

CPA ADVANCED AUDIT AND ASSURANCE 5TH EDITION 2020 HD NOTES

High Distinction

MODULE 1: The Auditing and Assurance Services Framework

MODULE 2: Planning the audit of historical financial information

MODULE 3: Understanding the entity, assessing risk and responding to risk

MODULE 4: The auditor's response to assessed risks

MODULE 5: Audit conclusions and reporting requirements

Certified Practising Accountants Program (CPA)

Advanced Audit and Assurance CPA 2020

MODULE 1: The Auditing and Assurance Services Framework

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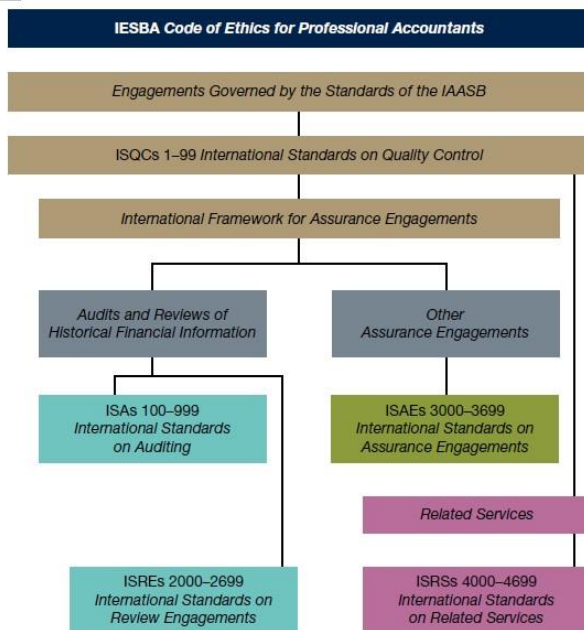
The assurance environment

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IFAC: International Federation of Accountants: headquartered in NYC and members are the associations of professional accountants around the world.

IAASB: Intentional Auditing and Assurance Standards Board: an independent standard-setting body that serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards (IAASB 2016).

FIGURE 1.1 Pronouncements Issued by the IAASB

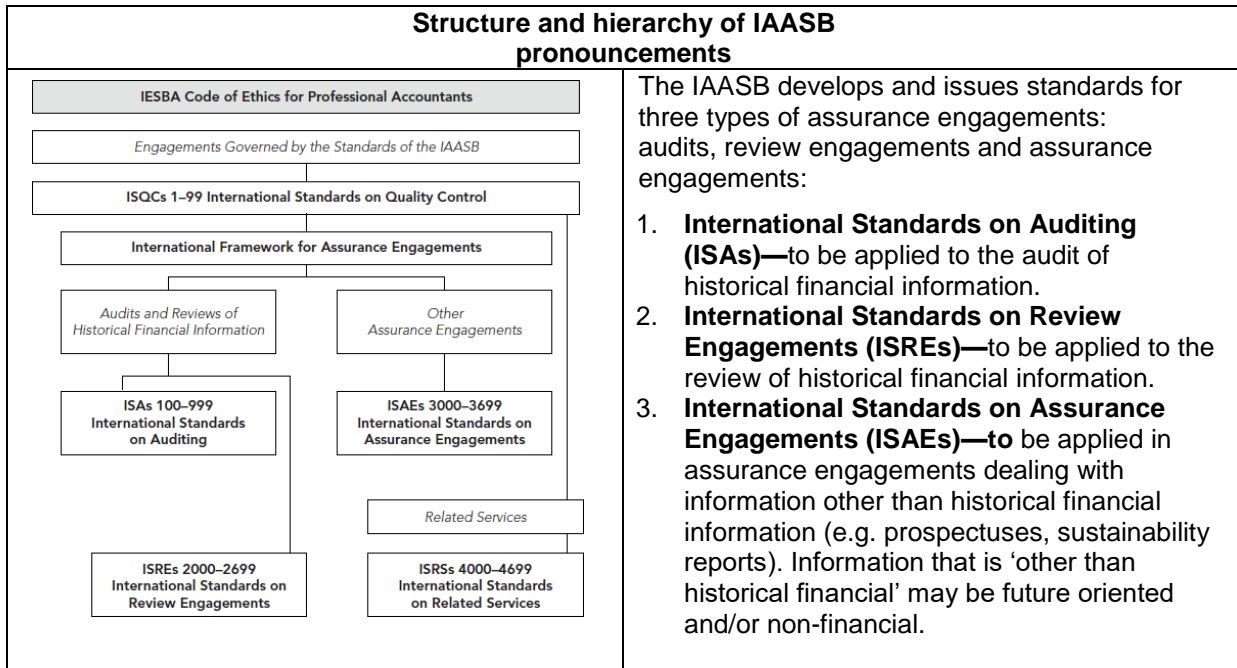


IFIAR: International Forum of Independent Audit Regulators: formed in 2006, with current membership of over 50 independent public oversight bodies (such as ASIC in Australia).

Structure and hierarchy of IAASB pronouncements

IESBA (2016) *Handbook of the Code of Ethics for Professional Accountants* (Code) is the fundamental pronouncement for assurance practitioners.

The Preface to this Handbook states that the IESBA develops and issues the Code for use by professional accountants globally and a member body of IFAC or firm 'shall not apply less stringent standards than those stated in the Code' (IESBA 2016, Preface).



Regulation of auditing in Australia: FRC, ASIC, APESB and AUASB

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Financial Reporting Council	<p>An independent statutory agency.</p> <p>Oversees: accounting standards-setting process, the auditing standard-setting process and the monitoring of auditor independence.</p> <p>Responsibilities: appointing the members of the Auditing and Assurance Standards Board (AUASB).</p>
Australian Securities and Investment Commission	<p>An independent Commonwealth body that was set up under the <i>Australian Securities and Investments Commission Act 2001</i> (Cwlth) (ASIC Act).</p> <p>Works under the <i>Corporations Act 2001</i> (Cwlth).</p> <p>Responsibilities: registration of auditors, enforcement of rules regarding auditor independence and use of auditing standards, and inspection of audit firms</p>
Accounting Professional and Ethical Standards Board	<p>An independent body (funded by professional accounting bodies in Aus)</p> <p>Responsibilities: setting ethical standards in Australia (setting standards on quality control, ethical conduct and compliance with auditing and assurance standards)</p>
Australian Auditing and Assurance Standards Board	<p>An independent statutory agency under the ASIC Act.</p> <p>The AUASB's mandate requires it to consider revisions and improvements to the pronouncements initiated by the IAASB.</p> <p>The <i>Australian Framework for Assurance Engagements</i> (Australian Framework) conforms with the <i>International Framework for Assurance Engagements</i> (the Framework) with only minor differences.</p> <p>The AUASB issues guidance statements as well.</p>

Preamble to Australian auditing standards

The ASAs also include some standards that do not exist at the international level. For example, ASA 101 Preamble to Australian Auditing Standards has no international equivalent, and outlines how the AUASB intends the Australian standards to be understood, interpreted and applied.

'Auditing standards' (are legally enforceable) include:

- all the ASAs;
- ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity; and
- ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports, Other Financial Information, and Other Assurance Engagements.

'Auditing and assurance standards for other purposes' consist of standards that are designed for assurance engagements other than audits and reviews of historical financial information. These other assurance engagements include, for example:

- reviews other than a review by the independent auditor of an entity, of an interim or other financial report for other purposes;
- evaluations of the efficiency and/or effectiveness of an entity's activities (performance audits);
- prospective financial information; and
- the effectiveness of internal controls.

Australian specific requirements

ISREs contain two standards:

- ISRE 2400 Engagements to Review Financial Statements where the practitioner, **who is not the auditor of the entity**, undertakes an engagement to review the financial statements; and
- ISRE 2410 Review of the Interim Financial Information Performed by the Independent Auditor of the Entity where the practitioner, **who is the entity's auditor**, reviews interim financial information.

No international equivalent to Australian approach to reporting for companies limited by guarantee or not for profits to report.

ASRE 2415 Review of a Financial Report: Company Limited by Guarantee or an Entity Reporting under the ACNC Act or Other Applicable Legislation or Regulation:

- **Tier 1:** exempt from preparing a financial report
- **Tier 2:** must prepare a financial report but can choose to have it reviewed instead of audited (revenue between 250K and 1m, or a charity with revenue below 250K)
- **Tier 3:** must prepare an audited financial report

Regulation of auditing in New Zealand

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The External Reporting Board (XRB) is an independent Crown entity established under the *Financial Reporting Act 1993* with the following functions:

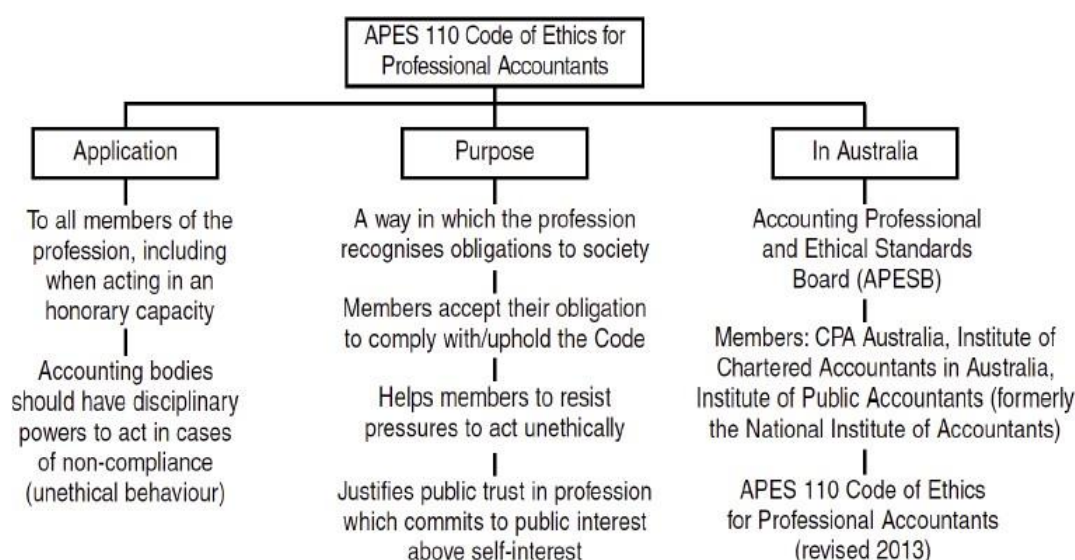
- developing and implementing an overall strategy for financial reporting standards and auditing and assurance standards (including developing and implementing tiers of financial reporting and assurance);
- preparing and issuing accounting standards;
- preparing and issuing auditing and assurance standards, including the professional and ethical standards that will govern the professional conduct of auditors; and
- liaising with national and international organisations that exercise functions that correspond with, or are similar to, those conferred on the XRB (XRB 2016a).

The International Framework for Assurance Engagements (Framework) issued by the IAASB applies to all assurance engagements. It is not a standard and does not include any requirements for performance. Matters discussed include:

- ethical principles;
- quality control;
- definition of assurance engagements;
- reasonable and limited assurance engagements;
- attestation and direct engagements; and
- elements of an assurance engagement:
 - three-party relationship (preparer, user and assurance provider);
 - underlying subject matter;
 - criteria;
 - evidence; and
 - an assurance report.

Ethical principles

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Fundamental principles

Integrity	Centred on concepts of trust, honesty, and honourable and reliable behaviour. Integrity requires the strength of character and courage to pursue one's convictions, otherwise good intentions may not be sufficient. Not being associated with false or misleading information Acting on principle not from expediency Concept of independence is linked partly to integrity
Objectivity	Impartiality and honesty, freedom from conflicts of interest The state or quality of being true, outside any individual feelings or interpretations. Accountants should be impartial, honest, free from conflicts of interest and not be unduly influenced by others. Related party transactions can compromise objectivity due to a lack of independence (needs to be arms length).
Professional Competence and Due Care	<i>Professional competence:</i> Membership of professional body dependent on achieving standards of knowledge, skill and experience.

	<p>Continuing CPD Maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service.</p> <p><i>Due care:</i> Act diligently in accordance with applicable professional standards when providing Professional Activities (i.e. act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.)</p>
Confidentiality	<p>Cannot disclose information to third parties without proper and specific authority, unless there is a legal or professional duty to disclose it.</p> <p>Must refrain from using confidential information 'to their personal advantage or the advantage of third parties'.</p> <p>Confidentiality applies to accountants in other parts of the same organisation (Chinese walls)</p> <p>A member must not disclose information to a third party without specific authority, unless there is a legal or professional right or duty to disclose it.</p> <p>Do not use confidential information to the accountant's personal advantage or the advantage of third parties.</p> <p>A legal duty may arise when there has been a breach of the law. A professional duty to disclose may arise when a member is required to respond to an investigation by the professional body or a regulator.</p> <p>The duty applies in social and family situations as well as at work.</p> <p>The duty of confidentiality does not end with the termination of the member- client relationship or the member-employer relationship.</p> <p>The principle of professional behaviour means that as well as complying with relevant laws and regulations, the accountant must also ensure he or she does not behave in such a way as to damage the reputation of the profession as a whole.</p>
Professional behaviour	<p>Comply with relevant laws and regulations and avoid any act or omission that the member knows or should know may bring discredit to the profession.</p>

Threats and safeguards

Using the conceptual framework approach recommended by the Code, members must identify any threats to compliance with the fundamental principles and evaluate those threats.

Threats

Self-interest threat	<p>Self-interest could mean financial self-interest or another self-interest, such as a desire for recognition.</p> <p>Examples – public practice</p> <p>Member of assurance team has a direct financial interest in client (buys or inherits shares)</p> <p>Firm relies heavily on the client for fees</p> <p><i>Where fees generated by an assurance client exceed 15% of the firm's total fees, an additional independent professional accountant must review the work done and the documentation of that review should be provided to the relevant professional body (p29)</i></p> <p>Firm is concerned about the loss of client</p> <p>Accountant discovers a serious error in previous work done by himself or a colleague</p> <p>Examples – in business</p> <p>Existence of incentives in compensation arrangements</p> <p>Concern for your job security</p> <p>Loan from employer</p>
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Self-review threat	<p>This is the possibility that an accountant will not properly check and evaluate work done previously by himself or another member of the firm or employer organisation, where he will rely on that work to carry out a current assignment.</p> <p>Examples – public practice</p> <p>Firm issues an assurance report on the operation of a financial system, having previously advised on its design and implementation</p> <p>Firm has previously prepared data used to generate records that are now the subject of an assurance investigation by the firm</p> <p>A member of the assurance team was previously a senior officer or director in the client company.</p> <p>Examples – in business</p> <p>Reporting to senior management on an issue that you have previously reported or made recommendations.</p>
Advocacy threat	<p>This creates a threat of loss of objectivity.</p> <p>Examples – public practice</p> <p>The firm promotes a share issue by an audit client</p> <p>The firm acts as an advocate of an audit client in litigation or in a dispute with a third party.</p> <p>Examples – in business</p> <p>Not as great as threat in public practice</p> <p>Member can promote their employer, but must not use false or misleading information to do so</p>
Familiarity threat	<p>This is a risk that the accountant will become too sympathetic and too accepting of the information provided or statements made by a client or employer organisation.</p> <p>Examples – public practice</p> <p>Member of the assurance team has a close family member who is a director or significant officer in the client company</p> <p>Accepting gifts or preferential treatment from the client, unless the value is trivial</p> <p>Senior personnel of the assurance team have a long association with the client</p> <p>Examples – in business</p> <p>Over-reliance on word / work of a trusted subordinate</p>
Intimidation threat	<p>This is a threat to independence from intimidation, either real or imagined from someone who is able to exert a strong influence, such as a boss or major client.</p> <p>Examples – public practice</p> <p>Threat by client to take work away from the firm in the future</p> <p>The client threatens the firm with legal action</p> <p>The firm is put under pressure to reduce the amount of work they do, in order to reduce the fee.</p> <p>Examples – in business</p> <p>Dominant boss</p>

Safeguards

May eliminate or reduce threats to the fundamental principles of professional conduct.

Safeguards may be applied to **prevent threats from occurring or becoming significant**.
Alternatively, measures should be taken to **remove or reduce any significant threat that arises**.

Types of safeguards:

External safeguards	Safeguards in the workplace	
Created by profession, legislation or regulation	Firm wide	Specific to the audit or assurance engagement
Educational	Actions by firm's leaders to promote	Removal of threatened individual

requirements for entry into profession	ethical and professional behaviour	from team
Corporate Governance regulations or guidelines	Documentation of policies / internal controls identifying and assessing threats to compliance with ethical conduct, and policies on dealing with those threats	Discussing ethical issues relating to an assurance service with those charged with governance in the client company
Professional standards of conduct	Policies for identifying family links or financial links between clients and members of the assurance team	Rotation of senior personnel
Professional and regulatory monitoring and disciplinary procedures	Policies for monitoring reliance of the firm on revenue from a single client It may be possible to rely, to some extent, on safeguards implemented by the client, but a firm cannot rely exclusively on such safeguards to reduce threats of independence and professional conduct to a safe level.	Arrangements for members of the firm not connected with an assurance service to review the work of an assurance team
Legal advice	Recruiting high calibre staff – ethics should be emphasised during recruitment and training process	Refusal to accept assurance work
	Empowering and encouraging employees to raise ethical issues Establishing an effective system for reporting concerns or complaints within the workplace without fear of retribution	Discussion of audit findings with client's audit committee as well as management
		Sourcing valuation information from an external source, such as broker or fund manager

Safeguards for member in business	
Strong code of ethics fully supported by the Board of Directors	Policies and procedures for monitoring the quality of accounting work (for example, internal audit)
Use employers formal dispute resolution process	A procedure that allows a subordinate to take a matter above the head of the boss, for example, by referring to an audit committee or the board.
Strong internal controls over accounting	

Safeguards should be imposed continually, and may be required:

- externally, by the requirement to comply with the *Code of Ethics for Professional Accountants* (or a similar national code of professional ethics), or
- internally, by a firm's quality assurance processes and rules of

conduct. Safeguards against threats to the fundamental principles are provided by:

- the professional body, the law or regulation, and also
- by the employer organisation or the firm's own code of conduct.

Success of a safeguard to mitigate the threat:

For a safeguard to mitigate a threat to an acceptable level, it is necessary to select the most appropriate in the specific situation. Consideration will be given to what a **reasonable and informed third party**, having knowledge of all relevant information, would conclude.

If safeguard is not successful:

- Obtain advice from his professional body, or legal advice, provided that confidentiality can be maintained or there is a legal requirement to make a disclosure to an authorised body.
- If specific to an individual on an audit – the member should be removed from the audit team.

- The firm should refuse to do the assurance work, or may need to disassociate itself from the client entirely (s290.7)
- If the threat remains, the member is not compliant and so must resign / withdraw.

Summary

Threats to the fundamental principles arise in all aspects of public practice and business. The requirement is to:

- recognise the threat(s)
- assess the possible significance of the threat(s)
- assess if the threat(s) are potentially significant, consider the existing safeguards and whether these are sufficient
- if additional safeguards are needed, implement them
- if it is impossible to eliminate the threat(s) or reduce them to an acceptable level, even with safeguards, refuse to do the work.

Responding to non-compliance with law and regulation

The IESBA released a new standard, Responding to Non-Compliance with Laws and Regulations (NOCLAR), effective 15 July 2017. It sets out an approach to guide professional accountants who encounter or become aware of a potential NOCLAR committed by a client.

Regardless of the nature of the client, including whether or not it is a public interest entity, the accountant has the following responsibilities if they encounter or are made aware of NOCLAR:

- To comply with the fundamental principles of integrity and professional behavior;
- By alerting management or, where appropriate, those charged with governance of the client, to seek to:
 - Enable them to rectify, remediate or mitigate the consequences of identified or suspected non-compliance; or
 - Deter the commission of the non-compliance where it has not yet occurred; and
- To take such further action as appropriate in the public interest (NOCLAR, para. 225.4).

Quality control standards

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International standard: *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* (ISQC 1).

Australia: equivalent standard referred to as

ASQC 1 The elements of quality control are as

follows:

1. Leadership responsibilities	<p>Leadership culture underpins all other elements of QC. A senior person should be responsible for the firm's QC system.</p> <p>Assurance firm: assurance firm should develop, document and implement appropriate QC procedures and a formal code of conduct, leadership should demonstrate commitment to QC (even over commercial considerations).</p>
2. Ethical requirements	<p>Assurance firm: develop, document and implement policies and procedures to guide and reinforce ethical behaviour.</p> <p>Includes: independence policies describing permitted and prohibited behaviour, independence consultations that allow the referral of independence threats.</p> <p>Systems that support: databases to match staff disclosures with a prohibited securities list, and (in Australia) tracking auditor rotation requirements (per Corps Act)</p>
3. Acceptance and continuance of client	<p>An assurance firm must:</p> <ul style="list-style-type: none"> • consider the integrity of each client; • determine that it is competent to perform the engagement; and

relationships	<ul style="list-style-type: none"> determine that it can comply with the Code, including especially those matters related to independence. <p>One approach taken by practitioners to assess the integrity of a client is a risk check list</p>
4. Human resources	<p>An assurance firm's human resource policies must apply at both the staff and partner levels.</p> <p>Important issues include:</p> <ul style="list-style-type: none"> recruitment; performance evaluation; promotion and compensation; training and work experience; and coaching by more experienced staff. <p>Assurance firm: important that partner evaluations and promotions are documented and that the documentation covers quality controls and independence.</p>
5. Engagement performance	Engagement performance means completing assurance engagements in accordance with professional standards, and legal and regulatory requirements.
a. Engagement support materials	<p>Most audit firms provide support materials to ensure that engagements are performed competently and consistently. Materials include:</p> <ul style="list-style-type: none"> technical updates on the standards and the firm's policies; sample company financial statements; standard letters, templates and reports prepared for a variety of circumstances; check lists for financial disclosure, internal control and other matters; information regarding auditor independence, ethics and QC; and databases providing industry-specific information.
b. Supervision and review	Establish a hierarchy of review within audit teams
c. Consultation	Specialist partners exist for consultation on technical or complex aspects of auditing and accounting issues, tax, systems and legal matters.
d. Engagement quality control review	<p>On completion of the audit of listed entities and other public interest entities, assurance firms must perform an engagement quality control review (EQCR).</p> <p>The EQCR provides an objective and independent evaluation of the significant judgments made and the conclusions reached by the audit team and the audit partner.</p> <p>EQCR reviewers are experienced audit partners who are not otherwise involved in the audit engagement.</p>
6. Monitoring	<p>'Monitoring' requires ongoing examination of QC systems and procedures, any identified problems are communicated to the partner responsible for the firm's QC, and that appropriate responses to problems are implemented.</p> <p>To improve audit quality: regular peer reviews within firms of a sample of completed audits</p>

In 2014 the IAASB published *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality (2014a)*, which describes, in a holistic manner, the different elements that create the environment for audit quality at the engagement, firm and national levels, as well as relevant interactions and contextual factors.

There are three parts to the framework. As outlined diagrammatically in Figure 1.3, these are the input, process and output stages of the audit, with each of these capable of being identified at the engagement, firm and national level.

Part 1:	
Inputs	<p>The inputs to quality audits include auditors:</p> <ul style="list-style-type: none"> • exhibiting appropriate values, ethics and attitudes; and • being sufficiently knowledgeable, skilled and experienced, and having sufficient time allocated to them to perform the audit work.
Process	A quality audit process involves auditors applying a rigorous audit process and appropriate quality control procedures that comply with laws, regulations and applicable firm and national standards.
Outputs	<p>Provide a useful and timely report to users and include outputs from the auditor, the audit firm, the entity and audit regulators.</p> <p>Publicly available: independent auditor's report at the individual engagement level or the audit firm's transparency report at the national level.</p> <p>Internal: management letter provided by the auditor to the audit committee at completion of the audit</p>
Part 2:	
Participants in the financial reporting supply chain	<p>Framework covers the interactions between the various participants in the financial reporting supply chain.</p> <p>Participants: management, those charged with governance, regulators, users and auditors.</p> <p>Increased interaction is promoted in the audit quality framework (including emphasis on communication between the auditors and the audit committee)</p>
Part 3:	
Contextual factors	<p>The 10 contextual factors identified in the framework are:</p> <ul style="list-style-type: none"> • business practices and commercial law; • laws and regulations relating to financial reporting; • the applicable financial reporting framework; • information systems; • corporate governance; • broader cultural factors; • audit regulation; • litigation environment; • attracting talent; and • financial reporting timetable. <p>Collectively, the contextual factors have the potential to affect the nature and quality of financial reporting and, directly or indirectly, audit quality.</p> <p>Where appropriate, auditors respond to these factors when determining how best to obtain sufficient appropriate audit evidence.</p>

Attestation and direct engagements

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Type	Description	Examples
Attestation engagements	Where a party other than the assurance practitioner (normally management) measures or evaluates the underlying subject matter against the criteria (i.e.	Management evaluates the internal control system against the criteria, and the assurers attest to

	prepares the financial statements in accordance with the accounting standards) (Framework, para. 12). For this type of engagement the preparers of the subject matter assert in the report that it is in accordance with a stated framework. The auditor's role is to attest to whether (in their opinion) that is the case.	the credibility of their report. Audits and reviews of financial statements: financial statements are prepared by management. Auditors and reviewers are not permitted to prepare the financial statements that they audit.
Direct engagements	Where the assurance practitioner directly 'measures or evaluates the underlying subject matter against the criteria' (Framework, para. 13). Auditors must directly test the content themselves Direct engagements can offer an additional level of assurance to users, as the assurer undertakes the measurement and prepares the information	The assurers undertake the evaluation of the internal control system against the criteria, and report on this.

Reasonable and limited assurance

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SUMMARY:

Type of assurance	Example	Nature of key work performed	Example form of conclusion
Reasonable assurance	An audit of financial statements	Detailed testing, evidence gathering and substantiation to support the conclusion	"We believe the financial statements present a true and fair view"
Limited assurance	A review of financial statements	Primarily enquiries and analysis, less detailed procedures	"We have not become aware of any matter to cause us to believe the financial statements do not present a true and fair view"
No assurance	Preparing financial statements (compilation)	Preparation of the financial statements	No conclusion provided

Reasonable (e.g. an audit)

The practitioner reduces engagement risk to an **acceptably low level** in the circumstances of the engagement as the basis for their conclusion.

The practitioner's conclusion is expressed in a form that conveys their opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria (Framework, para. 14).

Limited (e.g. a review) – lower level of confidence

The practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement

– but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to **believe the subject matter information is materially misstated** (Framework, para. 15)

ASAE 3000, para. A4, suggests that the assurance offered by a limited assurance engagement should be '**meaningful**', and that **meaningful is 'clearly more than inconsequential'**. Other than that, any judgment about the meaning of the terms 'limited' and 'reasonable' is left up to the practitioner.

The Framework suggests (but does not require) that the auditor considers a number of criteria in