

**INTERNATIONAL STANDARD ON AUDITING
(UK AND IRELAND) 200**
**OBJECTIVE AND GENERAL PRINCIPLES GOVERNING
AN AUDIT OF FINANCIAL STATEMENTS**
CONTENTS

	Paragraph
Introduction	1 - 1-4
Objective of an Audit	2 - 3
General Principles of an Audit	4 - 6
Scope of an Audit	7 - 7-1
Reasonable Assurance	8 - 12
Audit Risk and Materiality	13 - 23
Responsibility for the Financial Statements.....	24
Effective Date	25

International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) 200 “Objective and General Principles Governing an Audit of Financial Statements” should be read in the context of the Auditing Practices Board’s Statement “The Auditing Practices Board - Scope and Authority of Pronouncements (Revised)” which sets out the application and authority of ISAs (UK and Ireland).

Introduction

1. The purpose of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance on the objective and general principles governing an audit of financial statements.
 - 1-1. This ISA (UK and Ireland) uses the terms ‘those charged with governance’ and ‘management’. The term ‘governance’ describes the role of persons entrusted with the supervision, control and direction of an entity. Ordinarily, those charged with governance are accountable for ensuring that the entity achieves its objectives, and for the quality of its financial reporting and reporting to interested parties. Those charged with governance include management only when they perform such functions.
 - 1-2. In the UK and Ireland, those charged with governance include the directors (executive and non-executive) of a company or other body, the members of an audit committee where one exists, the partners, proprietors, committee of management or trustees of other forms of entity, or equivalent persons responsible for directing the entity’s affairs and preparing its financial statements.
 - 1-3. ‘Management’ comprises those persons who perform senior managerial functions.
 - 1-4. In the UK and Ireland, depending on the nature and circumstances of the entity, management may include some or all of those charged with governance (e.g. executive directors). Management will not normally include non-executive directors.

Objective of an Audit

2. The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The phrases used to express the auditor’s opinion are “give a true and fair view” or “present fairly, in all material respects,” which are equivalent terms.
 - 2-1. The “applicable financial reporting framework” comprises those requirements of accounting standards, law and regulations applicable to the entity that determine the form and content of its financial statements.

3. Although the auditor's opinion enhances the credibility of the financial statements, the user cannot assume that the audit opinion is an assurance as to the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

General Principles of an Audit

4. **The auditor should comply with the *Code of Ethics for Professional Accountants* issued by the International Federation of Accountants.** Ethical principles governing the auditor's professional responsibilities are:
 - (a) Independence;
 - (b) Integrity;
 - (c) Objectivity;
 - (d) Professional competence and due care;
 - (e) Confidentiality;
 - (f) Professional behavior; and
 - (g) Technical standards.
- 4-1. **In the UK and Ireland the relevant ethical pronouncements with which the auditor should comply are the APB's Ethical Standards and the ethical pronouncements relating to the work of auditors issued by the auditor's relevant professional body.**
- 4-2. Auditors in the UK and Ireland are subject to ethical requirements from two sources: the Ethical Standards established by APB concerning the integrity, objectivity and independence of the auditor, and the ethical pronouncements established by the auditor's relevant professional body. The APB is not aware of any significant instances where the relevant parts of the IFAC Code of Ethics are more restrictive than the Ethical Standards.
5. **The auditor should conduct an audit in accordance with ISAs (UK and Ireland).** These contain basic principles and essential procedures together with related guidance in the form of explanatory and other material.
 6. **The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.** An attitude of professional skepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to

audit evidence that contradicts or brings into question the reliability of documents or management representations. For example, an attitude of professional skepticism is necessary throughout the audit process for the auditor to reduce the risk of overlooking suspicious circumstances, of overgeneralizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof. In planning and performing an audit, the auditor neither assumes that management is dishonest nor assumes unquestioned honesty. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

Scope of an Audit

7. The term “scope of an audit” refers to the audit procedures deemed necessary in the circumstances to achieve the objective of the audit. **The audit procedures required to conduct an audit in accordance with ISAs (UK and Ireland) should be determined by the auditor having regard to the requirements of ISAs (UK and Ireland), relevant professional bodies, legislation, regulations and, where appropriate, the terms of the audit engagement and reporting requirements.**

7-1. Although the basic principles of auditing are the same in the public and the private sectors, the auditor of a public service body often has wider objectives and additional duties and statutory responsibilities, laid down in legislation, directives or codes of practice.

Reasonable Assurance

8. An audit in accordance with ISAs (UK and Ireland) is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.
9. An auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor’s ability to detect material misstatements. These limitations result from factors such as:
 - The use of testing.

- The inherent limitations of internal control (for example, the possibility of management override or collusion).
 - The fact that most audit evidence is persuasive rather than conclusive.
 - The impracticality of examining all items within a class of transactions or account balance.
 - The possibility of collusion or misrepresentation for fraudulent purposes.
- 9-1. The view given in financial statements is itself based on a combination of fact and judgment and, consequently, cannot be characterized as either 'absolute' or 'correct'. A degree of imprecision is inevitable in the preparation of all but the simplest of financial statements because of inherent uncertainties and the need to use judgment in making accounting estimates and selecting appropriate accounting policies.
10. Also, the work undertaken by the auditor to form an audit opinion is permeated by judgment, in particular regarding:
- (a) The gathering of audit evidence, for example, in deciding the nature, timing, and extent of audit procedures; and
 - (b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management^{1a} in preparing the financial statements.
11. Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions¹ (for example, transactions between related parties). In these cases certain ISAs (UK and Ireland) identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:
- (a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or
 - (b) Any indication that a material misstatement has occurred.

^{1a} In the UK and Ireland, those charged with governance are responsible for the preparation of the financial statements.

¹ Paragraphs 15-18 of ISA (UK and Ireland) 500, "Audit Evidence" discuss the use of assertions in obtaining audit evidence.

12. Accordingly, because of the factors described above, an audit is not a guarantee that the financial statements are free of material misstatement.

Audit Risk and Materiality

13. Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks.² Management^{1a} is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the financial statements. The auditor is ultimately concerned only with risks that may affect the financial statements.
14. The auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the applicable financial reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is known as “audit risk”.³
15. **The auditor should plan and perform the audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit.** The auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.
16. Audit risk is a function of the risk of material misstatement of the financial statements (or simply, the “risk of material misstatement”) (*i.e.*, the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (“detection risk”). The auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit

² Paragraphs 30 - 34 of ISA (UK and Ireland) 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement,” discuss the concept of business risks and how they relate to risks of material misstatement.

³ This definition of audit risk does not include the risk that the auditor might erroneously express an opinion that the financial statements are materially misstated.

procedures based on that assessment (see ISA (UK and Ireland) 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement” and ISA (UK and Ireland) 330, “The Auditor’s Procedures in Response to Assessed Risks”). The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (*i.e.*, what are the potential misstatements that may arise) at the assertion level (see ISA (UK and Ireland) 500, “Audit Evidence”) and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.

17. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. The auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the financial statements taken as a whole. Materiality and audit risk are related (see ISA (UK and Ireland) 320, “Audit Materiality”). In order to design audit procedures to determine whether there are misstatements that are material to the financial statements taken as a whole, the auditor considers the risk of material misstatement at two levels: the overall financial statement level and in relation to classes of transactions, account balances, and disclosures and the related assertions.⁴
18. The auditor considers the risk of material misstatement at the overall financial statement level, which refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity’s control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the auditor’s consideration of the risk of material misstatement arising from fraud. The auditor’s response to the assessed risk of material misstatement at the overall financial statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant

⁴ ISA (UK and Ireland) 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement” provides additional guidance on the auditor’s requirement to assess risks of material misstatement at the financial statement level and at the assertion level.

engagement responsibilities, including whether to involve experts; the appropriate levels of supervision; and whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

19. The auditor also considers the risk of material misstatement at the class of transactions, account balance, and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level.⁵ The auditor seeks to obtain sufficient appropriate audit evidence at the class of transactions, account balance, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish that objective.⁶
20. The discussion in the following paragraphs provides an explanation of the components of audit risk. The risk of material misstatement at the assertion level consists of two components as follows:
 - “Inherent risk” is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, complex calculations are more likely to be misstated than simple calculations. Accounts consisting of amounts derived from accounting estimates that are subject to significant measurement uncertainty pose greater risks than do accounts consisting of relatively routine, factual data. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that

⁵ ISA (UK and Ireland) 330, “The Auditor’s Procedures in Response to Assessed Risks” provides additional guidance on the requirement for the auditor to design and perform further audit procedures in response to the assessed risks at the assertion level.

⁶ The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.

relate to several or all of the classes of transactions, account balances, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

- “Control risk” is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity’s objectives relevant to preparation of the entity’s financial statements. Some control risk will always exist because of the inherent limitations of internal control.
21. Inherent risk and control risk are the entity’s risks; they exist independently of the audit of the financial statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor’s assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. The ISAs (UK and Ireland) do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risk of material misstatement.” Although the ISAs (UK and Ireland) ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
22. “Detection risk” is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of a class of transactions, account balance, or disclosure and because of other factors. Such other factors include the possibility that an

auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

23. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

Responsibility for the Financial Statements

24. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework is that of the management of the entity, with oversight from those charged with governance.^{71a} The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Effective Date

25. This ISA (UK and Ireland) is effective for audits of financial statements for periods commencing on or after 15 December 2004.

⁷ The structures of governance vary from country to country reflecting cultural and legal backgrounds. Therefore, the respective responsibilities of management and those charged with governance vary depending on the legal responsibilities in the particular jurisdiction.

NOTICE TO READERS

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The ISAs (UK and Ireland) are based on International Standards on Auditing of the same titles, which have been issued by the International Auditing and Assurance Standards Board and published by the International Federation of Accountants.