Final review procedures and Audit Reports, January 2017.

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Introduction

In previous articles the following areas were discussed:

- specific procedure of internal controls
- auditing in a computer environment
- the audit acceptance and planning process

This article will consider the area of final review procedures and audit reports.

The area of final review procedures is an expansive area that can entail consideration of such topics as:

- post-balance sheet period
- provisions
- contingencies
- letter of representation etc.

It is not the intention to address all these topics but we will look primarily at the general matters of final audit work and some issues and terminology that have a common facet to many audits.

Review purpose, format and procedures

As the audit approaches its completion the auditor having reviewed all evidence available, must assess whether or not all issues and uncertainty that arose during the audit and considered significant/material are adequately disclosed. The auditor will have collected a great volume of information about the client and should be aware of the main problems management are likely to encounter in preparing the year-end financial statements. The auditor will also have adapted the audit plan in the light of issues and risks related to problem areas not anticipated at the initial planning stage.

To ensure this is process is complete and all issues have been addressed in the appropriate manner, a final review of the audit file/ working papers should be undertaken.

The principle purpose of an audit review is to consider whether:

1. all significant matters have been resolved or are reflected in audit conclusions
2. the work performed and the results obtained have been adequately documented
3. the objectives of the audit procedures have been achieved; and
4. the conclusions expressed are consistent with the results of the work performed and support the audit opinion.

(This is not meant to be an exhaustive list and there may be other factors that could be included).

The format of a review can differ with regards to the industry involved but some common methodologies are as follows:

Hot review
A hot review involves any review of audit work carried out, prior to the signing of the audit report.

Audit work may be reviewed as and when it is being carried out, during the course of the audit, by a more experienced member of staff. In such circumstances a thorough review should ensure that adequate feedback is given to those audit staff carrying out the work enabling them to make good any omissions in the procedures they have carried out.
In any event all work carried out should be reviewed at the final stage of the audit, by the partner responsible for the audit assignment. A thorough review at this stage should ensure that the audit work is reviewed alongside the financial statements, that any risk areas identified during the audit process have been adequately covered by the audit work carried out, and that all conclusions have been properly stated and are adequately supported.

Cold Review
This involves any type of review carried out after the audit has been completed, by persons who are independent of it. Such a review may be carried out either internally or externally.
An internal review may be carried out by suitably qualified staff, from the same office or perhaps from another office of the same firm. Alternatively, it may be carried out by another audit firm, this knowns as a 'peer review'. In either case a thorough review should ensure that adequate feedback is given so that perceived weaknesses in procedures, may be discussed and improved where deemed appropriate.

Unmodified opinion/ Unqualified opinion
When the review is complete the auditors communicate his views on the accounts in the audit report. If the auditor is satisfied the accounts give a true and fair view and comply with legislation, he gives an unqualified opinion/unmodified report.

An example of the standard wording of the opinion paragraph for financial statements free from material misstatements of an auditor's report (Republic of Ireland) could be as follows:

Opinion on financial statements
In our opinion the financial statements:

- *give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the company's affairs as at 31 December 201X and of its profit for the period then ended; and*
- *have been properly prepared in accordance with International Financial Reporting Standards and with the requirements of the Companies Act 2014.*

Unqualified Opinion (Modified) - Emphasis of a Matter
An emphasis of a matter arises where, in the auditor's opinion, the matter in question is not materially misstated and is adequately presented and disclosed in the financial statements, but is of such importance that it is fundamental to users' understanding of the financial statements and therefore that the attention of the users of the financial statements should be drawn to it. The auditor will not qualify his opinion with respect to the matter as he/she has gained sufficient appropriate audit evidence that the matter is not materially misstated and he/she are satisfied that it is adequately presented and disclosed in the financial statements.
The emphasis of matter paragraph is included immediately after the opinion paragraph in the auditor's report and is headed 'Emphasis of Matter'. The paragraph should include the following clarifications:

- that the auditor's opinion is not qualified in respect of the matter being emphasised, and
- make clear reference to the location of the disclosure note in the financial statements that makes reference to the significant matter being emphasised.

ISA 706, paragraph A1 provides the following as examples of matters which may give rise to an emphasis of matter paragraph:

- "An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position."

Modified Opinion
Unqualified opinions are considered above and now we will consider the types of modified opinion that result in audit report qualifications. A modified opinion can be damaging to an audited entity as the users of the accounts are advised of an issue contained in the financial statements or pertaining to the auditor's ability to complete the audit. As such, the normal assurance provided by the external auditor's report is not available and this could affect the decisions of the users of the financial statements.

ISA 705 gives the auditor guidance on the expression of modified opinions on the financial statements. It aims to ensure that the auditor's assessment giving rise to the modified audit opinion is appropriate and that a modified opinion is expressed when:

- **disagreement** arises: "The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement" (ISA 705, para 4(a)); or

- there has been a **limitation of scope:** "The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement." (ISA 705, para 4(b)).

Disagreement
Once the auditor has determined that a disagreement has occurred, he must then determine:
- if it is material; and
- if it is material, how material is it?

ISA 320 defines an items as material, if individually, or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Once the auditor determines that the disagreement is material, the auditor must issue a qualified opinion. There are two types of qualified opinion relating to disagreement and the auditor determines which one to apply based on the level of materiality, as follows:

1. material but not pervasive- while the item is material, it is not so material that the entire financial statements do not give a true and fair view. In this case the auditor will issue a “modified/qualified opinion, except for”.
   Hence, included in the audit report will be a paragraph outlining that “except for matter” which the auditor disagrees with, the financial statements give a true and fair view (i.e. matter is material but not so material so as to affect the entire set of financial statements).

2. material and pervasive - in this case financial statements (FS) do not give a true & fair view – The issue is so material or pervasive, involving significant uncertainties or lack of disclosure, that it affects the truth and fairness of the financial statemenets as a whole. In this case the auditor will issue a “modified/adverse opinion”.

Limitation of scope
When an auditor cannot perform the necessary procedures or the procedures applied do not generate sufficient appropriate audit evidence, the auditor is said to have a limitation of scope LOS. Such limitations can be imposed by management or arise due to other circumstances.

When a scope limitation exists the auditor should:

- Describe the limitation and quantify its effects (where possible)
- Express a qualified “except for” opinion where the matter is material but not pervasive
- Issue a disclaimer opinion if the matter is so material and so pervasive that the auditor is unable to form an opinion

Disclaimer:

- A disclaimer arises out of a limitation of scope
- The auditor is unable to reach any opinion on any part of the financial statements due to a LOS (i.e. I don’t know if the financial statements give a true and fair view).

Except For:

- Except for the “matter stated” which the auditor’s scope was limited the financial statements give a true and fair view (i.e. matter is material but not so material so as to affect the entire set of financial statements).

The audit file should be reviewed by the partner responsible for the audit assignment. The partner will examine the working papers and the information gathered over the course of the audit to ensure that areas such as the following have been adequately addressed:

- sufficient appropriate audit evidence has been obtained in each area of the audit process
- the work performed by the auditor and the final financial statements are in compliance with statutory requirements (e.g. Companies Act 2014 (RoI), Companies Act 2006 (UK/NI)), with accounting and auditing standards (e.g. IASs/IFRSs, ISAs, etc.) and with other relevant regulations
- the work completed by audit staff is accurate, thorough and in accordance with the audit programme
- the judgements exercised by audit staff during the course of the audit were reasonable and appropriate and have been properly documented
- all audit work has been completed in accordance with the conditions and terms specified in the letter of engagement
- the audit staff have properly resolved any significant accounting, auditing and reporting questions raised during the audit

(This is not meant to be an exhaustive list and there may be other factors that could be included)

This article provides the reader with an introduction to final review procedures and audit reports. The reader should consult relevant texts and recommended readings for further details on the different controls mentioned in this article.

Bibliography

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Modern Auditing, 3rd Edition 2008/ Cosserat and Rodda, Wiley.

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COMPANIES ACT 2014

ISA 320- MATERIALITY IN PLANNING AND PERFORMINGAN AUDIT

ISA 705- MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

ISA 706- EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

The ISA's referenced are those relevant to the present (2017) examinations.