ACCA AA Section A Mind Map

Got it Pass

Audit framework and regulation

Explain the concept of audit and assurance and the functions of audit, corporate governance, including ethics and professional conduct

1. The concept of audit & other assurance engagements

The **objective** of **an audit** of financial statements is to enable 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.

An **audit provides assurance** to the shareholders and other stakeholders of a company on the financial statements because it is **independent** and **impartial**.

An external audit is a type of assurance engagement that is carried out by an auditor to give an independent opinion on a set of financial statements.

The auditor's report on company financial statements is expressed in terms of **truth and fairness**. This is generally taken to mean that financial statements: i) Are factual; ii) Are free from bias; iii) – Reflect the commercial substance of the business's transactions

2. External audits

Most companies are required to have an audit by law, but some small companies are exempt. The outcome of the audit is the auditor's report, which sets out the auditor's opinion on the financial statements.

The law gives auditors both rights and duties. This allows auditors to have sufficient power to carry out an independent and effective audit.

There are various legal and professional requirements **on appointment, resignation and removal of auditors** which must be followed.

Requirements for **the eligibility, registration and training** of auditors are extremely important, as they are designed to maintain standards in the auditing profession.

International Standards on Auditing are set by the International Auditing and Assurance Standards Board.

3. Corporate governance

Corporate governance is the system by which **companies are directed and controlled.**

The OECD Principles of Corporate Governance set out the rights of shareholders, the importance **of disclosure and transparency** and the responsibilities of the board of directors.

The UK Corporate Governance Code contains detailed guidance for UK companies on good corporate governance.

An **audit committee** can help a company maintain objectivity with regard to financial reporting and the audit of financial statements.

The directors of a company are responsible for ensuring that a company's risk management and internal control systems are effective.

Auditors shall communicate specific matters to those charged with governance and **ISA 260** provides guidance for auditors in this area.

4. Professional ethics and ACCA's Code of Ethics and Conduct

Members of the ACCA must comply with the fundamental principles set out in the Code of ethics and conduct (**integrity, objectivity, professional competence and due care, confidentiality and professional behaviour**).

Although auditors have a professional duty of confidentiality, they may be compelled by law it necessary in the **public interest** to disclose details of clients' affairs to third parties.

Threats to independence and objectivity may arise in the form of **self-review, self-interest, advocacy, familiarity and intimidation threats**.

ACCA AA Section B Mind Map

Got it Pass

Planning and risk assessment

Demonstrate how the auditor obtains and accepts audit engagements, obtains an understanding of the entity and its environment, assesses the risk of material misstatement (whether arising from fraud or other irregularities) and plans an audit of financial statements

1. Obtaining, accepting & continuing audit engagements

The present and proposed auditors must **communicate** with each other prior to the audit being accepted; however, if the client refuses to give **permission** to the proposed auditors to make contact, the proposed auditors must decline nomination. The terms of the audit engagement shall be agreed with management and recorded in an audit engagement

ISA 220 requires firms to implement quality control procedures over individual audit engagements.

2. Objective and general principles

In order to obtain assurance about whether the financial statements **are free from material misstatement**, the auditor needs to consider how and where misstatements are most likely to arise. Full description of the auditor's objectives are given in **ISA 200**.

Auditors are required to carry out the audit with an attitude of **professional scepticism**, exercise **professional judgement** and **comply with ethical requirements**.

3. Assessing audit risks

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are **materially misstated**.

It is a function of the risk of material misstatement (**inherent risk and control risk**) and the risk that the auditors will not detect such misstatement (**detection risk**).

Materiality for the financial statements as a whole and performance materiality must be **calculated at the planning stages** of all audits.

The calculation or estimation of materiality should be **based on experience and judgement**.

Materiality for the financial statements as a whole must be reviewed throughout the audit and revised if necessary.

4. Understanding the entity & its environment

The auditor is required to obtain an understanding of the entity and its environment in order to be able to assess the risks of material misstatements.

When the auditor has obtained an understanding of the entity, they shall assess the risks of material misstatement in the financial statements, also identifying significant risks.

5. Fraud, laws & regulations

Significant risks are complex or unusual transactions that may indicate fraud, or other special risks.

The auditor shall formulate an approach to the assessed risks of material misstatement.

When carrying out risk assessment procedures, the auditor shall also consider the risk of fraud or noncompliance with law and regulations causing a misstatement in the financial statements.

6. Audit planning and documentation

Auditors must ensure they have documented the work done at the risk assessment stage, such as the discussion among the audit team of the susceptibility of the financial statements to material misstatements, significant risks, and overall responses.

ISAs 315 and **330** contain a number of general requirements about documentation

The auditor formulates an overall **audit strategy** which is translated into a **detailed audit plan** for audit staff to follow.

The overall audit strategy and audit plan shall be updated and changed as necessary during the course of the audit.

It is important to document audit work performed in working papers to:
– Enable reporting partner to ensure all planned work has been completed adequately
– Provide details of work done for future reference
– Assist in planning and control of future audits
– Encourage a methodical approach

ACCA AA Section C Mind Map

Got it Pass

Internal control

Describe and evaluate internal controls, techniques and audit tests, including IT systems to identify and communicate control risks and their potential consequences, making appropriate recommendations. Describe the scope, role and function of internal audit.

1. Internal control systems: The auditors must understand the accounting system and control environment in order to determine their audit approach. Internal control has **five components**: i) The control environment; ii) The entity's risk assessment process; iii) The information system relevant to financial reporting; iv) Control activities; v) Monitoring of controls

2. Use and evaluation of internal control systems by auditors

The auditors shall **assess the adequacy** of the systems as a basis for the financial statements and shall **identify risks of material misstatements** to provide a basis for designing and performing further **audit procedures**.

The auditors must keep a record of the client's systems which must be updated each year. This can be done through the use of narrative notes, flowcharts, questionnaires / checklists.

Internal Control Questionnaires (ICQs) vs Internal Control Evaluation Questionnaires (ICEQs)

3. Test of controls

Tests of control are tests performed to obtain audit evidence about the effectiveness of the:

- **Design** of the accounting and internal control systems, ie whether they are suitably designed to prevent, or detect and correct, material misstatement at the assertion level; and
- **Operation** of the internal controls throughout the period.

There are special considerations for auditors when a system is computerised. **IT controls comprise general and application controls.**

Test of controls in different systems:

Sales system: Selling (authorisation); Goods outwards (custody); Accounting (recording).
Purchase system: Buying (authorisation); Goods inwards (custody); Accounting (recording)
Inventory controls designed to ensure safe custody.
Cash system: Prevent fraud or theft
Payroll system: Control in staff changes; Calculation & payment of wages and salaries;
Key controls over **capital and revenue expenditure** are the general purchase controls.

4. Communication on internal control

Significant deficiencies in internal controls shall be communicated in writing to those charged with governance in a report to management in accordance with ISA 265.

A **significant deficiency in internal control** is a deficiency in internal control that is of sufficient importance to merit the attention of those charged with governance.

Reports to management can be sent by external auditors after both the interim and final audits. They set out deficiencies in internal control, the implications of those deficiencies on the business and suggested recommendations to mitigate them.

5. Internal audit & governance & differences between external audit and internal audit

Internal audit assists management in achieving the entity's corporate objectives, particularly in establishing good corporate governance.

Although many of the techniques internal and external auditors use may be similar, the basis and reasoning of their work is different. **Objective**:
Internal Audit - Designed to add value to and improve an organisation's operations.
External Audit - An exercise to enable auditors to express an opinion on the financial statements.

6. Scope of internal audit function, outsourcing and internal audit assignments

Internal audit has two key roles to play in relation to organisational risk management:
– Ensuring the company's risk management system operates effectively
– Ensuring that strategies implemented in respect of business risks operate effectively

It is the responsibility of management and those charged with governance to prevent and detect fraud, and, internal auditors may have a role to play. These can range from **value for money** projects to **operational** assignments looking at specific parts of the business.

The internal auditors**' report may take any form**, as there are no formal reporting requirements for these reports as there are for the external auditor's report.

Internal audit departments may consist of employees or outsourced**. The advantages of outsourcing** include speed, cost and a tailored answer to internal audit requirements. One of the main **disadvantages** may include threats to independence and objectivity.

ACCA AA Section D Mind Map

Got it Pass

Audit evidence

Identify & describe the work & evidence obtained by auditor & others required to meet the objectives of audit engagements & application of the ISAs

1. Financial statement assertions & audit evidence:

Auditors must design and perform audit procedures to obtain sufficient appropriate audit evidence.

- **Audit tests** are designed to obtain evidence about the financial statement assertions. Assertions relate to classes of transactions and events and related disclosures and account balances at the period end and related disclosures. Audit evidence can be obtained by inspection, observation, enquiry and confirmation, recalculation, reperformance and analytical procedures.

2. Audit procedures

- **Substantive procedures** can be used to obtain sufficient appropriate audit evidence.
- **Substantive tests** are designed to discover errors or omissions.
- **Analytical procedures** are used at all stages of the audit, including substantive procedures.
- When auditing **accounting estimates**, auditors must: 1) Test the management process; 2) Use an independent estimate; 3) Review subsequent events

3. Audit sampling and other means of testing

- Auditors usually seek evidence from less than 100% of items of the balance or transaction being tested by **using sampling techniques**.
- **Key stages** in the sampling are as follows: 1) Determining objectives & characteristics of the population; 2) Determining sample size; 3) Choosing method of sample selection; 4) Projecting errors and evaluating the results

5. Computer-assisted audit techniques

- **Computer-assisted audit techniques** (CAATs) are applications of auditing procedures using the computer as an audit tool.

- The two most commonly used CAATs are **audit software** and **test data**.

6. The work of others

- External auditors may make use of the work of an **auditor's expert**, **internal auditors** and **service organisations** and their auditors when carrying out audit procedures.
- A **service organisation** provides services to user entities. There may be special considerations for the auditor of a user entity when that entity makes use of a service organization.

7. Not-for-profit organisations

- Audit risks associated with not-for-profit organisations are different from other entities.
- Cash may be significant in not-for-profit organisations and controls may be limited. Income may well be a risk area, particularly where money is donated or raised informally.
- Obtaining audit evidence may be a problem.

4. The audit of specific items

Receivables

- Usually audited using a combination of *tests of details* and *analytical procedures*.
- *Existence, completeness* & *valuation* are key assertions in the audit of receivables.
- A *confirmation of receivables* is a major procedure.

Payables & accruals

- The largest figure in *current liabilities* will normally be *trade accounts payable* which are generally audited by comparison of *suppliers' statements* with *purchase ledger accounts*.

Bank & cash

- *Bank balances* are usually *confirmed directly* with the bank in question.
- The *bank confirmation letter* can be used to ask a variety of questions.
- *Cash balances* should be verified if *material* or *irregularities* are suspected.

Tangible & intangible non-current assets

- Key areas when testing tangible non-current assets are: 1) Confirmation of ownership; 2) Inspection of non-current assets; 3) Valuation by third parties; 4) Adequacy of depreciation rates
- Key assertions: *existence and valuation*.

Non-current liabilities, provisions & contingencies

- Non-current liabilities are usually *authorised by board & well documented*.
- The accounting treatments for provisions & contingencies are complex; it involves *judgement and difficult to audit*.

Share capital, reserves & directors' emoluments

- The main concern is that the company has *complied with the law.*
- Disclosure of directors' emoluments is *complete, accurate & compliant* with both accounting standards & local legislation.

Inventory

- The *key assertions* relating to inventory are: 1) Existence; 2) Completeness; 3) Rights and obligations; 4) Valuation; 5) Cut-off. *Physical inventory count procedures are vital.*
- The valuation and disclosure rules for inventory are laid down in *IAS 2 Inventories*.
- Auditors should *test cut-off* by noting the serial numbers of GDNs and GRNs.
- Auditing the *valuation of inventory* includes: 1) Testing the allocation of overheads is appropriate; 2) Confirming inventory is carried at the lower of cost and net realisable value

ACCA AA Section E Mind Map

Got it Pass

Review and reporting

Explain how consideration of subsequent events and the going concern principle can inform the conclusions from audit work and are reflected in different types of auditor's report, written representations and the final review and report.

2. Going concern

If entity has inappropriately used the going concern assumption or a material uncertainty exists, this may impact on the auditor's report.

Under the **going concern assumption**, an entity is viewed as continuing in business for the foreseeable future. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

The auditor shall **communicate with those charged with governance** events or conditions that may cast doubt on the entity's ability to continue as a going concern. This will include:

- Whether the events or conditions constitute a material uncertainty
- Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements
- The adequacy of related disclosures

1. Subsequent events

- **Subsequent events** are events occurring between the period end and the date of the auditor's report and also include facts discovered after the auditor's report has been issued. Auditors shall consider the effect of such events on the financial statements and on their audit opinion.
- Auditors have a **responsibility to review subsequent events** before signing auditor's report, & have to take action if they become aware of subsequent events between the date they sign the auditor's report and the date the financial statements are issued.

3. Written representations

- The auditor obtains **written representations** from management concerning its responsibilities and to support other audit evidence where necessary.
- **Written representations** are written statements by management provided to the auditor to confirm certain matters or to support other audit evidence. They do not include the financial statements, assertions or supporting books and records.
- **ISA 580 Written representations** provides guidance to auditors in this area.

4. Audit finalization and the final review

The auditors must perform and document an overall review of the financial statements by undertaking analytical procedures before they can reach an opinion.

When examining the **accounting policies**, auditors should consider:
(a) Policies **commonly adopted in particular industries**
(b) Policies for which there is **substantial authoritative support**
(c) Whether any **departures from applicable accounting standards** are necessary for the financial statements to give a true and fair view
(d) Whether the **financial statements reflect the substance** of the underlying transactions and not merely their form

ISA 450 requires the auditor to document the following information:

- The amount below which misstatements would be regarded as clearly trivial
- All misstatements accumulated during the audit and whether they have been corrected
- The auditor's conclusion as to whether uncorrected misstatements are material and the basis for that conclusion

5. The independent auditor's report

- The auditor is required to produce an auditor's report at the end of the audit which sets out their opinion on the **truth and fairness** of the financial statements. The report contains a number of consistent elements so that users know the audit has been conducted according to recognised standards.
- An **unmodified opinion** is the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- Listed company auditor's reports include a description of the **key audit matters**.
- **Emphasis of matter paragraphs** and **other matter paragraphs** can be included in the auditor's report under certain circumstances. Their use does not modify the auditor's opinion on the financial statements.
- There are **three types of modified opinion**: a qualified opinion, an adverse opinion and a disclaimer of opinion.