THE AUDIT OF THE TRIAL BALANCE

FCPA - Mike Mbaya

Topics to be covered

- Preliminary Activities
- Planning and Risk Assessment
- Responding to Risk
- Adjusting Journal Entries
- Financial statements
- Reporting

Other Topics to be covered (if time allows…)

- Introduction & Preliminary planning activities
- Materiality considerations
- Tests of Control
- Consideration of Fraud
- Going concern
- Risks At Financial statement level
- Related Parties

Preliminary activities

1. Pre – engagement Activities (ISA 220)
   a. Acceptance and continuance of the engagement
   b. Compliance with the relevant ethical requirements
   c. Resolution of points a and b above and documenting the process.
2. Key Documentation to have
   a. Letter of engagement (with terms of engagement) (ISA 210)
   b. Planned scope and timing of the audit (ISA 260)
   c. Letter of instruction to component auditor(ISA 600/ 620)
   d. Letter of instruction to auditor's expert (ISA 600/620)
   e. Any other letter, e.g letter of independence for public companies (ISA 260)

Planning And Risk Assessment

1. Document overall and performance materiality and any changes thereon. (ISA 320)

2. Document any changes in audit engagement especially if to a lower level of assurance. (

3. Document why we agreed to the changes in the terms of engagement.

- If you are unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
- Withdraw from the audit engagement where possible under applicable law or regulation;
- Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

4. Matters raised in audit team discussions must be appropriately reflected in the overall strategy and audit plans (ISA 300)

5. Perform planned risk assessment procedures and document results (ISA 300)

Planning And Risk Assessment

6. Assess and Document the risk of material misstatement in the F/S (fraud and error) (ISA 300)
   a. The F/S level (pervasive risks and controls)
   b. The assertion level (specific risks and controls by FSA)

7. Update the assessed risks to reflect any changes required as a result of the audit procedures performed (ISA 315)

8. Communicate in writing to management and TCWG the significant control deficiencies noted. (ISA 265)

Responding to risk

1. Plan and implement the overall response to assessed risks at the F/S level and document results (ISA 330)
2. Apply the responses to significant risks and ensure they are implemented and results documented (ISA 330)
3. Perform the planned other audit procedures that may be identified (ISA 330)
4. Get the working papers to signed of by the preparer and reviewer(ISA 230)
5. The documentation should be such that an experienced auditor, having no previous connection with the engagement, could understand. (ISA230)
    a. The nature, timing, and extent of auditing procedures performed to comply with ISA's and any applicable legal and regulatory requirements?
    b. The results of the audit procedures performed and the audit evidence obtained
    c. All significant matters that arose during the audit, the conclusions reached on them, and significant professional judgments made in reaching those conclusions

Adjusting Journal Entries

1. Preparation

   Obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, and the suitability of design and implementation of such controls. For example…

   a. Management's policies regarding the use, authorization and control over journal entries. Address the use of standard entries, non-routine entries (corrections and adjustments) and unusual or management-requested entries.

   b. Automated procedures used to maintain the general ledger or prepare financial statements where journal entries used have no paper trail.

   c. Any history of unauthorized, inappropriate or fictitious journal entries identified.

   d. The assessed risk of material misstatement relating to the entity's financial reporting process. Consider deficiencies identified in entity level controls (Form 530.) and entity-specific risk factors (Forms 520E.)

Adjusting Journal Entries

2. Prior period journal entries

   Ensure that prior period adjusting journal entries have been properly recorded in the opening balances for the current period accounting records.

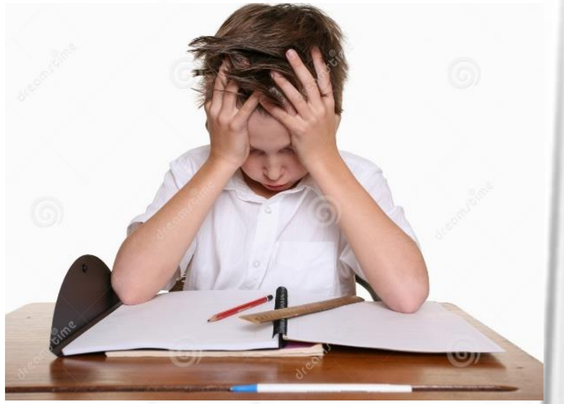
3. Current period

   a. Ensure all the usual/required period-end journal entries been made.

   b. Examine material journal entries and other adjustments made during the course of preparing the FS.

4. Inquiry

   Inquire of individuals involved in the financial reporting process about any unusual or large entries made or unusual activity relating to the processing of routine journal entries and other adjustments.



Adjusting Journal Entries

5. Analysis

   Compare entries made at the period end to entries made in the previous period and investigate:

   a. Significant changes in monetary amounts.
   b. New, unusual or missing entries
   c. Material entries for which there is no apparent reason

6. Population

   Document how the completeness of the population to be tested was determined

7. Identify unusual or inappropriate journal entries

   If you decide to test journal entries and other adjustments throughout the period, scan the accounting records to identify journal entries to be tested

Adjusting Journal entries

a. Identify whether any of the selected entries applies to accounts that:
   - Contain transactions that are complex or unusual in nature
   - Contain significant estimates and period-end adjustments
   - Have been prone to misstatements in the past
   - Have not been reconciled on a timely basis or contain unreconciled differences
   - Contain inter-company transactions
   - Are otherwise associated with an identified risk of material misstatement due to fraud

b. Identify other entries that are significant, non-routine, unusual or potentially fraudulent.

c. Consider fraud risk indicators, the nature and complexity of accounts, and entries processed outside the normal course of business.

Adjusting journal entries

8. Investigation

For each significant, unusual or potentially fraudulent entry identified above

- Determine who initiated and who (if anybody) approved the entry.
- Inquire about and consider the reasonableness of the rationale provided for each entry and the amount.
- Review supporting documentation to ensure the entries were adequately supported and properly reflect the rationale provided.
- Design and perform such other procedures as considered necessary to reduce the risk of material misstatement to an appropriately low level.
- Consider the need to report the entries to management and those charged with governance.

Financial Statements

1. Do the F/S agree with the entity's underlying accounting records (e.g., entity's sub ledgers and general ledger) (ISA 330)
2. Are the F/S and notes accurately cross-referenced (ISA 330)
3. Are the accounting policies and assumptions used in preparation of the F/S consistent with the F/S disclosures (ISA 330)
4. Do the F/S contain all the necessary disclosures required by the applicable financial reporting framework (ISA 330)
5. Design and perform analytical procedures near the end of the audit to assist in forming an overall conclusion about whether the FS are consistent with your understanding of the entity (ISA 520)
6. Identify fluctuations or relationships that are inconsistent with analytics performed during planning or procedures performed during the audit including
    a. Inquiring of management and obtaining appropriate audit evidence relevant to management's responses?
    b. Performing other audit procedures as necessary (ISA 520)

Financial statements

- When forming an overall conclusion as to whether the financial statements are consistent with the auditor’s understanding of the entity, evaluate whether analytical procedures that are performed near the end of the audit, indicate a previously unrecognized risk of material misstatement due to fraud. (ISA 240)
- Ensure the FS Comply with the applicable financial reporting framework in form and content
- Ensure the FS Show the company’s assets, liabilities and equity, as well as its income and expenses, and any other prescribed information

Reporting

1. Identified misstatements (ISA 450)
    a. Accumulated all uncorrected misstatements, other than trivial matters
    b. Determined materiality of entries, individually or in aggregate
    c. Considered matters qualitatively and quantitatively
    d. Considered impact of misstatements in financial statements, including fraud risk
    e. Unless prohibited by law or regulation, communicate with management on a timely basis, all misstatements accumulated and request correction
    f. Where applicable, unless prohibited by law or regulation, communicate with TCWG on uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report and ask them to correct the errors

Reporting

2. Subsequent events (ISA 560)

   Identify and address subsequent events that may require adjustment of, or disclosure in the F/S

3. NOCLAR

   Report instances of non-compliance with laws and regulations identified or suspected, that require reporting to parties outside the entity.

4. Anti Money Laundering

   Have all matters relating to money laundering activities dealt with appropriately

5. Significant audit matters (ISA 230 – 260)

   a. Have discussions of significant audit matters with management and TCWG and document details of the decisions made

   b. Evaluate whether the two-way communication with TCWG has been adequate for the purpose of the audit

   c. If it has not been adequate, evaluate the effect, if any, on your assessment of the risks of material misstatements and ability to obtain sufficient appropriate audit evidence and take appropriate action.

Reporting

6. Auditor's report (ISA 700)

   Check the wording of the auditor's report to ensure it is appropriately worded and dated. The date can be no earlier than approval of final F/S by the recognized authority (e.g., owner/manager or TCWG).

7. Management Representation letter (ISA 580)

   a. Get a signed management representation letter, addressed to the auditor.

   b. The letter should contain all of the elements required to be addressed by ISA 580.10-.11, ISA 240.39 and any other matters you considered necessary in the circumstances

   c. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required by ISA 580.10-11, the relevant matters covered by such statements need not be included in the representation letter.

   d. Is dated as near as practicable to, but not after, the date of the date of the auditor's report

   e. Covers all periods presented

Reporting

7. Management representation letter (ISA 260, 580)

   f. If there are concerns about the competence, integrity, ethical values, or diligence of management or about its commitment to, or enforcement of, these may have effects on the reliability of representations (oral or written) and audit evidence in general. Consider the effect of such concerns

   g. If written representations are inconsistent with other audit evidence, perform audit procedures to attempt to resolve the matter

   If the matter remains unresolved, reconsider the assessment under f above

8. Management Letter

   The letter(s) to management and TCWG outlining significant audit findings including significant deficiencies in internal control, should be filed

9. Quality reviewer (ISQC 1)

   The engagement quality control reviewer should sign off on the file before the audit report is released

Reporting

10. Other reviews (ISA 720)

    Check other information (such as an annual report) related to the F/S to ensure consistency

11. Closing the file

    Check that the audit documentation in the file and all administrative processes of assembling the final audit file been completed on a timely basis, after the date of the auditor's report.

    Date scheduled for lockdown

The End

- Questions
- Responses
- Comments

- Bonus round

Some preliminary planning activities

- Consider client acceptance / continuance
- Consider engagement letter and the terms therein
- Overall audit strategy
  - Planned risk assessment procedures
  - Overall audit strategy
- Client meetings and deliverables
- Audit team discussions
- Time budget
- Materiality

Materiality considerations

- Overall materiality
  - Materiality of the financial statements as a whole
  - Use your professional judgement to decide the highest amount of misstatement that could be included in the financial statements without affecting the economic decisions taken by a financial statement user.
  - There could be a different outlook for profit oriented and not for profit oriented organizations
- Performance materiality
  - (used to reduce the risk that the aggregate of misstatement(s) could exceed overall materiality
  - Set performance materiality at an amount(s) that is based upon, but lower than, overall materiality (such as between 60% and 75% of overall materiality).
  - Use professional judgment about expectations of misstatements that could arise in the current period.
  - Consider the business and fraud risks identified
  - Also check the results of performing risk assessment procedures and the nature/extent of misstatements identified in previous audits.

Materiality considerations

- Materiality for specific circumstances
  - Specific user expectations that require a materiality level less than overall materiality for certain areas. Refer to ISA 320.10.
  - What specific expectations, sensitivities and legal/regulatory requirements would influence the economic decisions of a user?
  - Also consider performance materiality for specific materiality
- Trivial misstatements
  - Amount below which misstatements would be clearly trivial and not recorded.
- Final Materiality assessment (Towards completion of audit)
  - revisions (if any) to overall and related performance materiality should be recorded and the reasons noted.
  - Consider changes in operations/results, new information obtained and misstatements identified during the audit
  - Assess the impact of any revisions in overall and performance materiality on the risk assessments and in the nature, extent and timing of further audit procedures required?

Control Design and considerations

- Tests of control on the following areas
  - Entity level and general IT operations
  - Revenues, receivables and receipts
  - Purchases, payables and payments
  - Payroll
  - Financial reporting
  - Inventory
  - Investments

Risk Assessment Procedures

- Use analytical review - Ratios

Identifying Fraud Risks

- Professional scepticism ISA 240.12
  - The auditor shall maintain professional scepticism 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 TCWG
- Questionable documents ISA 240.13
  - 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
- Response to inquiries
  - Where responses to inquiries of management or TCWG are inconsistent, the auditor shall investigate the inconsistencies.

Identifying fraud risks

- Management assessment of fraud risks
  - Has management assessed the risk that the F/S may be materially misstated due to fraud? If so, describe the nature, extent and frequency of such assessments.
  - Does management have a process of identifying and responding to the risk of fraud
  - Have management identified any specific risk of fraud or has any been brought to their attention
- Management communication
  - To, TCWG on its processes for identifying/responding to risks of fraud
  - To, Employees regarding its views on business practices and ethical behavior

Identifying fraud risk

- Knowledge of fraud
  - Do management or others know of any frauds or suspected frauds
- Internal audit
  - Does the internal audit team have any knowledge or suspicion of fraud
- Unusual or unexpected relationships identified
  - Evaluate whether unusual or unexpected relationships identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud

Conditions for fraud

- The fact that fraud is usually concealed can make it very difficult to detect. There are three conditions that are generally present when fraud exists:
- An incentive or pressure to commit fraud. Consider matters such as:
  - The need to meet expectations of third parties (bankers, etc.);
  - The need to obtain additional equity financing;
  - Operating losses or cash flows that threaten the future of the entity;
  - Intense competition or vulnerability to technological changes;
  - Performance bonuses; and
  - Personal financial pressures or guarantees of debts of the entity.

Conditions for fraud

- A perceived opportunity to commit fraud. Consider matters such as:
  - Related-party transactions not in the ordinary course of business;
  - Significant estimates involving subjective judgments/uncertainties;
  - Domination of management by a single person;
  - Poor oversight by TCWG;
  - Significant deficiencies in the control environment or other internal control;
  - Ineffective accounting and information systems;
  - Highly complex transactions or organizational structure; and
  - Remote operating locations.
- An ability to rationalize the fraudulent action. Consider matters such as:
  - Lack of distinction made by an owner/manager between personal and business transactions;
  - Known history of violations of laws and regulations;
  - Failure to remedy known significant deficiencies in internal control on a timely basis; and
  - Scope restrictions, frequent disputes or unreasonable demands placed on us as auditors.

Going Concern

- Consider whether there is a significant delay in the approval of the financial statements by management or those charged with governance after the date of the financial statements. If yes, inquire as to the reason for the delay
- Consider whether any adverse events/conditions that may cast significant doubt on the entity's ability to continue as a going concern. have been identified as a result of performing other risk assessment procedures.
- Ask management whether it has identified any events or conditions that create substantial doubt about the entity's ability to continue as a going concern. If events have been identified, inquire how management plans to address them.

Responding to risks at the financial statement level

1. Summarize the key reasons for risk assessment
   a. Summarize the key strengths that led to a low risk
   b. Summarize the key weaknesses that lead to a moderate or high risk assessment .
2. Composition of the audit Team
   a. Address the need for experience, skills, specialised knowledge and ongoing supervision.

Responding to risks at the financial statement level

3. Responding to fraud risk
   a. Ensure a professional scepticism approach
   b. Watch out for undisclosed related parties
   c. Review revenue recognition, look at types of revenue, transaction and accounting policies
   d. Design audit procedures to address identified risks, e.g
      i. Specific fraud scenarios
      ii. Manage override
      iii. Revenue recognition
      iv. Inappropriate use of related parties
      v. Bias in estimates
      vi. Inappropriate journal entries

Responding to risks at the financial statement level

5. Use some element of unpredictability to address fraud risk
   i. Specific procedures on selected account balances / assertions
   ii. Adjusting timing of audit procedures
   iii. Using different sampling methods
   iv. Performing audit procedures at different locations preferably unannounced

6. Where assessed risk is low
   a. Place reliance on internal control and audit evidence generated internally
   b. Perform more procedures at an interim date
   c. Use less experienced personnel in this section of the audit
   d. Reduce the planned audit procedures at the assertion level.

Responding to risks at the financial statement level

7. Where assessed risk is moderate / high
   a. Assign more experienced team or specialists to the task
   b. Increase staff supervision and emphasise the need for professional scepticism
   c. Retain an auditor's expert
   d. Use electronic data analysis tools to extract and analyse information
   e. Adding more elements of unpredictability in the selection of procedures;
   f. Performing further, more extensive audit procedures in relation to cut-off, journal entries, related parties and estimates;
   g. Performing additional testing of revenues, expenses, inventories, receivables and other major assets/liabilities

Responding to risks at the financial statement level

h. Verifying title to assets used as collateral;

i. Verifying more of management's representations.

j. Relying less on relevant internal controls

The End

- Questions
- Comments
- Thank You