MODULE 6

Topic 1 – Completing the audit

In this Topic

1. Auditing the contingent liabilities
2. Events that arise after the balance date
3. Obtaining a representation letter from management
4. Evaluating all of our audit evidence
5. Assessing going concern

Context

When do we start all of these activities?

- After we've conducted the bulk of our testing around balance sheet and income statement items.
- Many of these tasks are conducted by auditors at the Manager level and above.

1.1 Auditing the contingent liabilities

Applying the conservatism principle

Reminder from your ASR studies

- What is a contingent liability?

A *contingent liability* is:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

AASB137.10 Definitions

- Is a contingent liability recorded on the balance sheet?
- Why do we record them? 3 principles …

Examples of contingent liabilities

- Product warranties
- Lawsuits
- Disagreements with the ATO
- Guaranteeing the debt(s)/loan(s) of another entity

What auditing standard(s) apply?

- ASA 500 Audit Evidence
- ASA 502 Audit Evidence – Specific Considerations for Litigation and Claims
- ASA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

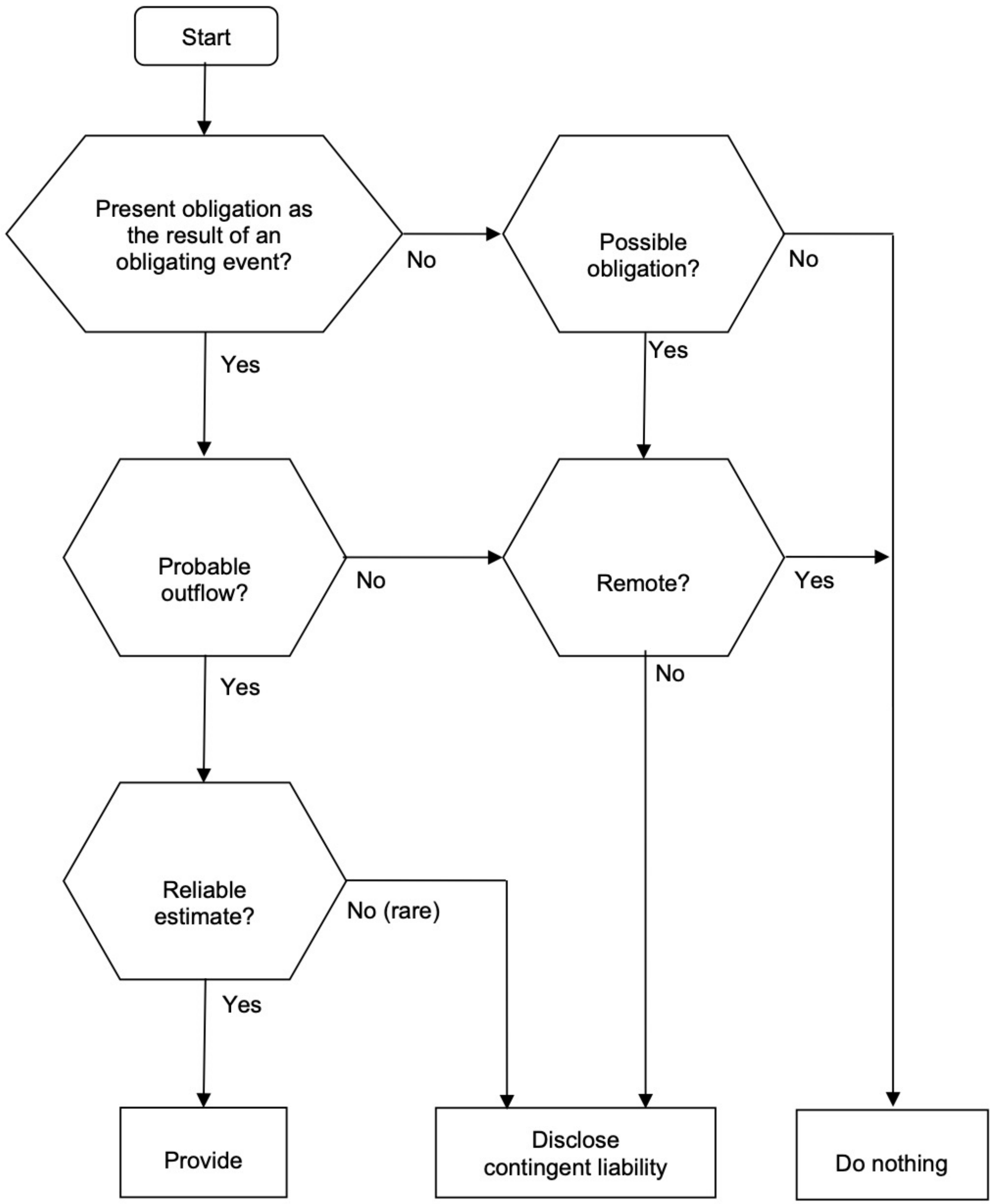
- Which assertion is most applicable when auditing contingent liabilities?

B Decision tree

Guidance on implementing AASB137

Applying the standard

The purpose of this diagram is to summarise the main recognition requirements of the Standard for provisions and contingent liabilities.



How do we gather this evidence?

- Reviewing the ______________prepared by management and comparing to _____________
- Review the Board meeting minutes
- Discussions with management
- Obtain a Letter of Enquiry from the client's legal counsel

1.2 Events that arise after the balance date

Handling subsequent events

What is a subsequent event?
AASB 110 Events after the reporting date

- From the Definitions of AASB 110

  Events after the reporting period are those events, favourable and unfavourable, that **occur between the end of the reporting period and the date when the financial statements are authorised for issue**. Two types of events can be identified:

  (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

  (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

- It is management's responsibility to identify subsequent events

Highly recommended - read AASB 110 – link in your Class Notebook

Examples of subsequent events

- A customer who owes funds (accounts receivable) is placed into voluntary administration
- Announcing a joint venture in the future
- Purchasing a major asset
- Deciding to sell off or close part of the entity’s operations
- Commencing or progress in a law suit
- Destruction of a major asset

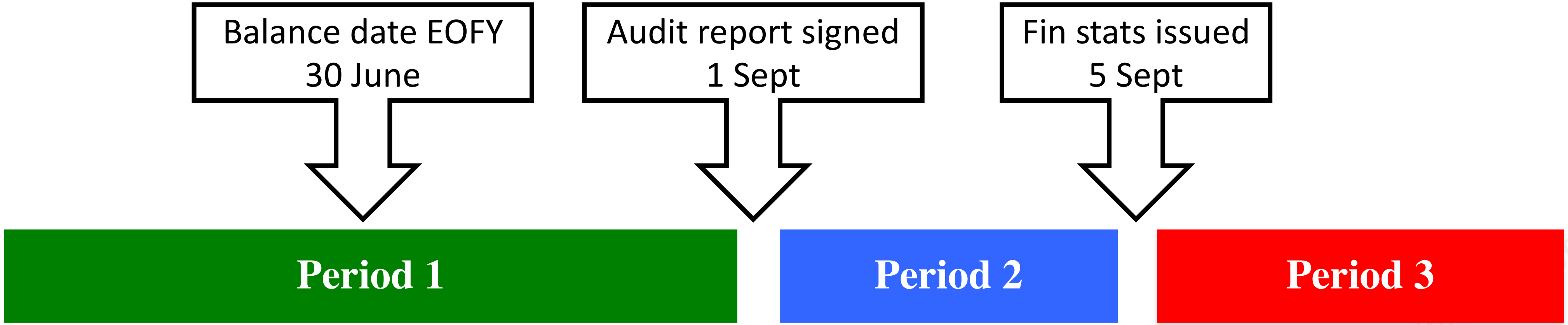
What auditing standard applies?

Read ASA 560!

- ASA 560 Subsequent events
- Auditors must determine whether subsequent events are appropriately adjusted, recorded and/or disclosed in the financial report
- Assertion most at risk? _______________
- The application of ASA 560 requires a deep technical understanding

Step 1 in applying ASA 560 – in what period does the event occur?

- ASA 560 identifies 3 different time periods where the auditor may identify a subsequent event (SE)



What the auditor must do is different in each of these periods
BEWARE!

Insert videos from ASA560

Examples

Scenario	Period discovered	Adjust?	Disclose?
A customer who owes funds (accounts receivable) is placed into voluntary administration	Period 1		
Announcing a joint venture in the future	Period 2		
Commencing or progress in a law suit	Period 1		
A factory fire destroyed all of the inventory after the EOFY	Period 2		

1.3 Obtaining a representation letter from management

ASA 580

What is a representation letter?

- A letter from management TO the auditor covers the following:
    1. Management acknowledge it is their responsibility to prepare the financial report
    2. They have provided auditors with all of the relevant information as per the Engagement Letter
    3. They confirm any evidence provided verbally, where no other source of confirmatory information can be found.

Does the auditor have to obtain one of these letters?

- Yes

- Without it, we do not have sufficient appropriate evidence for our opinion.

- Make sure you obtain one before you sign the audit opinion and report!

1.4 Evaluating all of our audit evidence

Are the financial statements free from material misstatement?

Accumulating audit evidence

- The audit team gathers evidence on:
  - Whether every single material account is free from material misstatement
  - Does each account meet the assertions?
- What counts as a misstatement? ASA _____
  - 4(a) Misstatement means a difference between the reported amount, classification, presentation, or disclosure of a financial report item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Accumulating misstatements

- Para 5 – we must create a list of the misstatements

- For material misstatements – the auditors need to make sure they have:
  - Evidence to support what they believe the number should be
  - Details about how much of the population they tested

- In the next topic, we will talk about presenting this list to management

Accumulate Evidence and Evaluate

- Having collected evidence on account balances and classes of transactions assertions, the auditor must also ensure that disclosures are fairly presented.
- Auditor will further ensure that financial information is appropriately classified and is understandable.
- Auditor should also perform Analytical Procedures (ASA 530) again as a final review for material misstatements - to check whether unusual trends and/or relationships are still present.
- The Auditor finally ‘steps back’ to ensure that the view presented by the financial report is consistent with the underlying state of affairs (i.e. represents a true and fair view).

Gathering evidence on the presentation assertion

- Auditors must also evaluate the presentation of the financial statements and the disclosures in the notes.
- What to compare them to? ____________
- How important are disclosures in comparison to the numbers on the income statement and balance sheet?

Final analytical procedures

- Using the audit team’s adjusted income statement and balance sheet – calculate the ratios used at the planning stage again.
- Why?
- What should you expect to see?
    - If you’ve found all of the misstatements

1.5 Assessing going concern

Will the client survive the next 12 months?

What management are supposed to do

AASB 101 Presentation of Financial Statements

Going concern

25 **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. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.**

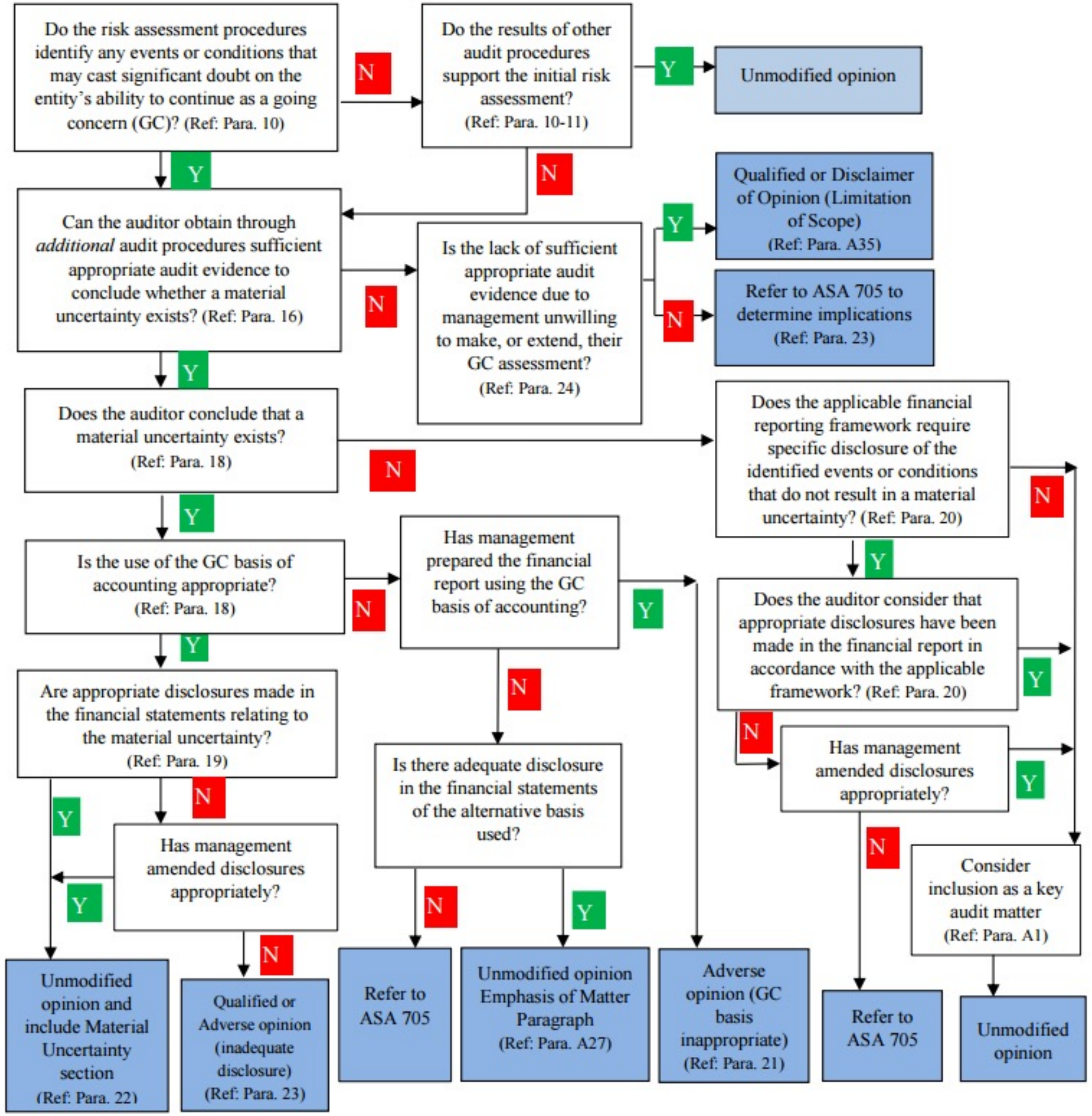
ASA 570 sets out what the auditor's responsibilities

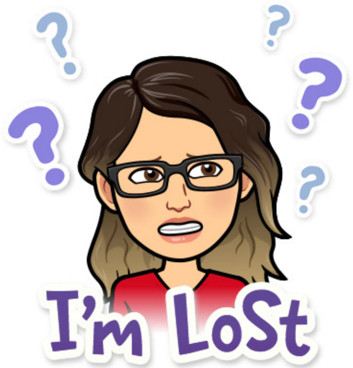
Read ASA 570!

- We must assess management's assessment
- Discuss with management any events or circumstances that might create material ________________
- How far into the future do we consider? ___________
- If there is an issue – what is management's plan? Does it seem reasonable?

- This assessment may impact the audit opinion given

LINKING GOING CONCERN CONSIDERATIONS AND TYPES OF AUDIT OPINIONS





To sum up

- Identify any contingent liabilities – do they need disclosure?
- Consider the subsequent events – are adjustments or disclosures needed?
- Make sure you get that Representation Letter!
- Consider the evidence as a whole (more on this in the next topic)
- Evaluate going concern – will the client continue operating?

Coming up in the final topic

- Evaluating and negotiating the adjustments to be made with management
- The audit opinion
- Key audit matter disclosures