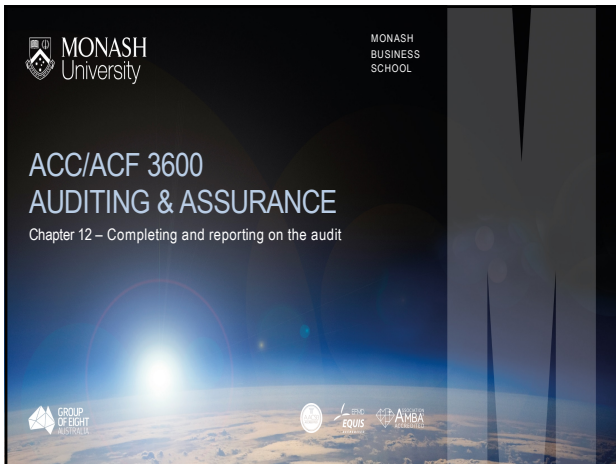




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MONASH BUSINESS SCHOOL

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- 12.1 Explain the procedures performed as part of the **engagement wrap-up**, including gathering and evaluating audit evidence
- 12.2 Explain the considerations when assessing the **going concern assumption** used in the preparation of the financial report
- 12.3 Assess the **two types of (material) subsequent events** to determine what effect they have on the financial report (if any)
- 12.4 Evaluate misstatements and explain the difference between **quantitative and qualitative considerations** when evaluating misstatements
- 12.5 Evaluate conclusions obtained during the performance of the audit and explain how these **conclusions link to the overall opinion** formed on the financial report
- 12.6 Explain the **components of an audit report**
- 12.7 Discriminate between the **types of modifications** to an audit report
- 12.8 Explain why **Corporations Act breaches** are important to understand
- 12.9 Explain what reporting is required to management and those charged with governance

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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MONASH BUSINESS SCHOOL

ENGAGEMENT WRAP-UP

- Auditor **finalises any open items** before issuing audit report
- Any **remaining audit procedures** are **assigned, due date set for completion**
- **Audit partner** determines if **procedures executed as planned** and **all relevant matters** have been considered appropriately

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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ENGAGEMENT WRAP-UP

AREAS COVERED DURING WRAP-UP

1. Review planned procedures for proper and complete execution
2. Determine all necessary matters appropriately considered
3. Revisit open review notes, 'to-do' items, incomplete procedures – attention needed? Resolve items
4. Remove all unnecessary documentation, drafts and review notes from review file
 - ❖ ASA 230; ISA 230, ASA 315; ISA 315, ASA 330; ISA 330 requirements for developing, altering and storing audit documentation

Adapted from Moroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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ENGAGEMENT WRAP-UP

AREAS COVERED DURING WRAP-UP

5. For multi-location audits, obtain documents from other auditors as required
6. Remove documents not required to support opinion
7. Consider materiality level used in audit
 - ❖ Is it still appropriate given factors or conditions found during audit?
 - ❖ For example, significant change in anticipated operating results, numerous unexpected misstatements

Adapted from Moroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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ENGAGEMENT WRAP-UP

AREAS COVERED DURING WRAP-UP

8. Reconsider assessments of internal control at entity level and risk of fraud given results of control tests, misstatements discovered during audit
 - ❖ Problems may be too pervasive to continue with audit
9. Revisit planning documentation to determine if all matters in plan have been addressed
10. Perform subsequent events procedures
 - ❖ Identify events occurring between year-end and date of audit report that might require adjustment or disclosure
11. The entity's annual report to consider if there are any material inconsistencies, that is, any material inconsistency between the audited financial report and the other information, found in ASA 720 (ISA 720) (Revised).

Adapted from Moroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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ENGAGEMENT WRAP-UP

Auditor must decide if there is **sufficient appropriate** audit evidence to support audit opinion - consider:

- **Materiality of misstatements**
- **Management responses**
- **Previous experience**
- **Results of audit procedures** performed
- **Quality of information** obtained
- **Persuasiveness** of the audit evidence
- Whether evidence obtained **supports or contradicts** the results of the risk assessment procedures

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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ENGAGEMENT WRAP-UP

- Auditor evaluates audit evidence to decide whether:
 1. **The assessments of the risk of material misstatement** at the assertion level are appropriate, and
 2. **Sufficient evidence has been obtained** to reduce the risk of material misstatement in the financial report to an acceptably low level
- **Audit team** discusses progress throughout engagement, modifies planned procedures to reflect changes to original risk assessments

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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ENGAGEMENT WRAP-UP

When **misstatements** or **control deviations** found in planned procedures, consider:

- **Reason** for the misstatement or deviation
- **Impact** on risk assessments and other planned procedures
- Need to **modify or perform further audit procedures**
- Need to **revise materiality level** due to:
 - ❖ **New information**, e.g. client obtained new loan with more restrictive debt covenants
 - ❖ **Change in auditor's understanding** of the entity and its operations
 - ❖ **New circumstances**, e.g. significantly lower profit

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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GOING CONCERN

- Going concern assumption underpins accounting on the basis that the entity will be **able to realise its assets and discharge its liabilities** in the normal course of business
- Management must assess going concern;
 - ❖ On basis of **12 months** from directors' report
 - ❖ Use **information available** at time of assessment
 - ❖ Judgments affected by **size and complexity of entity, nature and condition of its business**, degree to which business affected by **external factors**

Adapted from Maroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.), Wiley

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GOING CONCERN

Auditor considers **reasonableness of management's assessment of going concern** and whether **disclosures** are required in financial report (ASA 570; ISA 570)

- Consider reasonableness of management's procedures to **identify going concern issues** and **mitigating circumstances**
- If going concern assumption is not appropriate, management should prepare financial report on **liquidation basis**

Adapted from Maroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.), Wiley

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SUBSEQUENT EVENTS

- **Financial report is based on events up to, and conditions existing at, year-end**
- Three other key dates:
 - ❖ **Date financial report approved by management**
 - ❖ **Date of auditor's report**
 - ❖ **Date financial report publicly released**
- **Subsequent events:**
 - ❖ **Events that occur between year-end and the date of auditor's report, and facts discovered after date of auditor's report**

Adapted from Maroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.), Wiley

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SUBSEQUENT EVENTS

- **TYPE 1 SUBSEQUENT EVENTS**
 - ❖ Events that provide additional evidence with respect to **conditions that existed at year-end**
- **TYPE 2 SUBSEQUENT EVENTS**
 - ❖ Events that provide evidence with respect to **conditions that developed subsequent to year-end**
- See AASB 110 (IAS 10) and ASA 560; ISA 560 for guidance on reporting and auditing these events

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

TYPE 1 SUBSEQUENT EVENTS – Adjusting Events

- Can **affect estimates in financial report**, or **indicate that going concern assumption** is not appropriate
- Accounting treatment: **adjust financial report** for the effect of these events, where material
- Examples:
 - ❖ **Bankruptcy of customer** after year-end which would be considered when evaluating **provision for doubtful debts**
 - ❖ **Amount received for insurance claim in negotiation** at year-end
 - ❖ **Deterioration in operating results** after year-end that means going concern not appropriate

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

(Figure 12.1 Type 1 subsequent events – consequences depend on timing)

```

graph LR
    A[Change the amounts and possibly the disclosures in the draft financial report and consider impact on audit report] --> B[Withdraw audit report, change financial report and amend audit report, reissue]
    B --> C[Usually No Action Required]
    
```

Timeline:

← Directors adopt and sign financial report → Financial report is authorised for issue by the directors → Audited financial report and audit report signed and released →

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

TYPE 2 SUBSEQUENT EVENTS

- Do not result in changes to amounts in the financial report
- Might be so significant to require **disclosure**
- Do not require accounts to be adjusted
- Examples:
 - ❖ Uninsured loss of assets due to fire, flood, subsequent to year-end
 - ❖ Purchase of a business, issuance of shares or debt subsequent to year-end

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

(Figure 12.2 Type 2 subsequent events)

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

AUDITOR'S RESPONSIBILITIES FOR BOTH TYPES

- Prior to signing audit report, auditor completes procedures to **identify any events post year-end** that might require adjustment or disclosure in accounts
- After signing audit report, if auditor becomes aware of a fact that may **materially** affect financial report:
 - ❖ Consider if financial report needs changing
 - ❖ Discuss matter with client
 - ❖ Take action appropriate in circumstances
 - Before the release of financial report, if client will not adjust financial report where auditor believes it should be changed, consider **issuing qualified or adverse opinion**
 - If financial report issued, auditor might **withdraw audit report**, prevent reliance on report

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

AUDIT PROCEDURES:

- Auditor is concerned only with **significant events** occurring subsequent to balance sheet date that **might require adjustment, disclosure** in accounts
- Nature of procedures depends on:
 - ❖ Auditor's knowledge of client circumstances
 - ❖ Management procedures to identify events
 - ❖ Volatility and strength of client's business
 - ❖ Auditor's understanding and evaluation of sources of information for significant accounts
 - ❖ Presence of known problems increasing client exposure to significant changes in financial position

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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SUBSEQUENT EVENTS

AUDIT PROCEDURES:

- Gain understanding of and **make evaluation of management processes** to deal with subsequent events
- Read board meeting minutes
- Analyse latest interim results, budgets, accounting decisions, loan repayments and compliance
- Extend analytical procedures to audit report date
- Enquiries of legal counsel, board members, management
- Obtain written representations ASA 580; ISA 580

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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MISSTATEMENTS

FACTORS TO CONSIDER WHEN EVALUATING:

- Significance of **financial report element** affected by misstatement
- Significance of **misstatements** relative to **known user needs**
- Effect of misstatements on **segment information**, or other important portion of **client's business**
- Effects of **offsetting misstatements** in different financial report captions, e.g. cash and prepayments

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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MISSTATEMENTS

Current year misstatements

- Auditor prepares **schedule of uncorrected differences** in order to assess **overall** effect on financial report and on **individual** items or balances
- Consider **effect on future years' reports**

Prior year misstatements

- May be **immaterial in previous year**, could be **material this year** (ISA 450; ISA 450)
- Consider potential **turn around**
 - e.g. understating payables last year due to cut-off error turns-around this year

Adapted from Moroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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MISSTATEMENTS

- Consider both **quantitative** and **qualitative** aspects of misstatements
- Qualitative examples:**
 - Affects **compliance with regulatory requirements** or **debt covenants**
 - Affects client's **compliance with contractual requirements** of operating and **other agreements**
 - Affects management's **satisfaction of requirements for award of bonuses** and **incentive compensation**
 - Changes **reported profit into loss**
 - Changes **individual line items** by material amount
 - Changes **key ratios** monitored by analysts
 - Sensitivity of circumstances e.g. **fraud and illegal acts**.

Adapted from Moroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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EVALUATING CONCLUSIONS, FORMING OPINION

TO FORM AN OPINION:

- Evaluate **audit evidence obtained**
- Evaluate effects of **unrecorded misstatements** and **qualitative aspects** of entity's accounting
- Evaluate whether financial report **properly prepared and presented** according to standards
- Evaluate **fair presentation** of financial report

Adapted from Moroney, Robyn, et al. (2017). Auditing: A practical approach (3rd ed.). Wiley

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AUDIT REPORT STRUCTURE (ASA 700)

Report on the Audit of the Financial Report

Opinion

- True and fair view of financial position / performance
- Compliance with Corporations Regulations 2001

Basis for Opinion

- ASA
- Independence

Emphasis of Matter

- If any

Material Uncertainty Related to Going Concern

- If applicable, draw attention to the relevant note in the financial report

Key Audit Matters

- Matters of most significance in the audit

Other Information

- Unaudited Information in the annual report

Adapted from ISA 700

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DIFFERENT AUDIT OPINIONS

Unmodified:

- Also known as an **UNQUALIFIED OPINION** or **clean opinion** – as in a 'clean bill of health'.

Modified:

- Modifications that **do not affect** the auditor's opinion:

- ❑ Emphasis of matter

- Modifications that **affect** the auditor's opinion:

- ❑ Qualified Opinion
- ❑ Adverse opinion
- ❑ Disclaimer of Opinion

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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EMPHASIS OF MATTER

- Applies when resolution of a matter is **dependent on future actions or events not under direct control** of the entity, but that may affect the financial report, and the matter is **disclosed in the financial report**

Significant uncertainty — other	Emphasis of matter
Additional disclosures with which the auditor concurs	Emphasis of matter
Subsequent event resulting in a new auditor's report on a revised financial report	Emphasis of matter

Illustrative examples (ASA 706)

Emphasis of Matter

We draw attention to Note X of the financial report, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

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Material Uncertainty Related to Going Concern (ASA 570)

- Unqualified audit opinion
- Appropriate disclosure of the material uncertainty in the financial report

Illustrative example (ASA 570)

Material Uncertainty Related to Going Concern

We draw attention to Note 6 in the financial report, which indicates that the Company incurred a net loss of ZZZ during the year ended 30 June 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note 6, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

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Modifications that affect the auditor's opinion

Nature of matter giving rise to the qualification	Auditor's judgement about the pervasiveness of the effects or possible effects on the financial report	
	Material but not pervasive	Material and pervasive*
Financial report is materially misstated	A Qualified opinion	Adverse opinion C
Inability to obtain sufficient appropriate audit evidence	B Qualified opinion	Disclaimer of opinion D

Key concepts (ASA 705):

- Pervasive effects:**
 - "(i) Are not confined to specific elements, accounts or items of the financial report;
 - (ii) If so confined, represent or could represent a substantial proportion of the financial report; or
 - (iii) In relation to disclosures, are fundamental to users' understanding of the financial report. "
- Inability to obtain sufficient appropriate audit evidence**
 - Could result from auditor's inability to perform procedures or an imposition by the entity

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A - Qualified audit opinion

- Material misstatement
- Not Pervasive
- Able to obtain to sufficient audit evidence

DISAGREEMENT WITH THOSE CHARGED WITH GOVERNANCE

- Accounting policies
- Adequacy of disclosures in financial report

Illustrative example (ASA 705)

Qualified Opinion

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the accompanying financial report of ABC Company Ltd., is in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the company's financial position as at 30 June 20X1 and of its financial performance for the year then ended; and
- complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Qualified Opinion

The Company's inventories are carried in the statement of financial position at Sxxx. The directors have not stated the inventories at the lower of cost and net realisable value but have stated them solely at cost, which constitutes a departure from Australian Accounting Standards. The Company's records indicate that, had the directors stated the inventories at the lower of cost and net realisable value, an amount of Sxxx would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by Sxxx, and income tax, net income and shareholders' equity would have been reduced by Sxxx, Sxxx and Sxxx, respectively.

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B - Qualified audit opinion

☐ Material misstatement

DISAGREEMENT WITH THOSE CHARGED WITH GOVERNANCE

☐ Not Pervasive

☐ Unable to obtain to sufficient audit evidence

LIMITATIONS TO AUDIT PROCEDURES

Illustrative example (ASA 705)

Basis for Qualified Opinion

The ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at \$xxx on the consolidated statement of financial position as at 30 June 20X1, and ABC Company's share of XYZ Company's net income of \$xxx is included in ABC Company's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company's investment in XYZ Company as at 30 June 20X1 and ABC Company's share of XYZ Company's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

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C - Adverse opinion

☐ Material misstatement

DISAGREEMENT WITH THOSE CHARGED WITH GOVERNANCE

☐ Pervasive

SEVERAL ACCOUNTS AFFECTED

☐ Able to obtain to sufficient audit evidence

Illustrative example (ASA 705)

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary XYZ Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under Australian Accounting Standards, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had XYZ Company been consolidated, many elements in the accompanying financial report would have been materially affected. The effects on the financial report of the failure to consolidate have not been determined.

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D – Disclaimer of audit opinion

☐ Material misstatement

DISAGREEMENT WITH THOSE CHARGED WITH GOVERNANCE

☐ Pervasive

SEVERAL ACCOUNTS AFFECTED

☐ Unable to obtain to sufficient audit evidence

LIMITATIONS TO AUDIT PROCEDURES

Illustrative example (ASA 705)

We do not express an opinion on the accompanying financial report of the Entity. Because of the significance of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial report.

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Entity until after 30 June 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 30 June 20X0 and 20X1, which are stated in the statements of financial position at \$xxx and \$xxx, respectively. In addition, the

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Key Audit Matters (ASA 701)

- ☐ Required only for listed entities
- ☐ Not a Substitute for Expressing a Modified Opinion
- ☐ Exceptionally, it is possible not to disclose a KAM if there are adverse consequences of public disclosure that outweigh the public interest benefit.
- ☐ Exceptionally, the auditor can also decide that there are no KAM

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OTHER MATTERS

CORPORATIONS ACT 2001 BREACHES

- Auditor required to **report contraventions to ASIC within 28 days** of an event (s311 Corp Act)
- Reporting must be in a **timely** manner and auditor should not wait until the end of the engagement to report the matter
- Examples of suspected contraventions include:
 - **Insolvent trading**
 - if a company is insolvent and a director allows the company to incur a new debt, then the director can be personally liable for the new debts incurred.
 - **Breaches of accounting standards**
 - **Fraud** by officers or employees of the client
 - **Continual late lodgment or non-lodgment** of annual statements and financial reports

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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COMMUNICATION WITH MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE

COMMUNICATION WITH MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE (ASA 260)

Communicate **matters of governance interest** that come to auditors attention in audit (covered by several auditing standards)

- **Fraud** (ASA 240)
- **Non compliance** with laws and regulations (ASA 250)

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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COMMUNICATION WITH MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE

Matters of governance interest that the auditor may wish to discuss with those charged with governance include:

- General **approach** and overall **scope** of audit, **limitations**
- Selection of, changes in, **accounting policies with material effect** on financial report
- Potential effect on financial report of any **material risks and exposures**
- **Misstatements with material effect**
- **Material uncertainties** relating to **going concern**
- **Disagreements with management**
- **Expected modifications** to the audit report
- **Practical difficulties** in performing audit
- **Irregularities, suspected noncompliance** with laws
- **Comments on design and operation of internal controls**, suggestions for improvements (also in management letter)
- Any other matters as agreed

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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DOCUMENTATION CONSIDERATIONS

- Auditor retains **a copy of communication** in working papers with any **responses** from management and their intended actions.
- Depending on the nature, sensitivity and significance of the matters communicated, the auditor could **confirm oral communication** in writing, to prevent disputes at a later date.
- Auditor should **communicate weaknesses in internal controls** to management (or those charged with governance) and should be communicated in **writing**.

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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Question 1

- Toyota Ltd. operates in the automotive industry, with passenger vehicles accounting for 70% of its sales. Due to recent news about airbag faults and safety defects, demand has dropped significantly leading to discounting. While the entity remains a going concern, the Director's Report contains very optimistic revenue projections that are inconsistent with the audited financial statements.
- When auditing Valeant Inc., your audit staff identified an overstatement of \$500,000 in the revaluation of plant and equipment (PPE) due to misclassification of repairs. The balance of non-current assets is \$10,000,000. Valeant's management refused to amend their financial statements and stand by their valuation.

Question: For each situation, specify the audit opinion that should be issued. Justify your answer.

Adapted from Moroney, Robyn, et al. (2017). *Auditing: A practical approach* (3rd ed.). Wiley

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