervision and other controls performed by parties outside the audited organization that relate to areas such as:
  - Compliance with laws and regulations, such as procurement regulations;
  - Execution of the budget;
  - Other areas as defined by legislation or audit mandate; and
  - Management's accountability.

102. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. However, obtaining an understanding of an audited organization's controls and, if relevant government- wide controls, is not sufficient to test their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls. For example, obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. However, because of the inherent consistency of IT processing, performing audit procedures to determine whether an automated control has been implemented may serve as a test of that control's operating effectiveness, depending on the auditor's assessment and testing of controls such as those over program changes. Tests of the operating effectiveness of controls are further described in the section on responses to the assessed risks.

<u>Risk assessment</u>

103. **The auditor should assess the risks of material misstatement at the financial statement level; and if relevant, at the assertion level for classes of transactions, account balances, and disclosures to provide a basis for performing further audit procedures.**

104. Identifying and assessing the risks of material misstatement needs often to be conducted at both the financial statement level and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor needs to:
   - Identify risks throughout the process of obtaining an understanding of the audited organization and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
   - Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
   - Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
   - Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

105. As part of the risk assessment, the auditor determines whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor should exclude the effects of identified controls related to the risk. When judging on which risks are significant risks, the auditor needs to consider at least the following:
   - Whether the risk is a risk of fraud;
   - Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;
   - The complexity of transactions;
   - Whether the risk involves significant transactions with related parties;
   - The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty;
   - Whether the risk involves significant transactions that are outside the normal course of business for the audited organization, or that otherwise appear to be unusual; and
   - Whether the risk also affects compliance with laws and regulations.

106. If the auditor has determined that a significant risk exists, the auditor should obtain an understanding of the audited organization's controls, including control activities, relevant to that risk. The ISSAIs on level 4 establish further requirements and provides guidance when significant risks have been identified by the auditor.

107. Risk assessment procedures may include the following:
   - Inquiries of management and of others within the audited organization that in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
   - Analytical procedures.
   - Observation and inspection.

<u>Responses to assessed risks</u>

108. **The auditor should respond appropriately to address the assessed risks of material misstatement in the financial statements**

109. Responses to assessed risks include designing audit procedures that addresses the risks, such as substantive procedures and test of controls. Substantive procedures includes:
   - Tests of details (of classes of transactions, account balances, and disclosures); and
   - Substantive analytical procedures.

110. The nature, timing, and extent of audit procedures are based on and are responsive to the assessed risks of material misstatement at the assertion level. In designing the audit procedures to be performed, the auditor should 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. Such consideration should include the inherent risk of transactions (the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure) and the control risk (whether the risk assessment takes account of relevant controls).

111. Relevant consideration of the control risk requires the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures).

112. When designing and performing tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls, the auditor considers the need to obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.

113. Irrespective of the assessed risks of material misstatement, the auditor should design and perform substantive procedures for each material class of transactions, account balance, and disclosure. If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor should perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details.

Considerations relating to fraud in an audit of financial statements

114. **The auditor should identify and assess the risks of material misstatement of the financial statements due to fraud and obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, and respond appropriately to fraud or suspected fraud identified during the audit.**

115. 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. Although fraud is a broad legal concept, 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.

116. The auditor is expected to 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 management and those charged with governance. When performing risk assessment procedures and related activities to obtain an understanding of the audited organization and its environment, the auditor needs to perform procedures to obtain information for use in identifying the risks of material misstatement due to fraud.

117. When a misstatement is identified, the auditor evaluates whether such a misstatement may indicate instances of fraud. If there is such an indication, the implications of the misstatement need to be evaluated.

118. Areas where auditors are alert to fraud risks include areas such as procurement, grants, privatizations, intentional misrepresentation of results or information, and misuse of authority or power. When developing standards based on these fundamental principles, the guidance on fraud risk areas in ISSAI 1240 may be of assistance.

119. Requirements for reporting of fraud in the public sector may be subject to specific provisions of the audit mandate or related legislation or regulation, and the auditor may be required to communicate such issues to a party outside the audited organization. Such parties may include regulatory and enforcement authorities. In some environments, there may be a specific obligation to refer indications of fraud to investigative bodies and even cooperate with such bodies to determine if fraud or abuse has occurred. In other environments, auditors may be obliged to report circumstances that may indicate the possibility of fraud or abuse to the competent jurisdictional body or to the appropriate part of the government or legislature,

such as prosecutors, the police and (if relevant to legislation) affected third parties. Auditors take care to avoid interfering with potential investigations or legal proceedings by familiarizing themselves with applicable laws and regulations in regard to reporting, communication and documentation of indications or suspicions of fraud. Furthermore, auditors consider the need to obtain legal advice in issues regarding indications of fraud. Auditors in some public sector environments may have additional responsibilities to take when offences are discovered. ISSAI 1240 makes reference to the possible extended reporting responsibilities within the public sector to address concerns about public accountability.

120. Auditors in the public sector may have a formally mandated responsibility to detect fraud, and in addition, the use of public monies tends to impose a higher profile on fraud issues. As a result auditors may need to be responsive to public expectations regarding detection of fraud.

Considerations of Going Concern

121. **The auditor should consider whether there are events or conditions that may cast significant doubt on the audited organization’s ability to continue as a going concern.**

122. Financial statements are normally prepared on the assumption that the audited organization is a going concern and will continue in operation and meet its statutory obligations for the foreseeable future. In assessing whether the going concern assumption is appropriate, those responsible for the preparation of the financial statements take into account all available information for the foreseeable future, which should be at least, but is not limited to, twelve months from the approval of the financial statements. Under the going concern assumption, an audited organization is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the audited organization or to cease operations, or has no realistic alternative but to do so. The going concern concept may have little or no relevance for “ordinary” public sector entities such as authorities basically funded through appropriations on the government budget. When such organizations are abolished or merged with others their liabilities and assets are usually taken over by the government as a whole. For some types of entities such as government owned companies and joint ventures with other principals such as private sector entities that operates in legal forms that provides for limited liabilities for the owners this may not be the case. The responsibility for carrying out government programs may also be contracted to private sector organizations, such as NGOs and private companies but may still be audited by the Supreme Audit Institution. A general trend is outsourcing and thereby the going concern concept as well as the auditor’s judgment thereon may become increasingly relevant also for public sector auditors.

123. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the audited organization’s ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. Since the going concern assumption is a fundamental principle in the preparation of financial statements, the preparation of the financial statements requires management to assess the audited organization’s ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

124. The auditor should obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation and presentation of

the financial statements and to conclude whether there is a material uncertainty about the audited organization's ability to continue as a going concern. If the financial statements have been prepared on a going concern basis but, in the auditor's judgment, the use of the going concern assumption in the financial statements is inappropriate, the auditor shall express an adverse opinion.

125. The degree of consideration depends on the facts in each case, and assessments of the going concern assumption are not predicated on the solvency test usually applied to business enterprises. There may be circumstances where the usual going concern tests of liquidity and solvency appear unfavorable, but other factors suggest that the audited organization is nonetheless a going concern. For example:
- In assessing whether a government is a going concern, the power to levy rates or taxes may enable some audited organizations to be considered as a going concern even though they may operate for extended periods with negative net assets/equity; and
- For an individual audited organization, an assessment of its statement of financial position at the reporting date may suggest that the use of the going concern assumption in the preparation of its financial statements is not appropriate. However, there may be multi-year funding agreements, or other arrangements, in place that will ensure the continued operation of the audited organization.

126. The determination of whether the use of the going concern assumption is appropriate is primarily relevant for individual audited organizations rather than for a government as a whole. For individual audited organizations, in assessing whether the going concern basis is appropriate, those responsible for the preparation of the financial statements may need to consider a wide range of factors surrounding current and expected performance, potential and announced restructurings of organizational units, estimates of revenue or the likelihood of continued government funding, and potential sources of replacement financing before it is appropriate to conclude that the use of the going concern assumption is appropriate.

127. When performing risk assessment procedures the auditor should consider whether there are events or conditions that may cast significant doubt on the audited organization's ability to continue as a going concern. In forming a view of the audited organization's ability to continue its operations, the auditor's consideration of going concern embraces two separate, but sometimes overlapping, factors:
- The greater risk associated with changes in policy direction (for example, where there is a change in government); and
- The less common operational, or business, risk (for example, where an audited organization has insufficient working capital to continue its operations at its existing level).

<u>Considerations relating to laws and regulations in an audit of financial statements</u>

128. **The auditor should identify the risks of material misstatement of the financial statements due to non-compliance with laws and regulations. Identification of such risks should be based on a general understanding of the legal and regulatory framework applicable to the specific environment in which the audited organization operates and how the audited organization is complying with that framework.**

The auditor should obtain sufficient appropriate audit evidence regarding compliance with those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in financial statements.

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

However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

130. When conducting an audit of financial statements in accordance with standards based on or consistent with ISSAI 200, the auditor takes into account the applicable legal and regulatory framework for the audited organization.

131. The effect on financial statements of laws and regulations varies considerably. Those laws and regulations to which an audited organization is subject constitute the legal and regulatory framework. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an audited organization’s financial statements. Other laws or regulations are to be complied with by management or set the provisions under which the audited organization is allowed to conduct its operations but do not have a direct effect on an audited organization’s financial statements.

132. Non-compliance with laws and regulations may result in fines, litigation or other consequences for the audited organization that may have a material effect on the financial statements.

133. In the public sector there may, for instance, be specific laws and regulations on how to distribute grants and subsidies from an agency that will have a direct impact on the financial statements. The financial reporting framework may often also include information such as a budget report, appropriation report, or performance report. When the financial reporting framework includes such information, auditors may need to consider specific laws and regulations that may have a direct or indirect effect on such information.

134. The audit mandate, or obligations for public sector entities, arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature may result in additional objectives. These additional objectives may include audit and reporting responsibilities relating to reporting whether auditors found non-compliance with authorities including budget and accountability.

135. This broader scope may, for example, include additional responsibilities for expressing a separate opinion as to the audited organization’s compliance with laws and regulations. These additional responsibilities, and related audit and reporting objectives, are dealt within the Fundamental Principles on Compliance Audit and the related guidelines[17].

136. However, even where there are no such additional objectives, there may be general public expectations in regard to auditors’ reporting of non-compliance with authorities. Therefore, auditors keep such expectations in mind, and are alert to instances of non-compliance.

[17] ISSAI 400 Fundamental Principles of Compliance Audit, ISSAI 4000 General Introduction to Guidelines on Compliance Audit , and ISSAI 4200 Compliance Audit Guidelines Related to Audit of Financial Statements.

Audit Evidence

137. **The auditor should perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw conclusions on which to base the auditor's opinion.**

138. The audit procedures to be applied should be appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. The auditor should consider both relevance and reliability of the information to be used as audit evidence. An audit of financial statements does not involve the authentication of documentation, nor is the auditor trained as or expected to be an expert in such authentication. However, the auditor considers the reliability of the information to be used as evidence, for example photocopies, facsimiles, filmed, digitized or other electronic documents, including consideration of controls over their preparation and maintenance where relevant.

139. Audit evidence should be sufficient and appropriate. Sufficiency is the measure of the quantity of evidence. Appropriateness is the measure of the quality of evidence; that is, its relevance and its reliability. The quantity of evidence needed is affected by the risk of the subject matter information being materially misstated (the greater the risk, the more evidence is likely to be required) and also by the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence does not compensate for its poor quality.

140. The reliability of evidence is influenced by its source and nature, and is dependent on the individual circumstances under which the evidence is obtained. Generalizations about the reliability of various kinds of evidence can be made; however, such generalizations are subject to important exceptions. Even when evidence is obtained from sources external to the audited organization, such as external confirmations, circumstances may exist that could affect the reliability of the information obtained. While recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:
    - Evidence is more reliable when it is obtained from independent sources outside the audited organization.
    - Evidence that is generated internally is more reliable when the related controls are effective.
    - Evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
    - Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of what was discussed).
    - Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles.

141. The auditor ordinarily obtains more assurance from consistent evidence obtained from different sources or of a different nature than from items of evidence considered individually. In addition, obtaining evidence from different sources or of a different nature may indicate that an individual item of evidence is not reliable.

142. Audit evidence may be obtained by performing audit procedures to test accounting records. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In the case of financial statements in the public sector, management may often assert that transactions and events have been carried out in accordance with legislation or proper authority. Such assertions may fall within the scope of a financial audit. Auditors in the public sector may also need to consider requirements and the guidance in the Fundamental Principles on Compliance Audit and the related guidelines[18] for developing or adopting standards in such cases.

143. When adopting or developing auditing standards, SAIs also consider that audit procedures and requirements for the auditor need to be in place for the auditor to obtain sufficient and appropriate audit evidence in relation to:
- The use of external confirmations as audit evidence;
- Audit evidence when using analytical procedures and different audit sampling techniques;
- Audit evidence related to the use of fair value measurement, if relevant;
- Audit evidence when the audited organization has related parties; and
- Audit evidence in relation to the audited organizations use of service organizations.
- Audit evidence when using the work of internal audit functions or direct assistance from internal auditors
- Audit evidence when using external experts
- The use of written representations to support audit evidence.

Further guidance on such procedures and requirements are included in ISSAIs on level 4. Those may be of assistance for SAIs when developing further requirements in these areas.

144. Auditors in certain environments, such as a Court of Accounts environment, may be subject to laws and regulations requiring the auditors to understand and follow precise procedures related to rules of evidence. Public sector auditors familiarize themselves with any such policies and procedures describing additional requirements relating to audit evidence and that are designed to ensure compliance with applicable rules.

Considerations of subsequent events

145. **The auditor should obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor should also respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.**

146. Such procedures should be designed so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. Financial statements may be affected by certain events that occur after the date of the financial

[18] ISSAI 400 Fundamental Principles of Compliance Audit, ISSAI 4000 General Introduction to Guidelines on Compliance Audit , and ISSAI 4200, Compliance Audit Guidelines Related to Audit of Financial Statements.

statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

(a) Those that provide evidence of conditions that existed at the date of the financial statements; and

(b) Those that provide evidence of conditions that arose after the date of the financial statements.

147. Procedures to obtain sufficient appropriate audit evidence may include procedures such as:
- Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- Inquiring of management.
- Reading minutes.
- Reading the entity's latest subsequent interim financial statements, if any.

When inquiring of management auditors may need to include events that have occurred that have relevance for the government entity's ability to fulfill its program objectives and may impact the presentation of any performance information in the financial statements.

148. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, if, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, it may have caused the auditor to amend the auditor's report; the auditor should take appropriate actions. Such actions may include:
- Discuss the matter with management and, where appropriate, those charged with governance.
- Determine whether the financial statements need amendment and, if so,
- Inquire how management intends to address the matter in the financial statements.

149. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor should notify management and, those charged with governance, that the auditor will seek to prevent future reliance on the auditor's report. Auditor actions to seek to prevent reliance on auditor's report auditors may include the need to seek legal advice and also consider reporting to the appropriate statutory body.

<u>Evaluating misstatements</u>

150. **The auditor should accumulate misstatements identified during the audit, and communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management.**

151. Uncorrected misstatements should be evaluated whether they are material, individually or in aggregate, and the effect they may have on the opinion in the auditor's report.

152. The auditor should request management to correct those misstatements, and if management refuses to correct some or all communicated misstatements the auditor should obtain the reasons for not making the corrections. When evaluating whether the financial statements as a whole are misstated, the auditor considers the understanding of the reasons for not making the corrections.

153. Misstatements that are clearly trivial need normally not be communicated, except when the mandate requires the auditor to report all misstatements. The auditor needs to determine whether uncorrected misstatements are material, individually or in the aggregate. In making this determination, the auditor considers;
- 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; 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.

Forming an Opinion and Reporting on the Financial Statements

154. **The auditor should form an opinion based on an evaluation of the conclusions drawn from the audit evidence obtained, whether the financial statements as a whole are prepared in accordance with the applicable financial reporting framework. The opinion should be expressed clearly through a written report that also describes the basis for that opinion.**

155. The objectives of a financial audit in the public sector are often broader than expressing an opinion whether the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework. The audit mandate, or obligation for public sector entities, arising from legislation, regulation, ministerial directive, government policy requirements, or resolutions of the legislature may result in additional objectives. These additional objectives, which may be of equal importance to the opinion on the financial statements, may include audit and reporting responsibilities, for example, relating to reporting whether auditors found any instances of noncompliance with authorities. However, even when there are no such additional objectives, there may be general public expectations in regard to auditors' reporting of noncompliance with authorities or reporting on effectiveness of internal control.

156. The type of financial reporting framework applied will influence the evaluation of the auditor. The financial reporting framework may be a fair presentation framework or a compliance framework. "Fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:
- Acknowledges explicitly or implicitly that, it may be necessary for management to provide disclosures beyond those specifically required by the framework to achieve fair presentation of the financial statements; or
- Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements above.

157. Auditors with responsibilities relating to reporting on compliance or noncompliance with authorities may consider the Fundamental Principles of Compliance Auditing and related Guidelines[19].

158. In order to form an opinion, the auditor should conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The conclusion should take into account;

a) Whether sufficient appropriate evidence has been obtained,

b) Whether uncorrected misstatements are material, individually or in aggregate, and

c) That evaluations detailed below were performed and considered in determining the form of opinion:
   - Whether the financial statements are prepared in all material respects, in accordance with requirements of the applicable financial reporting framework, including consideration of the qualitative aspects of the entity's accounting practices, such as possible bias in management's judgments.
   - Whether the financial statements adequately disclose the significant accounting policies selected and applied,
   - Whether the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate,
   - Whether the accounting estimates made by management are reasonable,
   - Whether the information presented in the financial statements is relevant, reliable, comparable, and understandable,
   - Whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements,
   - Whether the terminology used in the financial statements, including the title of each financial statement, is appropriate,
   - Whether the financial statements adequately refer to or describe the applicable financial reporting framework.

d) When the financial statements are prepared in accordance with a fair presentation framework, the evaluation should also include whether the financial statements achieve fair presentation which includes consideration of:
   - Whether the financial statements' overall presentation, structure, and content achieve fair presentation,
   - Whether the financial statements, including the related notes, represent the underlying transactions and events in a matter that achieves fair presentation.

[19] ISSAI 400 Fundamental Principles of Compliance Audit, ISSAI 4000 General Introduction to Guidelines on Compliance Audit, and ISSAI 4200 Compliance Audit Guidelines Related to Audit of Financial Statements.

Form of Opinion

159. The auditor should express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework.

If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with paragraph 163 to 168.

160. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor should discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the opinion.

Elements Required in the Auditor's Report

161. The auditor's report should be in a written form and contain the following elements:
- A title that clearly indicates that it is the report of an independent auditor;
- An addressee as required by the circumstances of the engagement;
- An introductory paragraph that (1) identifies whose financial statements have been audited, (2) state that the financial statements have been audited, (3) Identify the title of each statement that comprise the financial statements, (4) refer to the summary of significant accounting policies and other explanatory information, and (5) specify the date or period covered by each financial statement comprising the financial statements;
- A section with the heading "Management's Responsibility for the Financial Statements," which describes that management is responsible of the financial statements in accordance with the applicable financial reporting framework, and for internal control to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- A section with the heading "Auditor's Responsibility," which states that the responsibility of the auditor is to express an opinion on the financial statements based on the audit, and describe an audit as involving performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements, with the procedures selected depending on auditor's judgment including the risks of material misstatement of the financial statements, whether due to fraud or error. In making the risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances. This section also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements. The auditor's report should state whether the auditor believes that the audit evidence the auditor has obtain is sufficient and appropriate to provide a basis for the auditor's opinion.
- A section with the heading "Opinion," which should use one of the following equivalent phrases when expressing an unmodified opinion on the financial statements prepared in accordance with a fair presentation framework:
  - The financial statements present fairly, in all material respects,… in accordance with [the applicable reporting framework]; or

    - The financial statements give a true and fair view of … in accordance with [the applicable financial reporting framework].

      When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion should be that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework]

      If the reference to the applicable financial reporting framework is not to the International Public Sector Accounting Standards or the International Financial Reporting Standards, the auditor's opinion should identify the jurisdiction of origin of the framework.

- If required or as determined by the auditor, a section with the heading "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, which addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the requirements to report on the financial statements.
- A signature of the auditor.
- A date when the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements, including evidence that
    - All the statements that comprise the financial statements, including the related notes, have been prepared; and
    - Those with the recognized authority have asserted that they have taken responsibility for those financial statements.
- The location in the jurisdiction where the auditor practices.

162. In cases where auditors are required by laws or regulations to use specific layout or wording in the auditor's report, auditors should evaluate whether such layout or wording contains the following minimum elements;
- A title;
- An addressee, as required by the circumstances of the engagement;
- An introductory paragraph that identifies the financial statements audited;
- A description of the responsibility of management
- A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes:
- A reference to International Standards on Auditing and the law or regulation; and
- A description of an audit in accordance with those standards;
- An opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements, including identifying the jurisdiction of origin of the financial reporting framework that is not International Public Sector Accounting Standards, or International Financial Reporting Standards;
- The auditor's signature;
- The date of the auditor's report; and
- The auditor's address.

Modifications to the Opinion in the Auditor's Report

163. Auditors may issue three types of modified opinions, namely a qualified opinion, an adverse opinion, and a disclaimer of opinion. The auditor should modify the opinion in the auditor's report when:
    - The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
    - The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.

Determining the Type of Modification to the Auditor's Opinion

164. The decision regarding which type of modified opinion is appropriate depends upon:
    - The nature of the matter, giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
    - The auditor's judgment about the pervasiveness of the effects of possible effects of the matter on the financial statements.

165. The auditor should express a qualified opinion when: (1) the auditor having obtained sufficient appropriate audit evidence concludes that misstatements, individually or in the aggregate, material, but not pervasive, to the financial statements; or (2) the auditor is unable to obtain sufficient appropriate audit evidence on which to base an opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

166. The auditor should express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

167. The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any could be both material and pervasive. If after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope for the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request management remove the limitation

168. When the auditor modifies the audit opinion, the auditor should modify the heading to correspond with the type of opinion expressed. ISSAI 1705[20] provides additional guidance on specific language to use to express the modified opinion and to describe the auditor's responsibility. It also includes illustrative report examples.

[20] ISSAI 1705 Modifications to the Opinion in the Independent Auditor's Report.

Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Auditor's Report

169. When the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include a Emphasis of Matter paragraph in the auditor's report provided that the auditor has sufficient appropriate evidence that the matter is not materially misstated in the financial statements. The Emphasis of Matter paragraphs should only refer to information presented or disclosed in the financial statements. When the auditor includes an Emphasis of Matter paragraph, the auditor should:
    - Include it immediately after the Opinion paragraph;
    - Use the Heading "Emphasis of Matter" or other appropriate heading;
    - Include in the paragraph a clear reference to the matter being emphasized and to where the relevant disclosures that fully describe the matter can be found in the financial statements; and
    - Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

170. If the auditor considers it necessary to communicate a matter other than those that are 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 sand this is not prohibited by law or regulation, the auditor should do so in a paragraph with the heading "Other Matter," or other appropriate heading. This paragraph should be immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to Other Reporting Responsibilities.

171. If the auditor expects to include either or both of these paragraphs in the auditor's report, the auditor should communicate with those charged with governance regarding this expectation and the wording of such paragraphs. Auditors may be required or decide to communicate with other parties, such as the legislature, in addition to those charged with governance.

172. In the public sector audit mandates or expectations may expand circumstances relevant for reporting by auditors in an Emphasis of Matter paragraph, if properly disclosed in the financial statements. For example, public sector auditors may decide to include an Emphasis of Matter paragraph for matters related to noncompliance with authorities that have been properly accounted for and/or disclosed in the financial statements. An Emphasis of Matter paragraph related to noncompliance may only be relevant is there is no requirement to provide a separate opinion on compliance with authorities.

173. Auditors may also expand circumstances to include Other Matter paragraph when the information is not disclosed in the financial statements. Restrictions on distribution or use of the auditor's report may not be an option in the public sector.

Comparative Information – Corresponding Figures and Comparative Financial Statements

174. The auditor should determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. To accomplish this, the auditor should evaluate whether:
    - The comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, have been restated; and
    - The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

175. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstance to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. When corresponding figures are presented, the auditor's opinion should not refer to the corresponding figures except for the following circumstances;
    - If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor should modify the auditor's opinion on the current period's financial statements
    - If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, and the corresponding figures have not been properly restated or appropriate disclosures have not been made, the auditor should express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements.
    - If the prior period financial statements were not audited, the auditor should state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited.

    When comparative financial statements are presented, the auditor's opinion should refer to each period for which financial statements are presented and on which an audit opinion is expressed.

176. When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor should disclose the substantive reasons for the different opinion in an Other Matters paragraph.

177. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor should include in an Other Matter paragraph:
    - That the financial statements of the prior period were audited by the predecessor auditor;
    - The type of opinion expressed by the predecessor auditor and if the opinion was modified the reasons therefore; and
    - The date of that report (unless the predecessor auditor's report on the prior period's financial statements is reissued with the financial statement).

178. If the prior period financial statements were not audited, the auditor should state in Other Matter paragraph that the comparative financial statements are unaudited.

The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements

179. The auditor should read the other information to identify material inconsistencies or material misstatement of fact, if any, with the audited financial statements. If the auditor identifies a material inconsistency or material misstatement of fact on reading the other information, the auditor should determine whether the audited financial statements or the other information needs to be revised. The actions the auditor should take may include possible modification of the auditor's opinion, withdraw for the engagement if possible, notifications to those charged with governance, or including an Other Matter paragraph in the auditor's report.

180. If the auditor identifies material inconsistency or material misstatement of fact that management refuses to correct, the auditor is required to communicate with those charged with governance. Auditors may also be required or decide to communicate with other parties, such as the legislature, in addition to those charged with governance.

Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

181. The auditor is required to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements. In an audit of special purpose financial statements, the auditor should obtain an understanding of:
    - The purpose for which the financial statements are prepared;
    - The intended users; and
    - The steps taken by management to determine that the applicable financial reporting framework is acceptable under the circumstances.

182. In planning and performing an audit of special purpose financial statements, the auditor should determine whether application of the ISSAIs require special consideration in the circumstances of the engagement.

183. When forming an opinion and reporting on special purpose financial statements, the auditor should comply with the same requirements as for general purpose financial statements. In the case of an auditor's report on special purpose financial statements, the report should:
    - Describe the purpose for which the financial statements are prepared; and
    - Make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of which framework to use in preparing the financial statements.

184. The auditor should include an emphasis of matter paragraph alerting users that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.

Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

185. In the case of an audit of a single financial statement or of a specific element of a financial statement, the auditor should determine whether the audit of a single financial statement or of a specific element of a financial statement is practicable. In the case of an audit of a single financial statement or of a specific element of a financial statement, the fundamental principles applies irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements. If the auditor is not also engaged to audit the entity's complete set of financial statements, the auditor should determine whether the audit of a single financial statement or of a specific element of those financial statements in accordance with the fundamental principles as included in the applied auditing standards.

186. The auditor should also determine whether application of the financial reporting framework will result in a presentation that provides adequate disclosure to enable the intended users to understand information conveyed in the financial statement or the element, and the effect of material transactions and events on the information conveyed in the financial statement or the element.

187. The auditor should consider whether the expected form of opinion is appropriate in the circumstances, and should apply the requirements in ISSAI 1700, adapted as necessary in the circumstances of the engagement.

188. If the auditor undertakes an engagement to report on a single financial statement or on a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor should express a separate opinion for each engagement. The auditor should also differentiate the opinion on the single financial statement or on the specific element of a financial statement from the opinion on the complete set of financial statements. The auditor should not issue the auditor's report containing the opinion on the single financial statement or on the specific element of a financial statement until satisfied with the differentiation of the information.

189. If the opinion in the auditor's report on an entity's complete set of financial statement is modified or that report includes an Emphasis of Matter paragraph or Other Matter paragraph, the auditor should determine the effect that this may have on the auditor's report on a single financial statement or on a specific element of those financial statements, and when deemed appropriate, the auditor should modify the opinion or include Emphasis of Matter paragraph or Other Matter paragraph in the auditor's report on the single financial statement or on a specific element of those financial statements.

190. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements, the auditor is prohibited from including an unmodified auditor's report on a single financial statement or a specific element. Additional requirements and guidance on issuing these special reports in conjunction with the opinion on the complete set of financial statements is provided in ISSAI 1805.

Considerations relevant for audits of the Group Financial Statements (including whole of government financial statements)

191. **Auditors engaged to audit group financial statements should obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the whole of government financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.**

192. The principles of ISSAI 200 apply to all public sector audits of financial statements, whether they are representing parts of government or the whole of government. In situations where the auditor is engaged to audit group financial statements such as the whole of government accounts, specific requirements and considerations may apply. The auditor performing the audit of group financial statements is referred to as the group auditor. The group auditor should establish a group audit strategy and develop a group audit plan. The principles on understanding the entity should include an understanding of the group, its components and their environments, including group-wide controls as well as the consolidation process. The understanding obtained should be sufficient to confirm or revise the initial identification of components that are likely to be significant for the group financial statements; and to assess the risks of material misstatement of the group financial statements, whether due to fraud or error.

193. Components of group financial statements may include agencies, departments, bureaus, corporations, funds, component units, districts, joint ventures and non-governmental organizations. Components may be considered to be significant:
- Due to their individual financial significance.
- If they are likely to include significant risks of material misstatement of the group financial statements due to their specific nature or circumstances.
- If they involve matters that have heightened public sensitivity, such as national security issues, donor-funded projects or the reporting on tax revenue.

194. In the public sector, it can be difficult to agree the inclusion of certain components in the group financial statements. The application of the financial reporting framework may result in the exclusion of a specific type of agency, department, bureau, corporation, fund, district, joint venture or non-governmental organization from the government financial statements. In such cases, if the group auditor believes that this outcome would result in a misleading government financial statement presentation, the group auditor may, in addition to considering the impact on the auditor's report, also consider the need to communicate the matter to the legislature or other appropriate regulatory bodies. In some situations, the financial reporting framework may not provide specific guidance for inclusion or exclusion of a specific type of agency, department, bureau, corporation, fund, district, joint venture or non-governmental organization in the group financial statements. In such cases, the government group auditor may participate in discussions between group management and component management to determine whether the treatment of the component in the group financial statements will result in fair presentation. Such difficulty may have implications for using the work of the component auditors. It is also possible that group management may not agree with the inclusion of the component in the group financial statements, which, in turn, may limit the ability of the group auditor to communicate with and use the work of the component auditor.

195. For a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on its behalf, should perform an audit of the financial information of the component using component materiality set by the

government auditor. For a component that is significant because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, may not need to perform an audit of the financial information, but may apply specified audit procedures relating to the significant risks identified. For components that are not significant components, the group engagement team should perform analytical procedures at group level.

196. The government group auditor needs to communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings.

197. When developing or adopting auditing standards based on or consistent with the fundamental principles of financial auditing it may be useful to consider the guidance in ISSAI 1600[21] that provides further detailed guidance on group audits.

[21] Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors).