Appendix A
Standardised Common Content Reference Material

Assurance
(For Jun 2020 Exam, last updated: 20 May 2020)

Important notes

1. This Standardised Common Content Reference Material (Reference Material) was first published on the SAC website on 4 May 2020.

2. The Reference Material was updated and published on SAC website on:
   - 20 May 2020 - Principle of Objectivity

3. The latest Reference Material will be incorporated into the examination question paper as an Appendix, and will be uploaded within your Exam in the e-exam software, Examplify.

Considerations for the professional accountants
Code of Professional Conduct and Ethics

Ethics Pronouncement (EP) 100 Code of Professional Conduct and Ethics

Fundamental Principles
A professional accountant shall comply with the following fundamental principles:
(a) Integrity – to be straightforward and honest in all professional and business relationships.
(b) Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgements.
(c) Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
(d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
(e) Professional Behaviour – to comply with relevant laws and regulations and avoid any conduct that discredits the profession.

Threats and Safeguards
Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant’s compliance with the
fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Threats fall into one or more of the following categories:

(a) Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant’s judgement or behaviour;

(b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or activity or service performed by the professional accountant, or by another individual within the professional accountant’s firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity or providing a current service;

(c) Advocacy threat – the threat that a professional accountant will promote a client’s or employer’s position to the point that the professional accountant’s objectivity is compromised;

(d) Familiarity threat – the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work;

(e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

Parts B and C of this Code explain how these categories of threats may be created for professional accountants in public practice and professional accountants in business, respectively. Professional accountants in public practice may also find Part C relevant to their particular circumstances.

Fraud and Error
Responsibilities of management and auditors:

- Management and those charged with governance in an entity are primarily responsible for preventing and detecting fraud. It is up to them to put a strong emphasis within the company on fraud prevention. This will include establishing a strong control environment, with an emphasis on the principles of good corporate governance.

- An auditor conducting an audit in accordance with SSAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement whether caused by fraud or error.

Matters to be considered and procedures to be carried out in response to risks of misstatements

- In accordance with SSA 330 the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.

- (SSA 240) When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

- The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the
auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks.

- In determining overall responses to address the risks of material misstatement due to fraud at the financial statement level the auditor should:
  (a) Consider the assignment and supervision of personnel
  (b) Consider the accounting policies applied by the entity
  (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures

**Professional Responsibility**

To succeed in an action for negligence, an injured party must prove three things:

- A duty of care which is enforceable by law existed.
- This duty of care was breached.
- The breach caused the injured party loss. In the case of negligence in relation to financial advisers/auditors, this loss must be pecuniary (i.e. financial) loss.

Some ways to restrict liability include:

- Professional indemnity insurance. In accordance with the Accountants Act, all Limited Liability Partnerships must be covered by professional indemnity insurance.
- Incorporation have been used to reduce personal liability for partners (i.e. incorporation as a company or incorporation as a limited liability partnership).

**Practice Management**

**Quality control**

The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:

- The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
- Reports issued by the firm or engagement partners are appropriate in the circumstances

The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. This includes:

- Leadership responsibilities
- Ethical requirements
- Acceptance/ continuance of client relationships and specific audit engagements
- Assignment of engagement teams
- Engagement performance
  - Direction
  - Supervision
  - Review
  - Consultation
  - Engagement quality control review
  - Disputes
- Monitoring

**Appointment and re-appointment of auditors**
The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm:

(a) Is competent to perform the engagement and has the capabilities, including time and resources, to do so
(b) Can comply with relevant ethical requirements, and
(c) Has considered the integrity of the client, and does not have information that would lead it to conclude that the client lacks integrity.

Auditors will outline the basis for the audit agreement in their tender to provide services. The engagement clarifies:

- Scope of the audit
- Objective of the audit
- Auditor’s and Management’s Responsibilities
- Applicable financial reporting framework
- Form and content of reports to be issued

**Performing the audit**

**Planning, materiality and assessing the risk of misstatement**

**Understanding the entity and its environment**

- Methods of understanding
  - Inquiries of appropriate individuals within the entity
  - Analytical procedures (financial and non-financial data)
  - Observation and inspection
  - Audit team discussion of the susceptibility of financial statements to material misstatement
  - Prior period knowledge

- For each risk identified:
  (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment.
  (b) Assess whether the identified risks relate more pervasively to the financial statements as a whole and potentially affect assertions.
  (c) Relate identified risk to what can go wrong at the assertion level, and assess the controls that the auditor intends to test.
  (d) Consider the likelihood of misstatement and whether the potential misstatement is of a magnitude that could result in a material misstatement.

**Materiality in planning and performing an audit**

Application of materiality to an audit:

- Make a preliminary judgement about materiality.
- Determine performance materiality.
- Accumulate non-trivial misstatements identified during the audit and compare totals to the preliminary judgement about materiality. The initial determination of materiality should be reviewed during the course of the audit and revised where necessary.
The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by:

- The auditor's understanding of the entity, updated during the performance of the risk assessment procedures.
- The nature and extent of misstatements identified in previous audits and thereby the auditor's expectations in relation to misstatements in the current period.

**Risk assessment**

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

Risk of material misstatement is risk that the financial statements are materially misstated prior to audit. This consists of two components: inherent risk and control risk

\[
\text{Audit risk} = \text{Inherent risk} \times \text{Control risk} \times \text{Detection risk}
\]

**Business risk is split into three components**

- Financial risks
- Operational risks
- Compliance risks

**Analytical procedures are a useful tool in performing risk assessments.**

**Analytical procedures commonly used by auditors include:**

- Standard ratio calculations
  - Gross profit margins
  - Receivables ratio
  - Inventory turnover ratio
  - Current ratio
  - Quick or acid test ratio
  - Gearing ratio
  - Return on capital employed
- Trend analysis
- Comparisons of financial information
- Examining related accounts
- Reasonableness tests
- Scanning analytics

**Responses to risk of material misstatement at the assertion level**

- The auditor must carry out substantive procedures on material items. As you know, substantive procedures fall into two categories:
  - Substantive analytical procedures and
  - Tests of details.
- The auditor’s substantive procedures shall include the following audit procedures related to the financial statement closing process:
  - Agreeing the financial statements to the underlying accounting records
  - Examining material journal entries
  - Examining other adjustments made in preparing the financial statements
- For significant risks, the auditor must perform substantive procedures that are specifically responsive to that risk.
Evidence
Assertions about classes of transactions and events, and related disclosures, for the period under audit:

- Occurrence—transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.
- Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
- Cutoff—transactions and events have been recorded in the correct accounting period.
- Classification—transactions and events have been recorded in the proper accounts.
- Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Assertions about account balances, and related disclosures at the period end:

- Existence — assets, liabilities, and equity interests exist.
- Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- Completeness — all assets, liabilities, and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy, valuation and allocation — assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
- Classification — assets, liabilities, and equity interests have been recorded in the proper accounts.
- Presentation — assets, liabilities, and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Common audit procedures used by auditors in obtaining audit evidence are:

- Observation
- Confirmation
- Inquiry
- Recalculation
- Re-performance
- Inspection of documents
- Inspection of assets
- Analytical procedures
Auditors need to obtain sufficient and appropriate audit evidence to support the audit opinion. When assessing the sufficiency and appropriateness of audit evidence, auditors must consider the following:

- Risk of misstatement related to the assertion
- Source and nature of evidence
- Contradictory or corroborative evidence

Auditors have sole responsibility for their opinion, but may use the work of an expert in order to obtain sufficient audit evidence regarding certain financial statement assertions.

- Auditor's expert - An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.
- Management's expert - An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

When using an auditor's expert, the auditors should:

(a) Evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

(b) Agree, in writing when appropriate, on the nature, scope and objectives of that expert's work.

(c) Evaluate the adequacy of the auditor's expert's work for the auditor's purposes including the relevance and reasonableness of that expert's findings or conclusions.

If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

(a) Evaluate the competence, capabilities and objectivity of that expert;

(b) Obtain an understanding of the work of that expert;

(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertions.

**Evaluation and review**

Once the bulk of the substantive procedures have been carried out, the auditors will have a draft set of financial statements which should be supported by appropriate and sufficient audit evidence. It is a requirement of SSA 220 *Quality Control for an Audit of Financial Statements* that the auditor conducts an overall review of the audit evidence obtained in relation to the financial statements.

The auditors need to consider whether:

(a) The financial statements are in compliance with statutory requirements and accounting standards

- The information presented in the financial statements is in accordance with the relevant financial reporting framework
• The accounting policies employed are in accordance with accounting standards, properly disclosed, consistently applied and appropriate to the entity.

(b) The financial statements are consistent with their knowledge of the entity's business and with the results of other audit procedures, and the manner of disclosure is reasonable.

At the end of the audit, auditors would undertake the following:

• Analytical procedures are used as part of the overall review procedures at the end of an audit.
• Summarise the uncorrected misstatements
• Evaluate the effect of misstatements and communicating misstatements to management and those charged with governance
  o If the auditors consider that the aggregate of misstatements may be material, they must consider reducing audit risk by extending audit procedures or requesting management to adjust the financial statements
• Completion checklists
• Audit clearance meeting

Subsequent events
Events occurring after the end of the reporting period may affect the results and the position of the company at that date. Auditors have a responsibility to review subsequent events before they sign the auditor's report. Subsequent events include:

• Events occurring between the period end and the date of the auditor's report
• Facts discovered after the date of the auditor's report

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. Procedures to identify subsequent events include, inquiries of management on subsequent events as well as other procedures such as reading minutes of meetings, review latest accounting records, etc.

Going concern
When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

The auditor must obtain sufficient, appropriate audit evidence to support the management’s conclusions. The auditors may evaluate:

• The process management followed to make its assessment
• The assumptions on which management's assessment is based
• Management's plans for future action and whether these are feasible in the circumstances

When events or conditions are identified which cast doubt on the appropriateness of the going concern basis of accounting, auditors may also have to carry out additional
procedures. The SSA 570 lists various procedures which the auditors may carry out in this context, including:

- Analysing and discussing cash flow, profit and other relevant forecasts with management;
- Analysing and discussing the entity's latest available interim financial statements;
- Reading the terms of debentures and loan agreements and determining whether any have been breached;
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties;
- Enquiring of the entity's legal counsel regarding litigation and claims;
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.

**Reporting**

**Auditor's reports**

Auditor's reports are addressed to the members or shareholders of the company, however, there are many different users of financial statements and they use them for many differing reasons. The standard auditor's report for listed companies would contain the following content:

- Audit opinion
- Basis for opinion
- Key audit matters
- Responsibilities of management and directors for the financial statements
- Auditor's responsibilities for the audit of the financial statements
- Report on other legal and regulatory requirements

**Emphasis of matter and Other matter paragraphs**

<table>
<thead>
<tr>
<th>Paragraphs</th>
<th>Definition</th>
<th>Must be used in the following circumstances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emphasis of matter</td>
<td>A paragraph included in the Auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.</td>
<td>(a) When the auditors have determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. (b) To alert users that the financial statements are prepared in accordance with a special purpose framework. (c) When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e. re-issuance of report due to subsequent events).</td>
</tr>
</tbody>
</table>
### Other matter paragraph

A paragraph included in the Auditor’s report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor’s judgement, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report.

### (a) Where prior period financial statements were audited by predecessor auditors

(b) Where prior period financial statements were not audited (Note: This does not relieve the auditors of the requirement of obtaining sufficient appropriate audit evidence on opening balances.)

(c) When reporting on prior period financial statements in connection with the current period's audit, if the auditors’ opinion on such prior period financial statements differs from the opinion the auditors previously expressed

### Modified opinions

The three types of modified opinions are:

- A qualified opinion (material misstatement or an inability to obtain sufficient appropriate audit evidence)
- An adverse opinion
- A disclaimer of opinion

<table>
<thead>
<tr>
<th>Nature of matter giving rise to the modification</th>
<th>Auditor’s judgement about the pervasiveness of the effects or possible effects on the financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial statements are materially misstated</td>
<td>Material but not pervasive</td>
</tr>
<tr>
<td>Inability to obtain sufficient appropriate audit evidence</td>
<td>Material and pervasive</td>
</tr>
<tr>
<td></td>
<td>Qualified opinion</td>
</tr>
<tr>
<td></td>
<td>Adverse opinion</td>
</tr>
<tr>
<td></td>
<td>Qualified opinion</td>
</tr>
<tr>
<td></td>
<td>Disclaimer of opinion</td>
</tr>
</tbody>
</table>

### Key audit matters

Key audit matters should represent the issues which have required the most audit attention during the audit. These are the most significant matters, and are more significant than the other matters communicated to those charged with governance. In determining the key audit matters, the auditor takes into account:

- Areas of higher risk of material misstatement, or significant risks.
- Significant auditor judgements in relation to areas where significant management judgements are involved.
- The effect of significant events or transactions.

Key audit matters are communicated in a separate subsection of the auditor’s report. The description of each key audit matter would contain (1) why the matter was considered to be one of most significant in the audit and (2) how the matter was addressed in the audit.
Other Reports
There are many similarities between the auditor’s report and other reports for assurance engagements. The key difference is with respect to the opinion itself. With an audit, the opinion will be expressed in a positive form and the matters which are reported on are set down in law. For other assurance engagements the opinion may be expressed in negative terms and the matters on which the opinion is expressed will depend on the nature of the engagement.