

Audit and Assurance

Topic 4: Audit Completion and Reporting

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Subsequent Events ISA 560



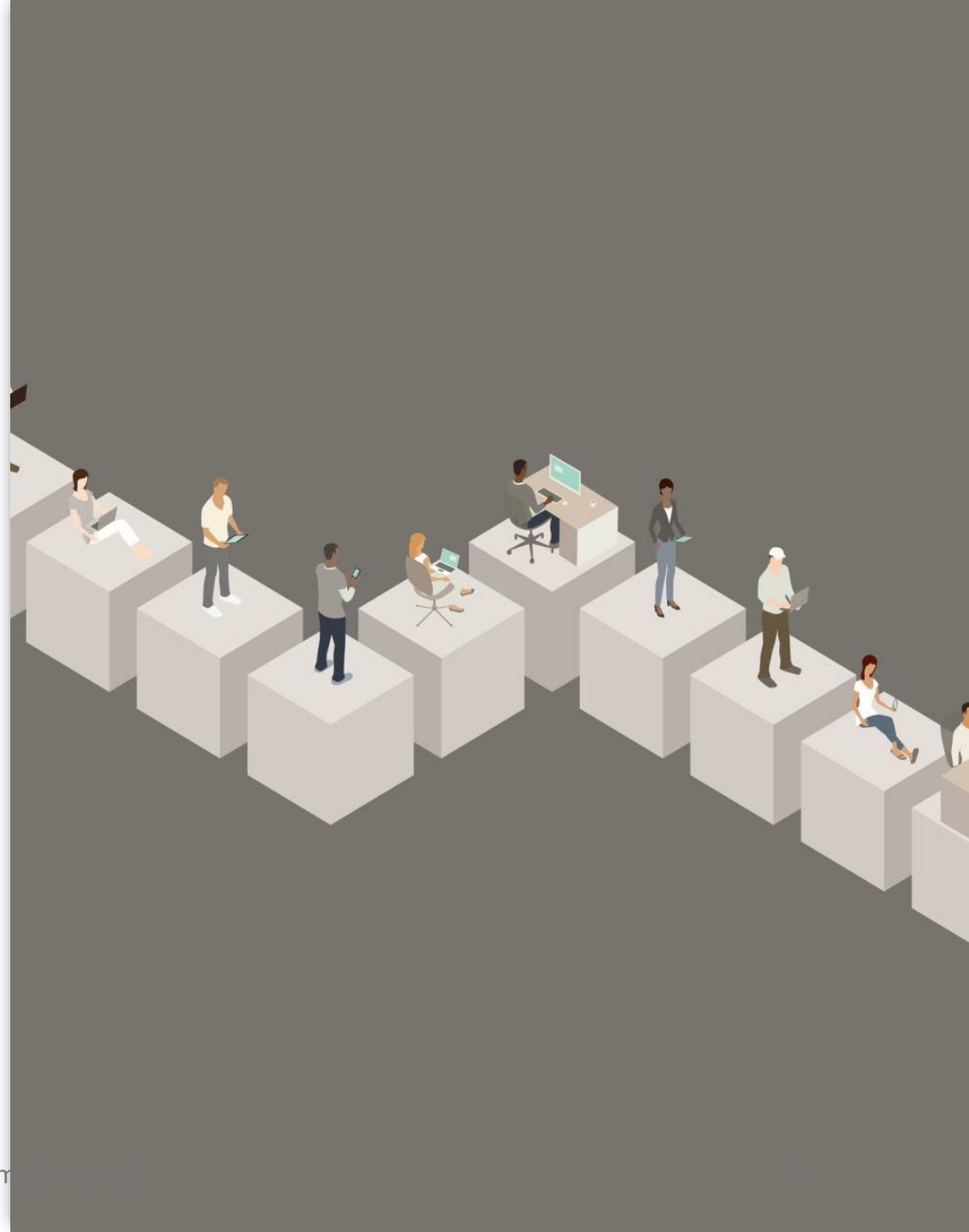
Meaning of Subsequent Events

Are events occurring between the **date of the financial statements** and the **date of the auditor's report**, and **facts that become known to the auditor after the date of the auditor's report**.

These events may provide additional information about conditions that **already existed at the reporting date** or indicate **new conditions that arose afterward**.

Strategic view of subsequent events

- Subsequent events are not only accounting adjustments but also **signals of risk, resilience, and future direction** of an organization.
- They bridge the gap between the reporting date and the date of approval of the financial statements, ensuring that stakeholders are not making decisions based on outdated or incomplete information.



Classification of Subsequent Events

Adjusting Events – These provide evidence about **conditions that existed at the reporting date.**

Example: A customer owing money at year-end is declared bankrupt shortly after—this confirms the receivable was impaired.

Non-Adjusting Events – These relate to conditions that **arose after the reporting date.**

Example: A factory burning down after year-end but before the financial statements are issued.

Need to Audit Subsequent Events

Auditing subsequent events is crucial because they can affect the fairness and accuracy of the financial statements.

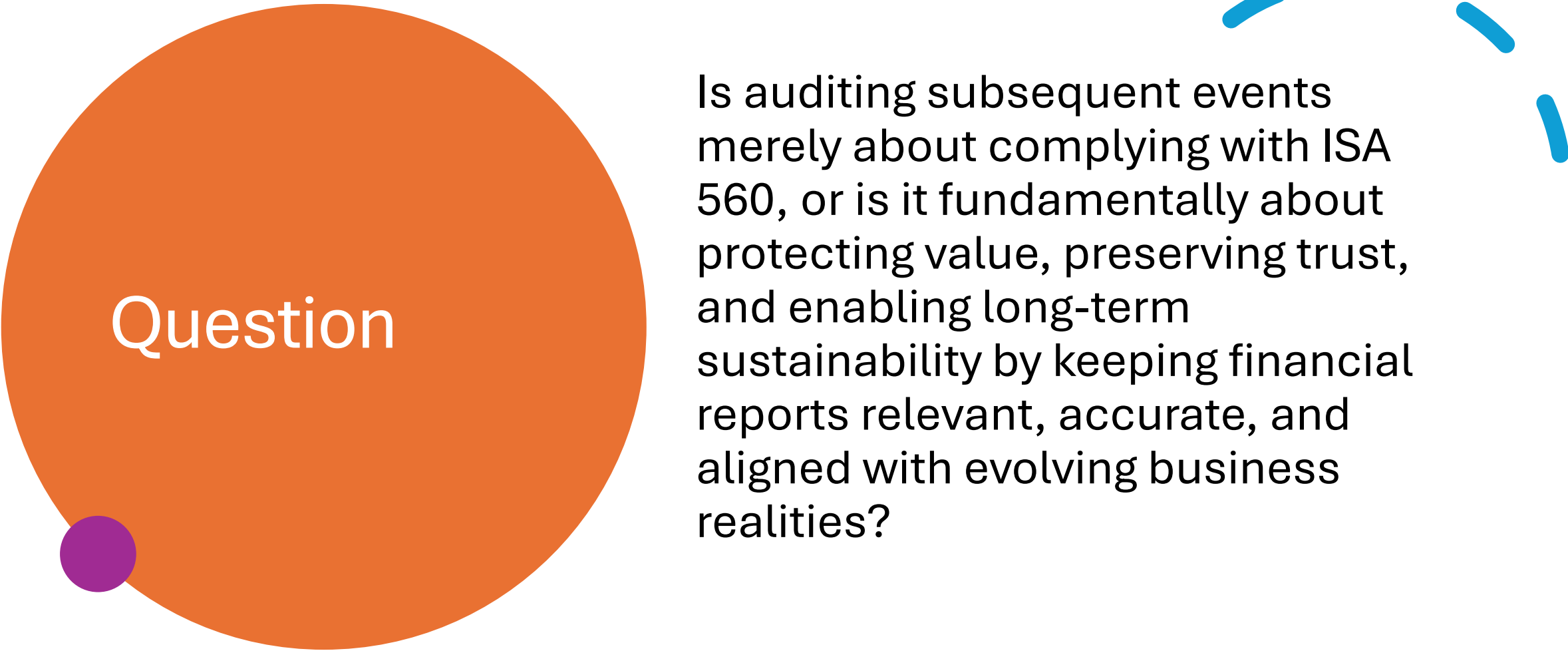
The audit procedures help to ensure:

- ❖ **Correct adjustments** are made for events that provide further evidence of existing conditions (adjusting events).
- ❖ **Appropriate disclosure** is made for significant non-adjusting events.
- ❖ The financial statements reflect an **accurate financial position** as of the reporting date.
- ❖ **Compliance with auditing standards** (e.g., ISA 560).
- ❖ **Protection of users** of financial statements from being misled.
- ❖ The auditor **avoids issuing an inappropriate opinion** based on incomplete or outdated information.

Need to Audit Subsequent Events (Strategic Outlook)

From a strategic perspective, auditing subsequent events is necessary because it:

- **Supports Decision-Making** – Investors, regulators, and creditors rely on financial statements to make forward-looking decisions. Proper audit of subsequent events ensures these stakeholders act on reliable and timely information.
- **Enhances Risk Management** – By scrutinizing subsequent events, auditors and management gain insights into emerging risks (e.g., bankruptcy of a major customer, new litigations, regulatory changes) that could affect the firm's strategy.
- **Strengthens Corporate Governance** – Transparent reporting of significant post-reporting date events builds stakeholder confidence in management's stewardship and the auditor's independence.
- **Protects Organizational Reputation** – Failure to recognize or disclose significant subsequent events may damage credibility and investor trust, leading to long-term reputational and financial consequences.
- **Aligns with Strategic Resilience** – Monitoring subsequent events allows firms to identify vulnerabilities and opportunities early (e.g., a sudden market collapse, acquisition opportunity, or natural disaster). This helps management adjust strategic plans promptly.



Question

Is auditing subsequent events merely about complying with ISA 560, or is it fundamentally about protecting value, preserving trust, and enabling long-term sustainability by keeping financial reports relevant, accurate, and aligned with evolving business realities?

Going Concern Assumption (ISA 570)

- **Introduction**

- The going concern assumption is a cornerstone of financial reporting and auditing.
- It assumes that an entity will continue its operations in the foreseeable future and has neither the intention nor the need to liquidate or significantly curtail operations.
- If this assumption is invalid, financial statements must be prepared on a liquidation basis.
- Auditing the going concern assumption, therefore, **is critical not only for compliance with standards such as ISA 570, but also for protecting stakeholders and ensuring strategic sustainability.**

Meaning of the Going Concern Assumption

- ❖ The going concern assumption underpins the valuation of assets and liabilities.
- ❖ It presumes that businesses will continue generating profits, meeting obligations, and sustaining operations for at least twelve months after the reporting date.
- ❖ If this assumption does not hold, assets must be valued at recoverable amounts and liabilities at settlement values, changing the overall outlook of the financial statements.
- ❖ Hence, it is a fundamental premise in preparing and presenting financial statements.

Need to Audit the Going Concern Assumption #1



Auditing the going concern assumption is critical because it determines whether the financial statements present a true and fair view of the entity's financial health.



From both a technical and strategic outlook, the need arises from the importances explained in the next slide.

Need to Audit the Going Concern Assumption #1

Need	Explanation
Assurance to Stakeholders	Investors, creditors, employees, and regulators rely on the auditor's evaluation of going concern to assess continuity of operations and financial stability. Stakeholders can make informed decisions about investing, lending, or engaging with the entity.
Risk Identification	Auditing going concern helps identify financial distress indicators (e.g., recurring losses, liquidity problems, loan defaults, adverse legal cases) early enough for corrective action.
Protects Auditor's Credibility	Failure to assess going concern properly (e.g., not highlighting material uncertainty before a company collapses) exposes auditors to reputational damage and legal liability.
Supports Corporate Governance	Ensures management's assessment of going concern is transparent, documented, and based on realistic assumptions, enhancing accountability.
Strategic Sustainability	Provides insights into long-term viability, enabling stakeholders and management to make informed strategic and risk management decisions.

Audit Procedures for Going Concern #1

Procedure	Strategic Purpose/Outlook
1. Evaluate Management's Assessment	Review management's going concern evaluation (usually covering at least 12 months from the reporting date). This tests whether management has realistically assessed risks and future cash flows.
2. Analyze Cash Flow Forecasts & Budgets	Examine the reasonableness of management's forecasts, including assumptions on revenues, expenses, and financing. This helps determine if the business has sufficient liquidity to sustain operations.
3. Review Borrowing and Loan Agreements	Inspect compliance with debt covenants and assess availability of financing facilities. Breaches may signal distress, while refinancing plans show resilience.
4. Examine Subsequent Events	Look at post-reporting date events (new contracts, lawsuits, defaults, or government policies) that may affect viability. Ensures decisions are based on updated conditions.

Audit Procedures for Going Concern #2

Procedure	Strategic Purpose/Outlook
5. Assess Financial Indicators	Review liquidity ratios, profitability trends, debt levels, working capital, and solvency indicators to gauge the financial health of the entity.
6. Assess Operational and External Factors	Consider industry conditions, regulatory changes, market competition, labor disputes, or supply chain disruptions that may threaten continuity.
7. Evaluate Plans for Mitigating Risks	Test the feasibility of management's mitigation strategies (e.g., raising capital, cost reductions, asset disposals, restructuring).
8. Obtain Written Representations	Secure management's written confirmation regarding their plans and assumptions about going concern to enhance accountability.

Audit Procedures for Going Concern #3

Procedure	Strategic Purpose/Outlook
9. Discuss with Those Charged with Governance	Engage boards or audit committees on viability and strategic plans, strengthening corporate governance.
10. Consider Auditor's Reporting Responsibilities	Decide if a material uncertainty exists. If so, ensure it is disclosed in the financial statements, or modify the audit opinion if necessary.



Conclusion

Auditing going concern goes beyond checking numbers. Auditors evaluate the financial, operational, and strategic capacity of the entity to survive, providing assurance, protecting stakeholders, and aligning reporting with long-term resilience. It is a strategic safeguard that enhances governance, protects the auditor's reputation, and supports sustainable decision-making, ensuring organizational viability in an uncertain environment.



Consideration of Compliance with Laws and Regulations (ISA 250 Revised)



1. Categories of Laws and Regulations

Category	Impact on Financial Statements	Examples	Strategic Outlook
Direct Impact	Affects amounts, disclosures, or presentation	Tax laws, Accounting standards, Pension obligations	Ensures accurate financial reporting, builds credibility with investors, and prevents regulatory penalties that can harm strategic objectives.
Indirect Impact	Does not directly affect FS but may lead to fines, penalties, or operational disruption	Environmental regulations, Labor laws, Health and safety regulations	Helps maintain sustainable operations, positive reputation, and long-term regulatory relationships.

2. Management's Responsibilities

- Ensure compliance with applicable laws and regulations.
- Implement internal controls to prevent and detect non-compliance.
- Monitor legal/regulatory changes and assess potential strategic risks.
- **Strategic Outlook:** Compliance supports sustainable growth, reduces legal risks, enhances stakeholder trust, and aligns operations with long-term organizational strategy.

3. Specific Compliance Areas

Area	Responsibility	Strategic Outlook
Money Laundering & Terrorism Financing	Implement AML/CTF policies and internal controls	Protects reputation, ensures access to global financial systems, and supports investor confidence.

4. Auditor's Responsibilities (ISA 250 Revised)

- **Obtain an Understanding:**
 - Knowledge of relevant legal/regulatory framework.
 - Assess risks of material misstatement due to non-compliance.
 - **Strategic Outlook:** Helps auditors identify risks that could affect strategic decision-making and organizational resilience.
- **Audit Procedures:**
 - Inquiries of management and governance.
 - Inspect documents and correspondence with regulators.
 - Substantive procedures to detect non-compliance.
 - **Strategic Outlook:** Ensures early detection of risks that may have operational or strategic implications.
- **Reporting:**
 - Communicate findings to management and governance.
 - Consider implications for financial statements.
 - **Strategic Outlook:** Provides actionable insights for management to mitigate regulatory and strategic risks.

ISA 580 – Written Representations

Written representations refer to **written statements** provided by management to the auditor to confirm certain matters or to support other audit evidence. These representations are part of the audit evidence that auditors use to form an opinion on the financial statements.

In simple terms, they are **formal letters or documents signed by management** (usually the CEO and CFO) declaring that:

- The financial statements are prepared in accordance with the applicable framework,
- All relevant information has been provided, and
- There are no undisclosed issues affecting the audit.

Purpose of Written Representations

According to **ISA 580**, the purpose of obtaining written representations is to:

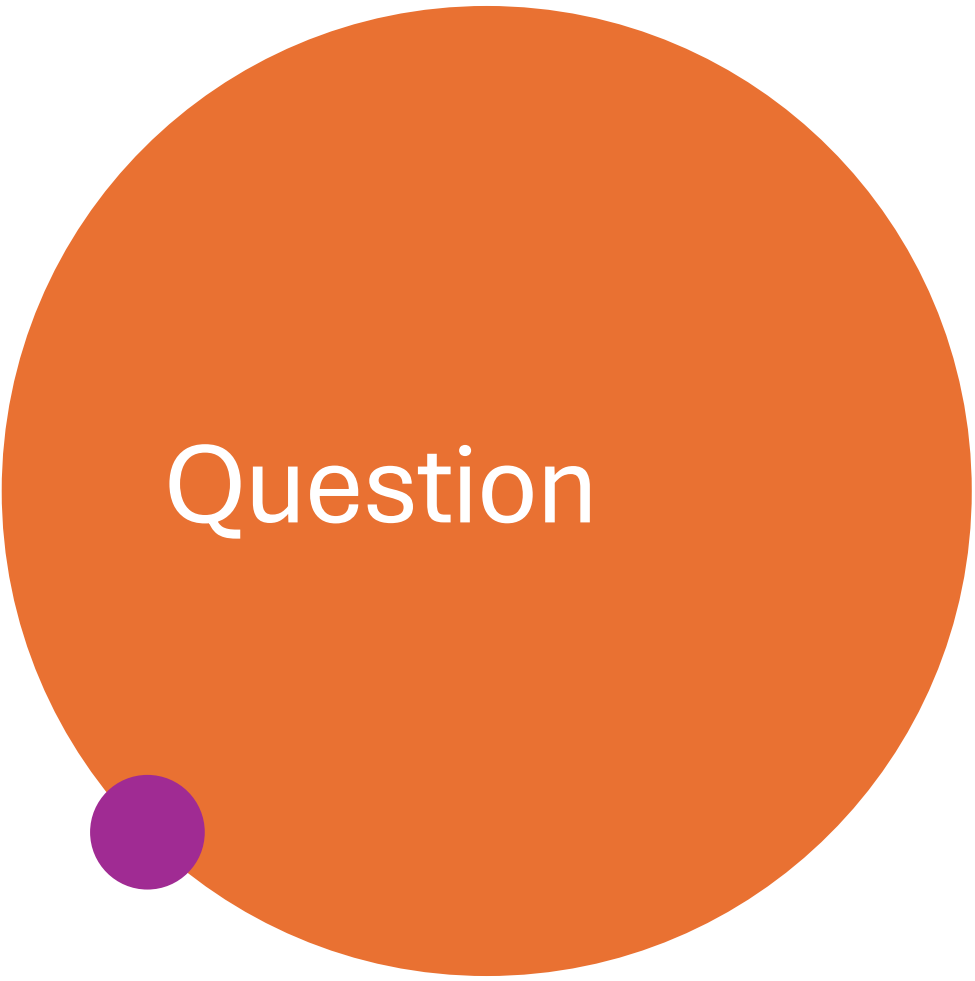
- **Confirm management's responsibility.** They affirm that management is responsible for the preparation and fair presentation of the financial statements and for providing complete information to the auditor.
- **Support other audit evidence.** Written representations complement other audit procedures by confirming oral statements or judgments made by management during the audit (e.g., about contingent liabilities or going concern assumptions).
- **Reduce misunderstandings.** They provide a formal record of management's assertions, reducing the risk of misunderstandings between auditor and management about key responsibilities or facts.
- **Provide evidence when other sources are not available.** In some cases, it may be difficult to obtain sufficient appropriate audit evidence by other means (e.g., future plans, intentions, or legal disputes). Written representations then serve as the main source of evidence.
- **Assist in evaluating management integrity.** Refusal or reluctance by management to provide written representations may indicate a potential integrity issue, which can affect the auditor's overall conclusion.

Strategic Purpose of Written Representations (ISA 580)

Strategic Purpose	Description	Impact / Value to Audit & Governance
Reinforces Accountability	Management formally acknowledges responsibility for financial statements and internal controls.	Strengthens governance and ethical leadership; reduces risk of misstatement.
Supports Audit Evidence	Provides documented confirmation of assertions made during the audit.	Enhances reliability of audit evidence, complementing other audit procedures.
Promotes Transparency	Discloses all relevant information, including contingent liabilities, related party transactions, and subsequent events.	Builds stakeholder confidence and protects the organization's credibility.
Facilitates Risk Management	Highlights potential areas of disagreement, fraud, or non-compliance.	Helps auditors identify risk areas and informs professional judgment.
Documents Management Integrity	Demonstrates management's commitment to honesty, completeness, and ethical reporting.	Provides auditors with insight into management's reliability and ethical stance.
Provides Legal & Regulatory Compliance	Satisfies ISA 580 requirements for obtaining written representations.	Ensures audit compliance and reduces exposure to audit challenges.
Reduces Misunderstandings	Formalizes verbal statements made during the audit process.	Minimizes ambiguity between management and auditors; strengthens communication.

Key Points in ISA 580

- The auditor must request a **written representation letter** dated as close as possible to the date of the auditor's report.
- It should be **signed by management and those charged with governance**.
- If management refuses to provide written representations, the auditor should treat it as a **limitation on scope** and consider the need to **modify or disclaim the audit opinion**.



Question

"Written representations, as prescribed by ISA 580, are often viewed merely as a procedural requirement in the audit process. Critically evaluate the strategic purpose of written representations in modern auditing. In your answer, discuss how they contribute to corporate governance, risk management, audit quality, and stakeholder confidence. Support your discussion with relevant examples or scenarios."

Management Letters in Auditing

- A **management letter** (also called an **internal control letter** or **letter of recommendations**) is a **formal communication issued by the auditor to management** after completing an audit. It contains:
 - Observations about the entity's **internal controls**,
 - Identified **weaknesses or inefficiencies**,
 - Recommendations for **improvement**, and
 - Other **matters requiring management attention** that are not necessarily material misstatements but could affect the organization's operations.
- Unlike the **audit report**, a management letter **does not form part of the audit opinion** but serves as a **feedback tool** to improve governance and operational efficiency.

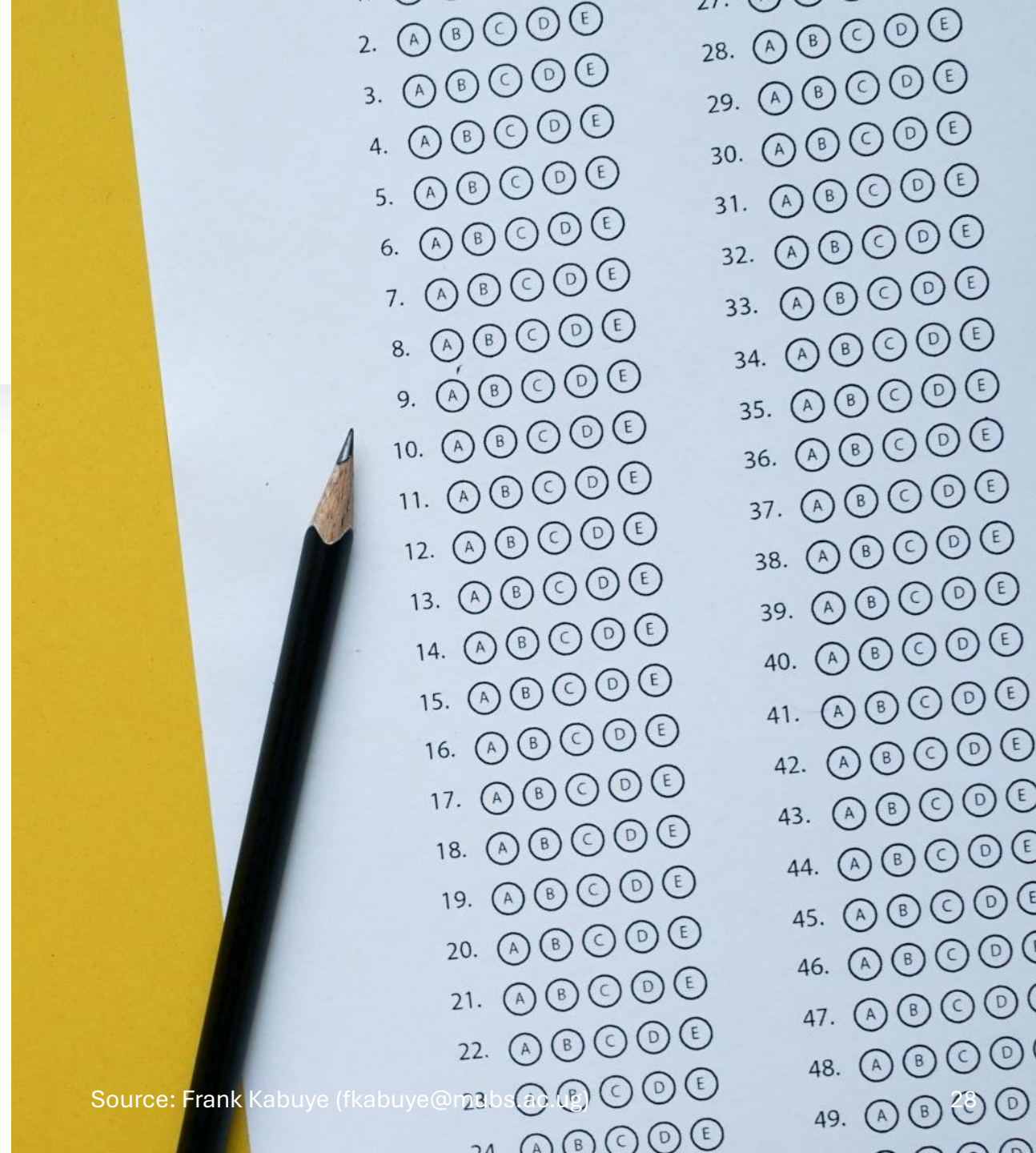


Purpose of Issuing a Management Letter

Purpose	Description
Improving Internal Controls	Highlights weaknesses in systems, processes, and controls, helping management strengthen control mechanisms.
Enhancing Operational Efficiency	Identifies inefficiencies and suggests improvements in procedures and processes.
Facilitating Governance	Informs the board or audit committee about potential risks and control deficiencies, supporting oversight responsibilities.
Promoting Risk Management	Alerts management to areas susceptible to fraud, errors, or non-compliance with laws and regulations.
Supporting Strategic Decision-Making	Provides actionable recommendations that management can use to make informed decisions and policy adjustments.
Strengthening Auditor-Management Relationship	Encourages constructive dialogue between auditors and management, fostering trust and transparency.

Contents of a Management Letter

- 1. Introduction** – Purpose of the letter and context of the audit.
- 2. Scope of Audit** – Overview of audit procedures performed.
- 3. Observations and Findings** – Details of internal control weaknesses, errors, or inefficiencies.
- 4. Recommendations** – Practical steps to correct or mitigate identified issues.
- 5. Acknowledgment** – Management responses or planned actions may be included in follow-up letters.



Issuing and Discussion Process

Step 1: Drafting the Letter. The auditor summarizes key observations, focusing on issues **significant enough to warrant management attention** but not necessarily affecting the audit opinion.

Step 2: Issuing to Management. Addressed to **senior management** and, where appropriate, the **audit committee or board of directors**.

Step 3: Discussion with Management

- The auditor discusses the findings and recommendations, clarifies points, and listens to management's perspective.
- Management may provide **feedback, corrective action plans, or explanations** for issues noted.

Step 4: Documentation and Follow-Up

- The auditor retains the management letter in audit files.
- Follow-up reviews may be conducted in the next audit cycle to evaluate implementation of recommendations.

Ke take away

Management letters are **post-audit communications** that provide management with observations, risks, and recommendations for improvement. Strategically, they serve to **strengthen internal controls, improve operations, enhance governance, and foster effective auditor–management relationships**, adding value beyond the audit opinion.

Audit Report Format and Contents (ISAs 700, 701, 705, 706)

ISA	Focus / Requirement
ISA 700 – Forming an Opinion and Reporting on Financial Statements	Establishes the overall structure and content of the auditor's report, including title, addressee, opinion paragraph, basis of opinion, and other sections.
ISA 701 (Revised) – Communicating Key Audit Matters (KAM)	Requires disclosure of matters that, in the auditor's professional judgment, were of most significance in the audit.
ISA 705 (Revised) – Modifications to the Opinion	Guides reporting when the auditor concludes the financial statements are materially misstated or unable to obtain sufficient evidence.
ISA 706 (Revised) – Emphasis of Matter and Other Matter Paragraphs	Covers additional explanatory paragraphs (Emphasis of Matter and Other Matters) that do not modify the auditor's opinion but highlight significant issues or communications.

Forming an Opinion on the Audited Financial Statements (ISA 700)

Auditor forms an opinion based on:

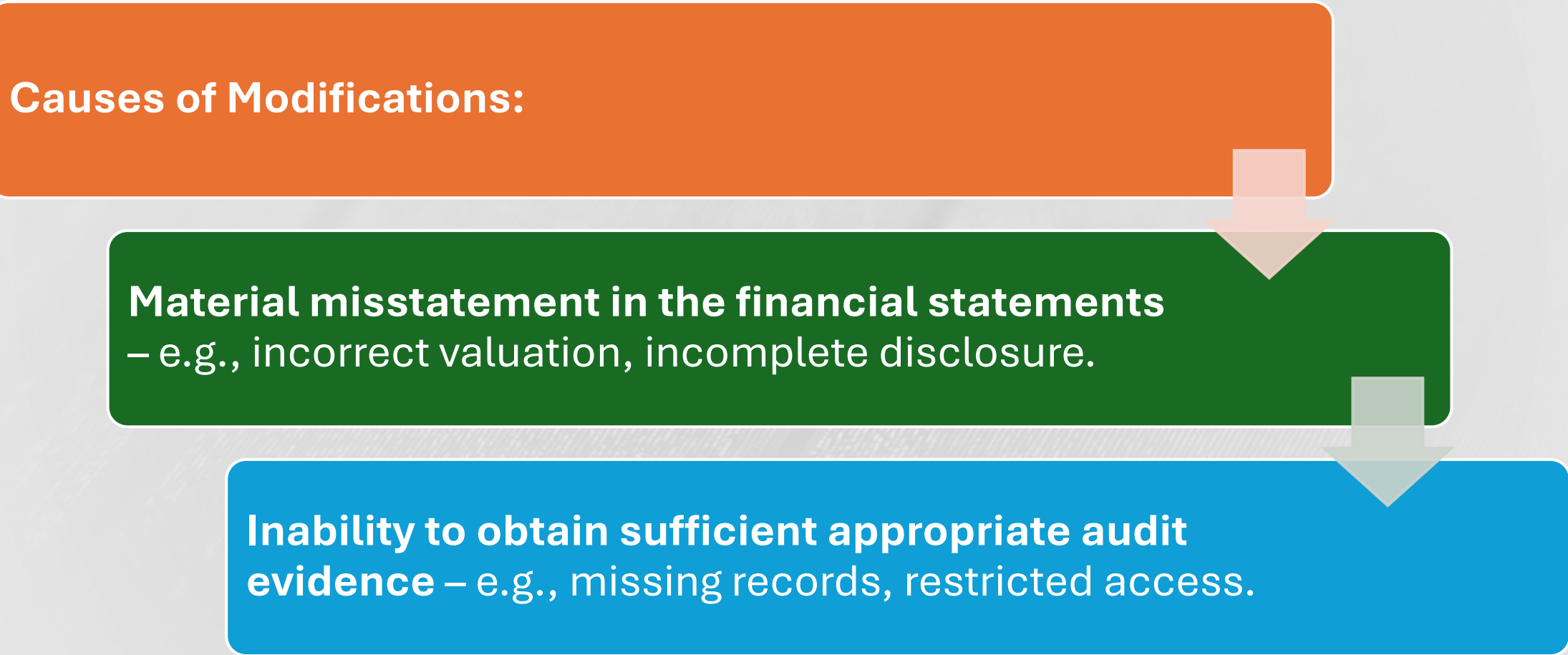
1. **Sufficient appropriate audit evidence** obtained through risk assessment, testing, and procedures.
2. **Compliance with applicable financial reporting framework** (e.g., IFRS).
3. **Evaluation of material misstatements**—errors, omissions, or deviations from reporting framework.

Key Types of Opinions:

- **Unmodified / Clean Opinion:** Financial statements are free of material misstatement and fairly presented.
- **Modified Opinion:** Issued when material misstatement exists or auditor cannot obtain sufficient evidence (see ISA 705).

Modifications to the Audit Opinion (ISA 705)

Causes of Modifications:



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graph TD; A[Causes of Modifications:] --> B[Material misstatement in the financial statements  
– e.g., incorrect valuation, incomplete disclosure.]; B --> C[Inability to obtain sufficient appropriate audit evidence – e.g., missing records, restricted access.];
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Material misstatement in the financial statements
– e.g., incorrect valuation, incomplete disclosure.

Inability to obtain sufficient appropriate audit evidence – e.g., missing records, restricted access.

Types of Modified Opinions

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Types of modifications

Type of Opinion	Definition / Use Case
Qualified Opinion	Financial statements are materially misstated in specific areas or scope limitation exists, but overall statements are fairly presented.
Adverse Opinion	Financial statements are materially misstated and do not present a true and fair view.
Disclaimer of Opinion	Auditor cannot obtain sufficient appropriate evidence, so no opinion is expressed.

Emphasis of Matter (ISA 706)

- Paragraph included to highlight **matters already disclosed in the financial statements** that are fundamental for users' understanding.
- **Purpose:** Draws attention to significant issues (e.g., going concern uncertainties, significant litigation) **without modifying the audit opinion.**
- **Placement:** Immediately after the opinion paragraph.

Key Audit Matters (KAM) – ISA 701

- **Meaning:** Matters that, in the auditor's judgment, were of most significance in the audit.
- **Purpose:** Improves transparency for stakeholders by highlighting **areas of high risk, significant judgment, or complexity.**
- **Characteristics of KAM:**
 - High estimation uncertainty, significant judgment, or unusual transactions.
 - Matters requiring significant auditor attention or effort.

Other Matters Paragraph (ISA 706 Revised)

- **Meaning:** Communicates matters not presented or disclosed in financial statements but relevant for **understanding the audit, auditor responsibilities, or users' decision-making**.
- **Purpose:** Provides additional information while **keeping the audit opinion unmodified**.
- **Example:** Reference to reports by other auditors on subsidiaries, regulatory considerations, or limitations of the audit.

Typical Structure of an Audit Report (ISA 700)

1. **Title:** Independent Auditor's Report
2. **Addressee:** Shareholders, Board of Directors, or other users
3. **Opinion Paragraph:** Unmodified or modified opinion on financial statements
4. **Basis for Opinion:** Statement of compliance with auditing standards, scope, and responsibilities
5. **Key Audit Matters Paragraph (if applicable – ISA 701)**
6. **Emphasis of Matter Paragraph (if applicable – ISA 706)**
7. **Other Matters Paragraph (if applicable – ISA 706)**
8. **Responsibilities of Management and Those Charged with Governance**
9. **Auditor's Responsibilities for the Audit**
10. **Signature, Auditor's Address, Date**

Strategic Purpose

- **Audit Opinion:** Confirms reliability and fairness of financial statements.
- **Modifications:** Alert users to risks, limitations, or misstatements.
- **KAM & Emphasis of Matter:** Enhance transparency and stakeholder understanding of significant matters.
- **Other Matters:** Provide context beyond financial statements, improving overall audit communication.

Summary Table: Audit Report Components and Purposes

Component	Meaning / Purpose	Reference ISA
Opinion Paragraph	Auditor's conclusion on financial statements	ISA 700
Basis for Opinion	Explains audit approach and compliance with standards	ISA 700
Key Audit Matters	Significant issues requiring auditor attention	ISA 701
Emphasis of Matter	Highlights disclosed matters fundamental to understanding	ISA 706
Other Matters	Additional relevant information outside financial statements	ISA 706
Modifications (Qualified, Adverse, Disclaimer)	Alerts users to misstatements or limitations	ISA 705