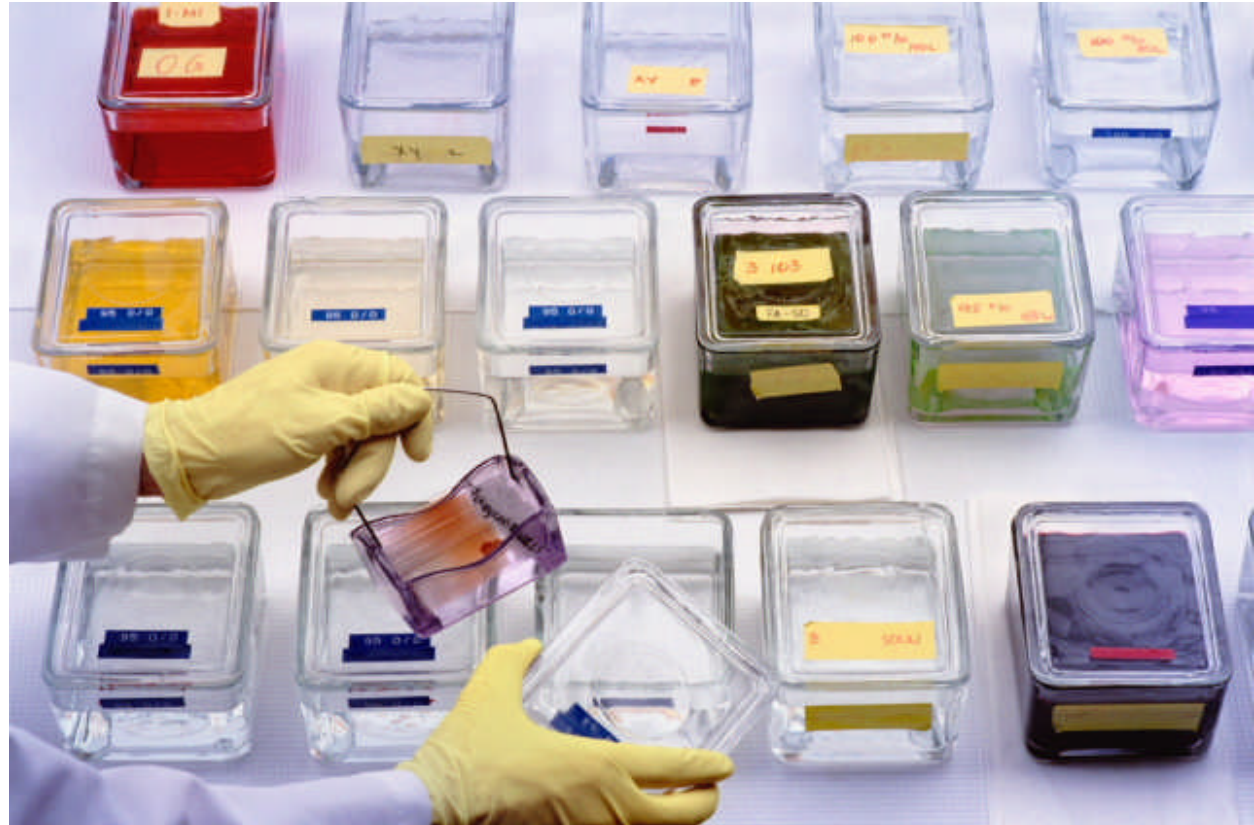


Technical Session:

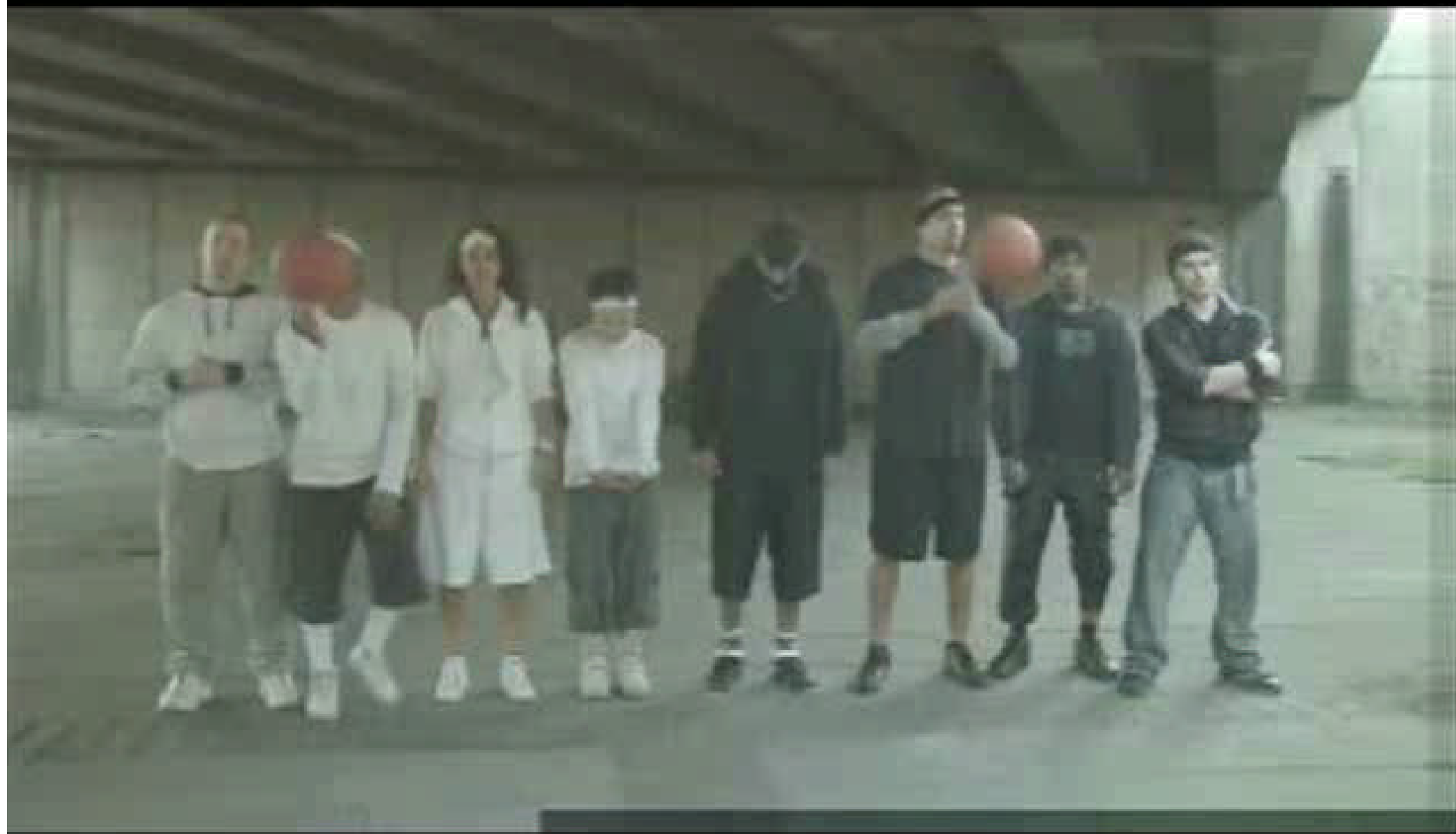
# Practical audit guidance – key audit areas



Awareness test – part 1

Pay close attention...

**Awareness Test**



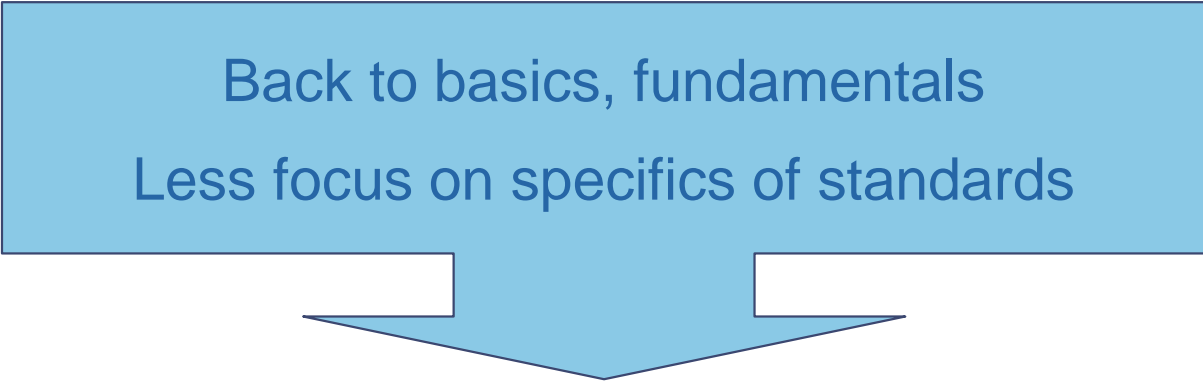
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# Agenda/Contents

## Practical guidance

- Auditors' skepticism in areas of fraud, material misstatements
- Management assumptions and estimates
- Auditors' role in presentation and disclosure of financial statements



Back to basics, fundamentals  
Less focus on specifics of standards

# Skepticism & Fraud

## What the standards say...

Standards abound

200

330

500

240



Professional Skepticism

15. **The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.**
16. An attitude of professional skepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. For example, an attitude of professional skepticism is necessary throughout the audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof. When making inquiries and performing other audit procedures, the auditor is not satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

→ Plan and perform an audit with an attitude of professional skepticism..

# Skepticism & Fraud

## What the standards say...

Standards abound

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### Overall Responses (Ref: Para. 5)



A1. Overall responses to address the assessed risks of material misstatement at the financial statement level may include:

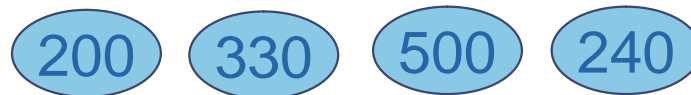
- Emphasizing to the audit team the need to maintain professional skepticism.
- Assigning more experienced staff or those with special skills or using experts.
- Providing more supervision.
- Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.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

→ Emphasize to the team the need to maintain professional skepticism..

# Skepticism & Fraud

## What the standards say...

Standards abound



### Sufficient Appropriate Audit Evidence

7. Sufficiency is the measure of the quantity of audit evidence. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions. The quantity of audit evidence needed is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of audit evidence are interrelated. However, merely obtaining more audit evidence may not compensate for its poor quality.
14. In forming the audit opinion the auditor does not examine all the information available because conclusions ordinarily can be reached by using sampling approaches and other means of selecting items for testing. Also, the auditor ordinarily finds it necessary to rely on audit evidence that is persuasive rather than conclusive; however, to obtain reasonable assurance,<sup>2</sup> the auditor is not satisfied with audit evidence that is less than persuasive. The auditor uses professional judgment and exercises professional skepticism in evaluating the quantity and quality of audit evidence, and thus its sufficiency and appropriateness, to support the audit opinion.

→ Exercise professional skepticism in evaluating audit evidence..

# Skepticism & Fraud

## What the standards say...

Standards abound

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500

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### Requirements

### Professional Skepticism



12. In accordance with SSA 200, the auditor shall maintain an attitude of professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref. Para. A7- A8)
13. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref. Para. A9)
14. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

→ Maintain attitude of professional skepticism throughout the audit..

# Skepticism – what is it?

But ..

how is professional skepticism acquired?

nature or nurture?

taught or caught?

Not confined to standards and compliance

DOES IT MAKE SENSE? ..... DOES IT SMELL RIGHT??

# Skepticism – helps & guides



# Skepticism – sources of help

Knowledge

Experience

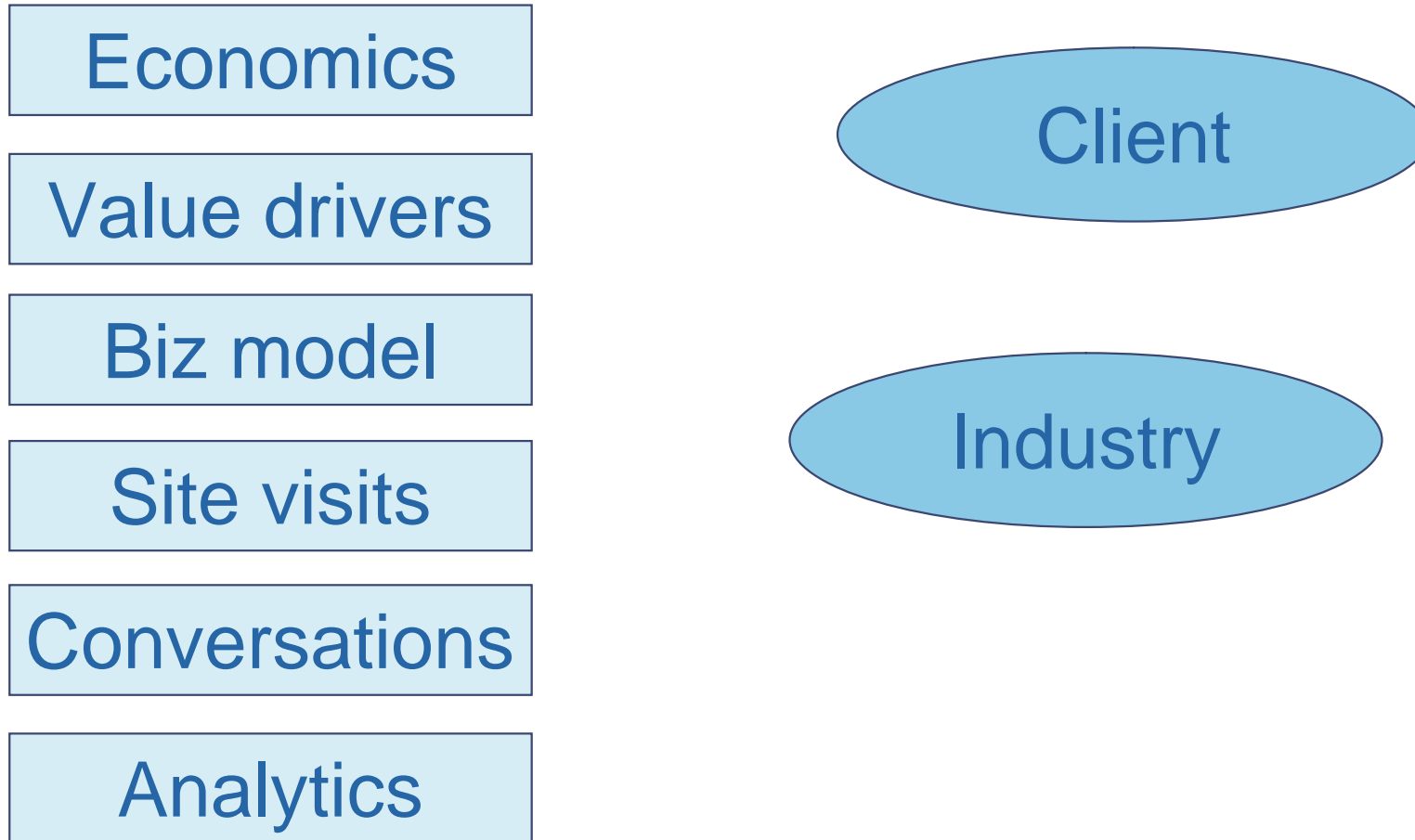
Market talk

Analyst reports

News feeds

Benchmarking

# Skepticism – other indicators & guide



# Skepticism – decoding management

Past interactions

Experience

Track record

Credentials

Other corroborative info

Show me meetings

Management

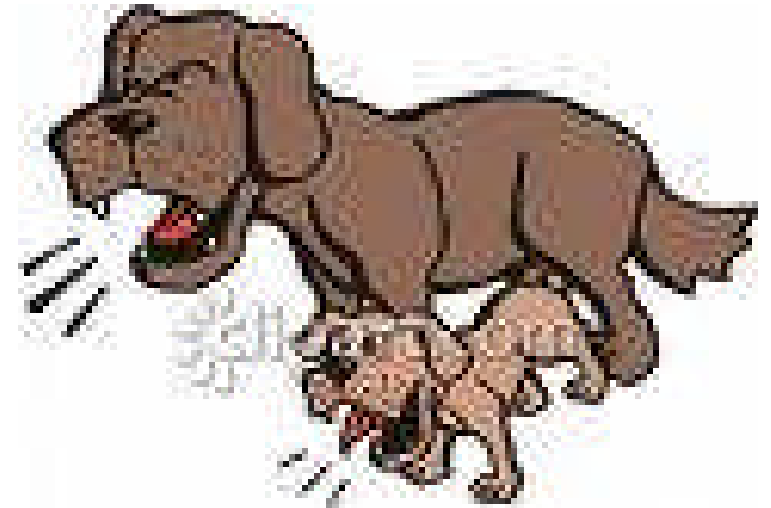
# Skepticism – what's called of auditors?

**BLOODHOUND**



**OR**

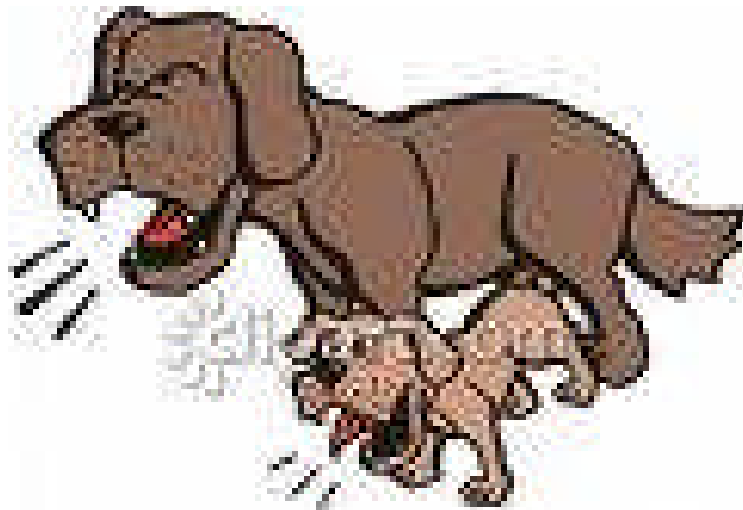
**WATCHDOG ?**



# Skepticism – our response

Typically → WatchDog

HOWEVER, if indicators of fraud exist → Bloodhound?



# Skepticism – our response

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## Evaluation of Audit Evidence (Ref: Para. A48)

34. The auditor shall evaluate whether analytical procedures that are performed when forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's understanding of the entity and its environment indicate a previously unrecognized risk of material misstatement due to fraud. (Ref: Para. A49)
35. When the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. (Ref: Para. A50)
36. If the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is or may be the result of fraud and that management (in particular, senior management) is involved, the auditor shall reevaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of audit procedures to respond to the assessed risks. The auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained. (Ref: Para. A51)
37. When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor shall evaluate the implications for the audit. (Ref: Para. A52)

- Heightened alertness
- Scrutinize evidence, representations, explanations
- Revisit – nature, extent, timing of audit tests

# Skepticism → when things go wrong

CASE STUDY 1

CASE STUDY 2



# Management's assumptions and estimates

540

## Requirements

### Risk Assessment Procedures and Related Activities

8. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, as required by SSA 315 (Redrafted),<sup>4</sup> the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates: (Ref. Para. A12)
  - (a) The requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosures. (Ref. Para. A13-A15)
  - (b) How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates. (Ref. Para. A16-A21)
  - (c) How management makes the accounting estimates, and an understanding of the data on which they are based, including: (Ref. Para. A22-A23)
    - (i) The method, including where applicable the model, used in making the accounting estimate; (Ref. Para. A24-A26)

- The auditor should obtain an understanding of how management makes the accounting estimates, and an understanding of the data on which they are based....

# Management's assumptions and estimates

Consider ..

- management's view → objective, neutral, 'best' judgement or biased?
- quality/existence of corroborative evidence?

Market expectations

Benchmarking

Expert views

Past track record

Analytics

- management representation in rep letter → good enough?

# Presentation & disclosure of financial statements

Financial reporting standards abound



Overriding objective of disclosures?

→ business drivers and results achieved

vs industry trends, economic happenings

# Financial statements – key expectations

No material  
adjustments after  
approval/release of  
financial statements

Company does **not**  
collapse after  
approval/release of  
financial statements

IF ....

THE KEY QUESTION for the auditor:

**Did the financial statements tell the 'Right' STORY??**

# Financial statements – getting the balance right

Quantity  $\leftarrow$   $\rightarrow$  Quality



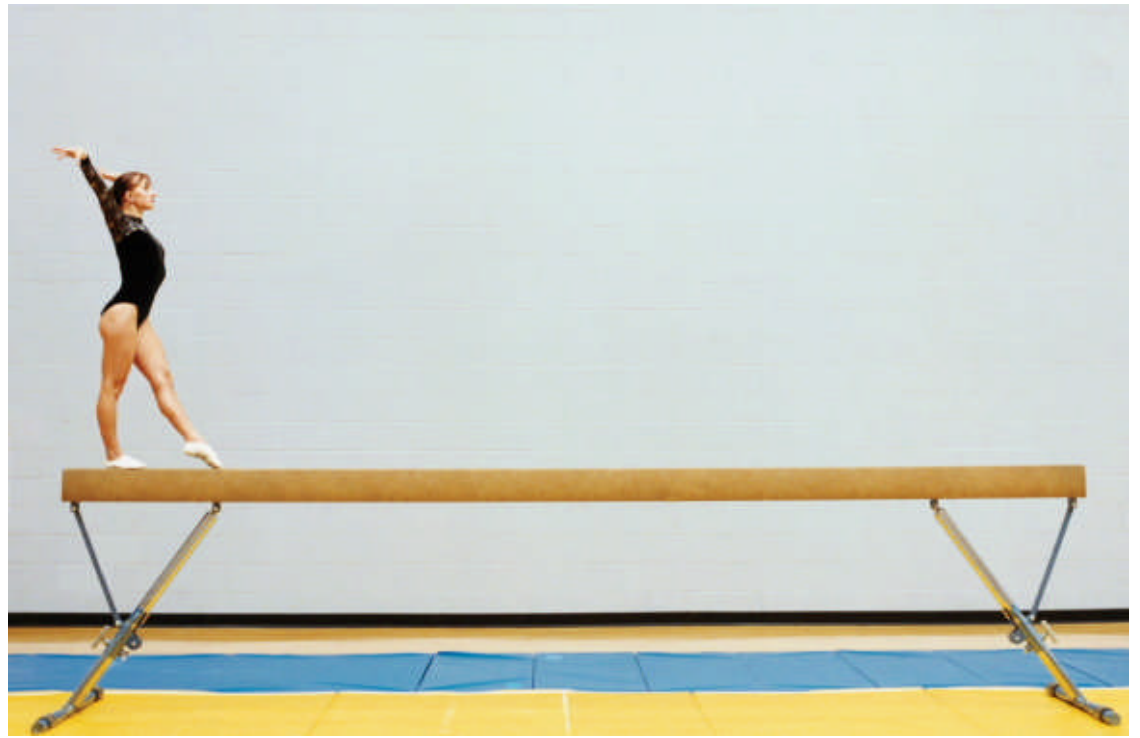
Focus on:

- Disclosure of key issues?
- On balance sheet items?
- Off balance sheet items?
- Areas of judgement & estimates?
- Risk assessment and issues?

# Summary

- How many steps does it take to complete an audit?

?



- But did you 'spot' ...

Material  
misstatement /  
fraud?

Mis-judgement of  
management  
assumptions /  
wrong estimate?

Inappropriate or  
inaccurate  
presentation /  
disclosure

# CONCLUSION

- Be skeptical, use your judgement
- Challenge management assumptions and estimates
- Consider big picture when reviewing financial statements

## How aware are you?

