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*Financial Audit ISSAIs*

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## *ISSAI 200 Financial Audit Principles*

INTOSAI Professional Standards Committee

PSC Secretariat

INTOSAI



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## INTRODUCTION

1. The public sector financial auditor works in the public interest by providing financial audit services. This involves giving assurance on the financial information prepared by public sector authorities or entities on their use and management of public funds and assets. The result - in the form of audit opinions and/or reports – can be used as a basis to hold those responsible to account. As such, financial audit constitutes an important element of the public finance accountability process.
2. Professional standards and guidelines drive the quality and professionalism of public sector auditing and thereby underpin the credibility of the profession and its work. The International Standards of Supreme Audit Institutions (ISSAIs), developed by the International Organisation of Supreme Audit Institutions (INTOSAI), aim to promote independent and effective auditing and serve as a basis for INTOSAI members to develop their own tailored professional approaches in accordance with their mandates and national laws and regulations. The principles in these standards do not override national laws, regulations or mandates.
3. *ISSAI 100 - Fundamental Principles of Public-Sector Auditing* establishes the fundamental principles which are applicable to all public sector audit engagements. ISSAI 200 complements the fundamental principles of ISSAI 100 with the specific context of audits of financial statements. Together they constitute the basis for INTOSAI's complete set of professional pronouncements in this area, and should both be complied with.
4. The main purpose of the ISSAIs on financial audit is to provide INTOSAI members with a comprehensive set of principles and standards for the audit of financial statements of public-sector entities. Accordingly the principles set out in ISSAI 200, form the basis for more specific audit standards on financial audit (ISSAIs 2000-2899) as well as Guidelines on how to apply them (GUID 2900-2999). ISSAIs contain [*application material*] issued by INTOSAI to provide guidance on the application of the relevant International Standards on Auditing (ISAs) developed by the International Auditing and Assurance Standards Board (IAASB). Supreme Audit Institutions (SAIs) may sometimes combine financial audits with elements of compliance and/or performance audit, in which case the related principles apply to the specific audit types as applicable.
5. ISSAI 200 provides the principles for the audit of individual or consolidated financial statements, or specific elements thereof. It covers the:
  - authority of ISSAI 200;
  - framework for financial auditing;
  - elements of financial auditing; and
  - principles of financial auditing.

## AUTHORITY OF ISSAI 200

6. ISSAI 200 provides the principles for an audit of financial statements. They establish the minimum requirements for public auditing standards set at national level, or standards applied by a SAI which it has developed itself, or by others. The authority of the ISSAIs is covered by ISSAI 100.

# FRAMEWORK FOR FINANCIAL AUDITING

## Definition and objectives of financial auditing

7. Financial audit involves determining, through the collection of audit evidence, whether an entity's financial information as presented in its financial statements is complete, accurate and, where applicable, fairly presented in accordance with the financial reporting and regulatory framework applicable. In the case of compliance frameworks the auditor assesses the extent to which compliance is achieved.
8. The objective of financial audit is, through the collection of sufficient appropriate evidence, to provide reasonable assurance to the users, in the form of an audit opinion and/or report, as to whether the financial statements are fairly and/or in all material respects presented in accordance with the applicable financial reporting and regulatory framework.

## Preconditions for an audit of financial statements in accordance with the ISSAIs

9. Before commencing a financial audit engagement the auditor should:
  - assess the acceptability of the financial reporting framework of the audited entity; and
  - ensure that the management of the entity acknowledges and understands its responsibility for:
    - preparing the financial statements in accordance with the applicable financial reporting framework;
    - internal control that management deems necessary for the preparation of financial statements that are free from material misstatement; and
    - providing the auditor with access to all information and persons necessary to complete the audit.

## Financial reporting framework

10. Financial reporting frameworks are either:
  - general purpose: designed to meet the information needs of a wide range of users; or
  - special purpose: designed to meet the needs of a specific user or group of users (for example the financial reporting provisions established by an international funding organisation, a governing body, the legislature or by a contract).
11. The principles of ISSAI 200 are relevant for audits of different types of financial statements, such as those prepared in accordance with both general purpose (e.g., IPSAS, IFRS or national financial reporting frameworks) and special purpose frameworks.
12. In addition, financial reporting frameworks can be either:
  - compliance-based: setting out the rules and requirements to be followed strictly in all cases; or
  - fair presentation-based: when the rules and requirements can be departed from, or additional disclosures given, in order to achieve a fair presentation of the entity's financial position and results.
13. The principles of ISSAI 200 are also applicable to audits of public-sector entities that prepare financial information, (including single financial statements or specific elements, accounts or items of a financial statement), for other parties such as governing bodies, the legislature or other parties with an oversight function.

14. In some environments the auditor is required to undertake audits of budgetary execution, which can include the examination of the regularity of budgetary transactions and comparison between actual and budget. Such environments often involve specific or individual financial reporting frameworks. For this type of audit engagement, the preconditions established by the ISSAIs on financial audit may not be in place, but the principles they contain can be used as guidance.

## **Assessing the financial reporting framework**

15. The financial reporting framework should be applicable to the circumstances of the audited entity, notably in terms of giving a fair presentation of the financial results and position when appropriate. The financial reporting framework applied is normally prescribed by law, regulation or other relevant authority. If not, it is at the discretion of management.
16. The auditor should assess the acceptability of the financial reporting framework used. At present, there is no objective and authoritative basis that has been generally recognised globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organisations that are authorised or recognised to promulgate standards (e.g., IPSAS, IFRS) to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities, provided the organisations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. To be acceptable, a financial reporting framework has to ensure that the information provided in the financial statements is of value to the intended users, namely: relevant, complete, accurate, objective and understandable.
17. If the framework is not considered acceptable, the auditor should assess the effect on the financial statements in terms of missing information or its impact on the financial results or position:
- when the choice of the reporting framework is at the discretion of management, the auditor should suggest the framework be changed; or
  - when a change in the framework is not possible, such as when prescribed by law or regulation, the auditor should inform the auditee of additional disclosures needed in the financial statements to avoid them being misleading.
18. The auditor should, taking account of the auditee's response, determine the impact on the audit opinion or consider an emphasis of matter explaining the impact of the financial reporting framework on the results or assets and liabilities. The auditor may also consider other actions such as informing the legislature or withdrawing from the audit engagement if the SAI is able to do so.

## **ELEMENTS OF FINANCIAL AUDITING**

19. In a public sector financial audit, the elements defined in ISSAI 100 (auditor, responsible party, intended users, subject matter and criteria) may vary from one auditee to another. Auditors should explicitly identify these elements for each audit, and analyse the implications.

## **Three parties in financial auditing**

20. The responsibility of the auditor is to plan and perform the audit in accordance with the applicable auditing standards and mandate, and communicate the results.
21. The responsible party is responsible for the subject matter information (financial statements) and underlying subject matter (accounting data). The responsible party is normally the executive branch of government and/or its underlying hierarchy of public-sector entities responsible for the management of public funds. These bodies manage resources, exercise authority in accordance with the decisions of the legislature and prepare the financial statements.
22. The 'intended user' of financial statements in the public sector is primarily the legislature, which represents citizens (the ultimate users). The legislature holds government to account for the use of public funds, largely based on the information provided by government. The assurance on the reliability of this information through financial audit is therefore a key part of this process. Other intended users may include ministries in the case of financial statements of public sector entities working on their behalf.

## **Subject matter for financial auditing**

23. The subject matter of a financial audit is the accounting data of an entity, which are presented in the form of financial statements (known as the subject matter information).

## **Criteria used in financial auditing**

24. Criteria are the benchmarks, measures or attributes against which the subject matter is measured against to come to a conclusion on the audit objectives. The criteria used in the audit of financial statements would generally be based on the financial reporting framework used by the responsible party in their preparation.

## **Reasonable assurance engagement**

25. Audits of financial statements conducted in accordance with the ISSAIs are attestation engagements which aim to provide reasonable assurance. Reasonable assurance is a high but not absolute level of assurance, which means it is not a guarantee that the audit will detect all cases of material misstatement.
26. In general, reasonable assurance audits are designed to result in a conclusion expressed in a positive form, such as "in our opinion the financial statements present fairly, in all material respects (or give a true and fair view of) the financial position of ... and its financial performance and cash flows ..." or, in the case of a compliance framework, "in our opinion the financial statements are prepared, in all material respects, in accordance with...".
27. Limited assurance engagements, such as some review engagements, are not covered by the current ISSAIs on financial audit.

## FINANCIAL AUDIT PRINCIPLES

28. The general principles of public sector auditing are set out in ISSAI 100<sup>1</sup>, and in standards on ethics, quality control, and on overall responsibilities of an auditor in an audit of financial statements. They cover:
- ethics and independence;
  - professional judgment, due care and scepticism;
  - quality control;
  - audit team management and skills;
  - audit risk;
  - materiality;
  - documentation; and
  - communication.
29. The following paragraphs set out the specific principles related to public sector financial audit.

### Agreeing the terms of the engagement

30. The terms of an audit engagement in the public sector are normally mandated by legislation. The public sector auditor should reach a common understanding with management or those charged with governance about the respective roles and responsibilities for each audit engagement, preferably in writing. When an engagement arises from a request from management, those charged with governance or the legislature, then all parties should agree on the terms of that engagement.

### Planning

31. The auditor should plan the audit to ensure that it is conducted in an effective and efficient manner, by determining the scope, timing and approach and the practical steps to be taken.
32. Detailed planning is key to auditing efficiently and effectively. The nature and extent of the planning needed will depend on whether it is the first audit of the entity or, a recurrent task, the size and complexity of the entity, and the team members' previous experience with the entity. Planning should be updated as the engagement progresses in order to take account of unexpected issues or events affecting the risk assessment or implementation of the audit.

### Materiality

33. The auditor should apply the concept of materiality, both in quantitative (by amount) and qualitative (by nature) terms, when planning and performing the audit, evaluating the findings and reporting on the results.

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<sup>1</sup> ISSAI 100 paragraphs 34 to 43.

34. When planning the audit, the auditor should determine an overall level of materiality for the financial statements as a whole, taking account of the level of misstatement which could influence the decisions of the users of those statements. The auditor should then reduce that level of materiality when establishing the audit work to be undertaken, in order to reduce to an acceptable level the risk that the aggregate of undetected and uncorrected misstatements do not exceed overall materiality.
35. This lower materiality level should be used to help determine the nature, timing and extent of audit procedures, and to assess the results of those procedures. The extent of uncorrected misstatements in the financial statements should be compared to overall materiality, taking into account their quantitative effect and nature, when forming the opinion in the auditor's report. The materiality applied to reporting may need to be revised compared with that established for planning, depending on the entity's final results or other factors.

### **Understanding the audited entity**

36. The auditor should obtain a sufficient understanding of the audited entity and the environment in which it operates, the applicable financial reporting framework and the entity's system of internal control, in order to identify and assess the risks of material misstatement. An entity's system of internal control comprises five components: the control environment, the entity's risk assessment process, the entity's process to monitor the system of internal control, the entity's information system and the control activities (including IT controls).

### **Risk identification and assessment**

37. The auditor's identification and assessment of the risk of material misstatement takes into account both inherent risk (the risk that a particular account heading or class of transactions will be subject to error or misstatement) and control risk (the risk that internal controls do not prevent or detect and correct particular errors or misstatements).
38. The auditor identifies and assesses inherent risk without taking into account the effect of any related controls, and determines whether any of the inherent risks are significant. The auditor should evaluate the design of the controls relevant to the audit (notably in relation to significant inherent risks), and consider whether they are likely to be implemented in practice.
39. The auditor should identify and assess the risk of material misstatement in the financial statements as a whole, and at assertion level, in order to determine the most appropriate audit procedures to address those risks.
40. Risk assessment procedures help identify the nature and extent of the audit work which should take place, but do not themselves provide sufficient appropriate audit evidence on which to base an audit opinion.

### **Response to assessed risks**

41. The auditor should obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, by designing and implementing appropriate responses to those risks. . The higher the risk, the more extensive may be the audit procedures required, and the more persuasive the audit evidence needed.

42. The auditor should design and implement overall responses to address the risks of material misstatement at the financial statement level, and further audit procedures whose nature, timing and extent take account of the risks of material misstatement at the assertion level. Such audit procedures usually include tests of control and substantive procedures (analytical procedures and/or tests of detail).
43. If controls are likely to be effective, the auditor can consider testing them. If the controls are found to be operating effectively, this can reduce the amount of substantive testing needed to address the identified risk.

### **Considerations relating to fraud**

44. As part of the identification and assessment of the risks of material misstatement, the auditor should consider whether material misstatements could arise due to fraud, and undertake appropriate responses to those risks.
45. The primary responsibility for the prevention and detection of fraud rests with an entity's management or those charged with governance. The auditor is responsible for providing reasonable assurance on the extent to which the financial statements are free from material misstatement. Material misstatements can arise from error or fraud. However, the nature of fraud makes it very difficult for the auditor to identify, and therefore there is no guarantee that all material misstatements caused by fraud will be detected. As such, the auditor should consider what audit procedures should be undertaken as appropriate when the risk of fraud is material. The auditor should consider bringing any cases of fraud or suspected fraud identified during the audit to the attention of the relevant authorities.

### **Going concern considerations**

46. The auditor should consider and conclude whether there are events or conditions that represent a material uncertainty about the audited entity's intention and ability to continue as a going concern.
47. The going concern of an audited entity is a fundamental principle with an impact on the financial statements, as it affects the accounting basis that should be used, notably the carrying value of assets and liabilities.
48. The auditor should obtain sufficient appropriate audit evidence to conclude on the management's use of the going concern assumption when preparing the financial statements, and report as necessary.

### **Considerations relating to laws and regulations in an audit of financial statements**

49. The auditor should identify the risks of material misstatement due to non-compliance with laws and regulations, and respond appropriately.
50. The auditor should obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations having a direct effect on the determination of material amounts and disclosures in the financial statements. The auditor should also perform audit procedures to help identify instances of non-compliance with those other laws and regulations that indirectly may have a material effect on the financial statements.

51. In the public sector, there may be additional audit responsibilities with respect to the consideration of any laws and regulations which relate to the audit of financial statements or other aspects of the entity's operations. In such cases, the auditor should distinguish between the scope of work performed to verify compliance with the laws and regulations for the needs of issuing the opinion on the financial statements, and the audit work performed to verify other compliance issues for the needs of issuing a compliance audit opinion and/or report.
52. The auditor should obtain an adequate understanding of the legal and regulatory framework applicable to the specific environment in which the audited entity operates, including how it complies with the framework.
53. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures therein. Other laws or regulations are to be complied with by the entity or set the provisions under which the entity operates, but only have an indirect effect on its financial statements.

### **Audit evidence**

54. The auditor should design and perform audit procedures in order to obtain sufficient appropriate audit evidence (in terms of quantity and quality) on which to base the audit conclusions and opinion.
55. The quantity of audit evidence needed to support a conclusion depends on the auditor's assessment of the risks of misstatement and also by the quality of that evidence. The quality of audit evidence refers to its relevance and reliability. The reliability of evidence is influenced by its source, nature and the circumstances under which it is obtained.

### **Evaluating misstatements**

56. The auditor should record misstatements identified during the audit and bring them to the attention of management or those charged with governance. The auditor should assess if the misstatements mean further audit work is required, and their impact on the financial statements, if uncorrected.
57. The auditor should assess whether uncorrected misstatements are material, individually or in aggregate, to determine what effect they may have on the audit opinion.

### **Forming an opinion and reporting on the financial statements**

58. Based on the audit evidence, the auditor should form an opinion as to whether the financial statements have been prepared in accordance with the applicable financial reporting framework, and if they are free from material misstatement.
59. In order to form an opinion, the auditor must first conclude whether they have reasonable assurance on whether the financial statements as a whole are free from material misstatement.
60. The auditor should express an unmodified opinion if the audit evidence shows that the financial statements have been prepared, in all material respects, in accordance with the applicable financial framework.

61. If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole contain material misstatement, or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with the section on "Modifications to the opinion in the auditor's report".
62. In addition to the opinion on the financial statements, the auditor may be required by law or regulation to report observations and findings which have not affected the opinion, and any recommendations made as a result thereof. These elements should be clearly distinguished from the opinion.

### **Modifications to the opinion in the auditor's report**

63. The auditor should modify the opinion in the auditor's report when the auditor concludes, based on the audit evidence obtained, that the financial statements as a whole contain material misstatement, or if the auditor was unable to obtain sufficient appropriate audit evidence to conclude.
64. Auditors may issue three types of modified opinion:
- a qualified opinion – when the auditor concludes that, or is unable to obtain sufficient and appropriate audit evidence about, misstatements, whether individually or in aggregate are, or could be, material but not pervasive;
  - an adverse opinion – when the auditor, having obtained sufficient and appropriate audit evidence, concludes that misstatements, whether individually or in aggregate, are both material and pervasive; or
  - a disclaimer of opinion – when the auditor is unable to obtain sufficient and appropriate audit evidence due to an uncertainty or scope limitation which is both material and pervasive.
65. The decision regarding which type of modified opinion is appropriate depends upon the:
- nature of the matter giving rise to the modification - that is, whether the financial statements are materially misstated or, in the event that it was not possible to obtain sufficient appropriate audit evidence, may be materially misstated; and
  - auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

### **Emphasis of Matter paragraphs and Other Matters paragraphs in the auditor's report**

66. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, and there is sufficient appropriate evidence that the matter is not materially misstated in the financial statements, the auditor should include an emphasis of matter paragraph in the auditor's report.
67. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements, which, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, and provided this is not prohibited by law or regulation, this should be done in a paragraph with the heading 'Other Matters' or another appropriate heading.

## **Consideration of subsequent events**

68. The auditor should 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 an adjustment to, or disclosure in, the financial statements have been identified and appropriately reflected in the financial statements.
69. The auditor should also respond appropriately to facts that became known after the date of the auditor's report and which, had they been known at that date, may have caused the auditor to amend the auditor's report.

## **Comparative information - corresponding figures and comparative financial statements**

70. The auditor should obtain sufficient appropriate audit evidence about whether any comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework and report in accordance with the auditor's reporting responsibilities.
71. Comparative information refers to amounts and disclosures included in the financial statements in respect of one or more prior periods. Corresponding figures are amounts and other disclosures for the prior period included as an integral part of the current period financial statements. Comparative financial statements are where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period with the same level of information as the current period.
72. The auditor should evaluate whether the comparative information matches the amounts and other disclosures presented in the prior period or, when appropriate, they have been restated. The auditor should also evaluate whether the accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
73. For corresponding figures, the auditor's opinion on the financial statements refers to the current period only. For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

## **The auditor's responsibilities in relation to other information in documents containing audited financial statements**

74. The auditor should read all other information in an entity's annual report and consider whether there are any material inconsistencies or material misstatement of fact with the audited financial statements, or with the auditor's knowledge obtained during the audit. If, when considering the other information, the auditor identifies a material inconsistency or material misstatement of fact, the auditor should determine whether the audited financial statements or the other information needs to be revised.

75. Other information refers to financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. This usually represents a document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide stakeholders with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements.
76. In case of material inconsistency, the action the auditor should take may include modifying the auditor's opinion, withholding the auditor's report, withdrawing from the engagement (in the rare cases where this is possible in the public sector), notifying those charged with governance, or including an Other Matter paragraph in the auditor's report.
77. If the auditor identifies a material inconsistency that the management of the audited entity refuses to correct, the auditor should notify those charged with governance. Auditors may also be required or decide to notify other parties, such as the legislature, in addition to those charged with governance.

### **Considerations relevant to audits of consolidated financial statements**

78. Auditors engaged to audit consolidated financial statements should obtain sufficient appropriate audit evidence on the reliability of the financial information of the components and the consolidation process to express an opinion as to whether the consolidated financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework.
79. These principles apply to all public sector audits of consolidated financial statements. In situations where the auditor is engaged to audit consolidated financial statements specific requirements and considerations may apply, including ensuring the quality of the work of the component auditors.