AN IDENTIFICATION, EVALUATION AND DEVELOPMENT OF THE THEORETICAL FRAMEWORK OF U.K. COMPANY AUDIT PRACTICES.

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ENDNOTES

INTRODUCTION

1. Strictly speaking there is no "auditing profession" in the U.K. Rather, members of relevant professional bodies are concerned with a wide range of accounting, taxation and other aspects of business in addition to their auditing activities. Together, these professional bodies are commonly referred to as the "accountancy profession". Since, however, company auditing is to be the focus of attention in this thesis, those members of the accountancy profession who are concerned with company audits will be referred to as members of the auditing profession.


3. Flint, Ibid., paragraph 5.7.2


5. Carsberg, Ibid., paragraph 9.15


CHAPTER 1

1. Organisations, including companies, are the result of co-operative action, which "is a mode of behaviour by which a collection of individuals seeks to satisfy their individual wants jointly...[an organisation] has no other function than the promotion of the ends of its members." R. J. Chambers, Financial Management, (3rd ed.), The Law Book Company, 1967, p2.


3. A. Smith, The Wealth of Nations, Methven & Co., 1904 (first published 1776), Book I, Ch VI


7. Such coalitions are "not so much overt combinations of interests as expressions of sympathy on the part of one class of participant for the interests of others." Chambers, Ibid. p.19.

8. For example, the U.K. Companies Act, 1948, provides that directors are appointed, and may be removed, by the shareholders. Further, the directors have a legal obligation to provide a report to the shareholders. See SS 183, 184 and 157.


10. See, for example, Simon, Ibid. p.102, with respect to employees.


12. The term "auditing" could, however, have a broader meaning. It could, for example, relate to the independent verification of statements such as newspaper circulation figures, statements of technical specifications, etc. In this thesis, discussion is limited solely to the audit of financial statements provided by company directors to shareholders.

14. In fact, it has become accepted audit practice for the external auditor to examine the internal control system of the client, including the process of internal audit itself: "Auditors today already spend a considerable portion of their time and effort reviewing the administrative systems of their client companies. As soon as they gave up checking every transaction they had to take an interest in the clerical control systems of their clients". P. Bird, *Accountability: Standards in Financial Reporting*, Accountancy Age Books, 1973, p.42.

15. This term, together with others which are of fundamental importance to the arguments presented in this thesis, is defined in Appendix D.

16. Other possible justifications are discussed at some length in Chapter 4. See also D. M. Gilling, "The Philosophy of Auditing Revisited", University of Georgia, 1982, for a useful survey of the literature concerning the role of the auditor.

17. The relationship between theory and theoretical framework is elaborated in Chapter 2. See also Appendix D.

18. "...the flow of investor funds to corporations, and indeed the whole process of allocation of financial resources through the securities markets, has become dependent to a large extent upon reports made by management." Stamp and Moonitz, Ibid. p.22.

CHAPTER 2


4. Achinstein, Ibid., p.133.

5. The extent to which company auditing can properly be considered to be scientific is considered in some detail in the second section of this chapter.


10. See, for example, Caws, Ibid., p.11.


13. FASB. Ibid., p.2.

14. FASB. Ibid., p.2.


16. Lakatos, Ibid., p.118.

17. Lakatos, Ibid., p.133.

18. To be valid, changes to auxiliary hypotheses must lead to new testable consequences as well as new prescribed procedures. For example, an auxiliary hypothesis in a theory of company auditing could be: "audit reports are used by employees in deciding whether to accept employment". If a subsequent investigation reveals this not to be the case in company X, the hypothesis could be changed to "audit reports are used by employees in deciding whether to accept employment except where employees have a representative on the board of directors". Such a change would lead to new testable consequences and would also suggest the need for the provision of audit reports to employees in some companies. On the other hand, a change to "audit reports are used by employees in deciding whether to accept employment except in company X" would lead to no new testable consequences or new procedures and would therefore be invalid. See Lakatos, Ibid., pp.117-118.


20. In providing a brief example for illustrative purposes only, some statements of doubtful validity have been introduced. Statement 2.1 is an example. For similar reasons, some steps in the argument have been left as implications only. The link between shareholders and allocation of resources to companies (statements 1.2 and 1.3) is an example. In a more fully developed theory, such as that presented in the later chapters of this thesis, such abbreviations must be avoided. The further issue of whether statements in a theory of auditing are empirically testable is addressed in Chapter 9.

21. "We cannot start reasoning or thinking without a starting point. We can 'prove' nothing to the man who will accept nothing as a basis for discussion". Mautz and Sharaf, The Philosophy of Auditing, p.37.
CHAPTER 3

1. Companies Act, 1981 Ss.5(1),7(5).
6. In re the Kingston Cotton Mill Co., Limited (No. 2) (1896 2 Ch.279).
8. re Thomas Gerrard and Son Ltd. (Chancery D: Pennycuick, J: TLR April 14th, 1967)
10. Attendance at stocktake had become common practice as a result of the decision by the U.S. Securities and Exchange Commission (SEC) in the McKesson and Robbins case. This case involved a huge fraud in which the financial statements included fictitious assets of 21 million dollars. After investigation, the SEC issued a report in 1941 which, inter alia, commended "the action of the [U.S. auditing] profession in subsequently adopting, as normal, procedures requiring physical contact with clients' inventories". Bigg suggested that it was the influence of auditors of American Subsidiaries in the U.K. (who were required to conform to American practice) which led to the introduction of the practice whereby auditors attended the stocktake. Bigg, Ibid., p.176.
12. "Auditing came into existence as the offspring of law and custom with prescribed forms and procedures." Mautz and Sharaf, The Philosophy of Auditing, p.1
13. In fact, by the profession's own admission, "Auditing Standards codify current good practice", so the Standards could be seen as the result of a process of distillation from the audit manuals of the large audit firms. They "are designed to be of general application and relevant to every size of business". As a result, they are of general relevance. Auditing Practices Committee, Auditing Standards and Guidelines - Discussion Drafts May, 1978.
14. The Institute of Chartered Accountants in England and Wales (ICAEW), The Institute of Chartered Accountants of Scotland (ICAS), The institute of Chartered Accountants in Ireland (ICAI) and The Association of Certified Accountants (ACA), as provided by Section 13 of the Companies Act, 1976.

15. In 1961, the ICAEW issued Statement U1, General Principles of Auditing. This statement was, however, only applicable to members of the English Institute and was withdrawn in June 1980. The current statement on Auditing Standards and Guidelines is applicable to all U.K. company audits.


17. Auditing Standards and Guidelines, Explanatory Foreword, Para 5.


20. The Explanatory Foreword to the Auditing Standards and Guidelines contains the following paragraph:

Members are advised that a court of law may, when considering the adequacy of the work of an auditor, take into account any pronouncements or publications which it thinks may be indicative of good practice. Auditing Standards and Guidelines are likely to be so regarded. (Paragraph 7)

21. This notion of auditing standards as a source of theory also receives support in the literature. Stamp, for example, suggested that "it is the function of accounting and auditing standards to create [a] general sense of confidence by providing a structural framework within which credible financial statements can be produced". E. Stamp, The Future of Accounting and Auditing Standards, International Centre for Research in Accounting, Lancaster, 1979, p.3 (emphasis added).

22. The profession enforces the requirement that members adhere to professional ethical and auditing standards by providing for reprimand, fine, suspension or expulsion if the standards are contravened. Auditing Standards and Guidelines, Explanatory foreword, Paragraph 11.

23. T. Johnson, Professions and Power, Macmillan, 1972, claims, for example, that "among the better-known attempts to specify these core elements are


26. A. M. Carr-Saunders and P. A. Wilson, The Professions, Oxford 1933, p.497. Carr-Saunders and Wilson also claimed that the professions "inherit, preserve and pass on a tradition... they engender modes of life, habits of thought and standards of judgement which render them centres of resistance to crude forces which threaten steady and peaceful evolution... the great professions stand like rocks against which the waves raised by these forces beat in vain".


28. For a detailed discussion of the views held by these writers, see Johnson, Ibid., Chapter 1.


32. The auditing literature contains similar references to the need for the profession to possess a "systematic theory". See, for example, Willingham and Carmichael, Auditing Concepts and Methods, p.42.


34. Johnson, for example, argues that "many innovators, particularly in medical science, were pilloried, ignored or excluded by those who resisted the application of new technologies and knowledge" Ibid., p.56.

35. For example, Johnson claims that "the general
characteristics of accountancy, as it has developed since the late nineteenth century in Britain, have been such that [it] has always been subject to a large measure of corporate control". Johnson, Ibid., p.66.

36. As at 9th June 1982, 47760 members, or 63.6% of the total membership of the ICAEW were classified as non-practicing members residing in the U.K. This classification "includes members employed by practicing accountants in industry or commerce, with nationalised undertakings, in Government or Local Government service and in other occupations". ICAEW List of Members and Firms 1982/1983. p.liii.

37. For example, comment on the proposed Auditing Standards and Guidelines was invited in May 1978. As a result of representations by members of the profession, the discussion drafts were amended and the final version of the Standards and Guidelines was issued two years later.


40. D. M. Gilling and P. J. Stanton, "Changes in the Structure of the Auditing Profession in Australia", Abacus, Vol 14, No.1, June 1978, claim that "a number of recent studies in New Zealand ...Britain ...Canada...and the United States ...have shown that both nationally and internationally the auditing of large public companies has become the almost exclusive preserve of a relatively small number of very large international public accounting firms". Ten works are cited as evidence for this claim. p.66.

41. Johnson, Ibid., p.70.

42. A detailed analysis of the content of the Standards and Guidelines, including both practical and theoretical statements, is presented in Chapter 5, supported by Appendix A.

CHAPTER 14

1. The issue of empirical verifiability will be taken up again in Chapter 9. In that chapter it is argued that even though some statements are not directly empirically verifiable, they may still be called "propositions".


8. The reader is referred to Chapter 3 in which the link between the Standards and Guidelines and the theory of U.K. company auditing was discussed and established.

9. Terms such as "reliability", "credibility" and "usefulness" are used within the literature without precise definition. See, for example, J. C. Shaw, The Audit Report, Gee & Co., 1980, p.12 where each of these terms appears without definition in the space of two paragraphs. In a fully developed theory of company auditing, such terms would be unambiguously defined within the "operational system".

10. There is, in fact, a wide range of arguments which purport to justify the company audit function. For a survey of the more common of these arguments, See Gilling, "The Philosophy of Auditing Revisited", Ibid. The two arguments discussed in the present chapter are commonly found in the U.K. literature.

11. Where no reference to earlier statements is made, the particular statement is underived and, therefore, satisfies one of the criteria for fundamentality.
12. The following authors are among those who support the accountability argument:
A. Devine, "How Independent are Auditors?", Accountancy, December 1976, Pp. 49-51

13. The following authors are among those who support the investment decision argument:
Pratt, Ibid., 1982.

14. In addition to the investment decision argument, Stamp and Moonitz, Ibid. also present a slightly different argument based on the fundamental normative statement that the capital markets should continue to exist and to operate;

the strength of capital markets, and indeed of the economic system, depends heavily upon the general confidence engendered by the credibility that attaches to a set of audited financial statements(p.17).

The primary and secondary capital markets in Western countries simply could not operate without the confidence which the work of the auditor ensures(p.24).

In this way, Stamp and Moonitz present an argument justifying the claim that shareholders ought to believe financial statements presented by management to be reliable. If the claim as to the need to ensure the continued operation of capital markets is an acceptable value judgement, and the argument is valid, there is no need to accept the desirability of reliable financial statements as a matter of faith. Pratt, Ibid., presents a similar argument.

15. This point has been argued in Chapter 2, Section 2.

Shaw, Ibid.

17. The following authors support the "prevention of fraud" argument:
Waldron, Ibid.
Woolf, Ibid.
Millichamp, Ibid.

18. Normanton, however, claims that "the fundamental idea (of an audit) is the prevention of fraud", thus adopting the fraud prevention argument as the major (if not only) justification for audit. Normanton, *The Accountability and Audit of Governments*, p.322.

19. A. Palmer and J. C. Crawford, in *Cutforth's Audits* (13th ed), Gee & Co., 1971, for example, explain the existence of an audit in purely legal terms. Similarly, Pratt writes: "Why have an audit? The answer to this question is simple. Company law says you must, and provides for substantial penalties if you do not!". Pratt, Ibid., p.3. Pratt does, however, go on to consider both the accountability and resource allocation arguments.
CHAPTER 5

1. Of the five objectives, two are specifically stated in the Standards and Guidelines and the other three are implied by recommended practices. The precise derivation of these objectives is discussed in Chapter 6.

2. That is, the objectives are asserted rather than derived, and no argument is presented to demonstrate that attainment of those objectives would be beneficial. In fact, if a fundamental normative statement to the effect that audit objectives should be achieved had not been introduced, the five identified objectives, expressed in the form of rules, would have constituted five fundamental normative statements.

3. The diagrams presented in this chapter are abstracted from Appendix C. For a detailed understanding of the logical relationships involved in the derivation of practices, that appendix should be consulted.

4. It should be emphasised that this is not the only possible argument which could derive the requirement to comply with auditing standards. However, it is strongly supported by the contents of the Standards and Guidelines in that both statements 1.16 and 1.17 are to be found in that document. The possibility of amending the theory in order to derive practices from objectives which reflect more of a desire to provide a useful service will be discussed in Chapter 7.

5. As is clear from Appendix C, statement 1.19 has been introduced in order to derive statement 1.20. There is no support within the Standards and Guidelines for statement 1.19, although it would, in principle, be possible to verify that statement 1.19 is true by conducting an empirical research project. The general issue of the extent of, and reasons for, introduced statements is discussed in some detail in Chapter 6.

6. Table 1 reveals that of the forty-three practices identified in Section 13, forty-two are derived within arguments which include statement 1.4 as a premise, forty-one are derived within arguments which include statement 1.10 as a premise, three are derived within arguments which include statement 1.14 as a premise, and five are derived within arguments which include statement 1.6 as a premise. Thus, any one practice could be justified in terms of more than one basic requirement. In section 1, for example, statement 1.20 is justified in terms of two basic requirements (1.10 and 1.14).
7. The details of this and other arguments can be examined in the appropriate section of Appendices B and C.

8. Although Section 8 contains two statements which define an "adequately controlled audit", they could be combined to constitute a single definition. One definition (statement 8.8) is derived from the other (statement 8.4) in that the former explicates a concept in the latter. They have been shown as separate statements in Section 8 because one (statement 8.4) is to be found within the Standards and Guidelines whereas the other has been introduced in order to derive company audit practices.

9. Although it might appear enigmatic that company audit practices are derived from the secondary objective of providing an effective, economic and efficient service rather than from the primary objective, it is more easily understood when it is recalled that the "service" referred to in the secondary objective is that of forming and reporting an opinion. Thus, a link with the primary objective is implied, and practices derived from the secondary objective will be consistent with the attainment of the primary objective.
CHAPTER 6

1. E. Woolf, "How vague words mask dissent behind the Audit Standards", Accountancy, November 1980, p61

2. This criticism of the Standards and Guidelines is only valid if it is assumed that that document ought to present a complete theory. An alternative viewpoint is that the Standards and Guidelines are only an extract from a complete theory. The issue of the relationship between a theory and professional pronouncements is considered further in Chapter 10. For the purposes of the present chapter, the criticism that the Standards and Guidelines are incomplete is intended to show that they do not specify a theory of company auditing, despite being the only extant professional pronouncement which could reasonably be expected to do so.

3. Since one statement can play more than one role, the number of roles exceeds the number of statements. The figure of 224 roles is calculated as follows;
   Role A: $87 + 16 + 15 + 10 = 128$
   B $3 + 16 + 8 + 10 = 37$
   C $26 + 15 + 8 + 10 = 59$

4. The practices fully derived are those appearing on the opaque pages of Appendix C for which arrows linking with earlier statements are also shown. They are:
   4.4 5.38, 5.51, 5.67
   7.4, 7.13, 7.39
   8.6, 8.11, 8.37
   9.11, 9.32
   10.14, 10.19, 10.20, 10.21, 10.33, 10.53
   11.35
   12.25

Those statements traceable to a basic requirement without reliance upon an introduced statement are those on the opaque pages of Appendix C for which arrows linking with a basic requirement are also shown. They are
   4.4
   7.4, 7.13, 7.39
   8.6, 8.37
   9.11, 9.32
5. Table 4 can be summarised as follows;

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<tr>
<td>1-4</td>
<td>13</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>6</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5-13</td>
<td>74</td>
<td>2</td>
<td>25</td>
<td>14</td>
<td>9</td>
<td>8</td>
<td>10</td>
</tr>
</tbody>
</table>

Roles played are;

| Sect 1-4: | Role A: | 13 + 2 + 6 = 21 68 |
| Role B: | 1 + 2 = 3 10 |
| Role C: | 1 + 6 = 7 22 |

| Sect 5-13: | Role A: | 74 + 14 + 9 + 10 = 107 55 |
| Role B: | 2 + 14 + 8 + 10 = 34 18 |
| Role C: | 25 + 9 + 8 + 10 = 52 27 |

6. As with Table 4, statements in Table 6 can play more than one role. The table can be summarised as;

Role A: 21 + 31 = 52
Role B: 1 + 31 = 32

7. The nineteen practices justified by, but not in, the Standards and Guidelines are;

4.19
5.4, 5.25, 5.45, 5.5
7.5
8.15, 8.21, 8.36
9.8
10.6, 10.16, 10.50, 10.69
11.17, 11.29, 11.40
12.10
13.70

The thirty practices justified by, and in, the Standards and Guidelines are those identified as "fully derived", Table 5 and footnote 2.

8. The statements included in Table 8 are as follows;

a) those contained in the Standards and Guidelines

4.9
5.41, 5.42, 5.48
10.30, 10.85, 10.87, 10.88, 10.89, 10.91, 10.93, 10.94
10.95, 10.96, 10.97, 10.98, 10.100, 10.101, 10.102
11.11, 11.28, 11.30
12.21
13.39, 13.40, 13.41

b) those not contained in the Standards and Guidelines

4.10
5.43, 5.46, 5.47
10.25, 10.86, 10.90, 10.92, 10.99
11.12
9. Section 10 theoretical statements not leading to practices: 15 (Table 8)
Section 10 theoretical statements: 68 (Table 3)
Section 10 introduced theoretical statements: 30 (Table 3)
Section 10 theoretical statements in the Standards and Guidelines: 38


11. The six propositional functions are (reference to Appendix A)
    PCR3, PCR24
    IC6, IC12
    ARS6
    QS6
    The rule is
    ARS10

12. For the precise argument used to derive the safe custody and confidentiality requirements, see Appendices B and C.

13. "The fact that a 'true and fair view' is a philosophical concept and not susceptible to definition ... is, in fact, its most fundamental and characteristic feature", D. Flint, A True and Fair View in Company Accounts, Gee & Co., p.2. It should be pointed out, however, that Flint's monograph prompted a rejoinder by T. A. Lee, who condemned the lack of definition of the concept of a "true and fair view". "The Will-o'-the-Wisp of 'True and Fair'", The Accountant, Vol. 187, No. 5601, July 15th 1982, pp. 16-18.

14. The strategy of specifying a general practice on the basis of more specific practices was adopted in Appendix B only when unavoidable in order to enable statements appearing in the Standards and Guidelines to be specified. These infrequent occurrences are ignored in the subsequent analysis in this chapter.

15. In fact, there is one case in the formal system where a definition does not lead to a practice. It is the definition of an "audit" provided by statements 1.11 and 1.12. As discussed in Chapter 5, that definition has not been relegated to the Operational system solely on the grounds that it receives considerable emphasis in the Standards and Guidelines.

16. See, however, comments in the previous section concerning the extent to which this is not true with respect to Appendix B.
17. The 35 definitions are:
1.11, 1.12
3.5
4.5, 4.7, 4.8, 4.12, 4.20
5.12, 5.19, 5.24, 5.58
7.2, 7.21
8.4, 8.8, 8.14,
9.3, 9.14, 9.22
10.17, 10.24
11.6
12.1, 12.5, 12.9
13.13, 13.22, 13.34, 13.39, 13.40, 13.43, 13.46,
13.49, 13.52

18. That is, 77% of statements of practice in Appendix B rely upon definition (Table 11), whereas only 52% of statements of practice in the Standards and Guidelines rely upon definition (Table 12).

19. This criticism is ameliorated to some extent by the fact that statement 5.7 is not to be found within the Standards and Guidelines. However, the introduction of a statement relating relevance of evidence to all objectives is supported by the following paragraphs in the Standards and Guidelines:
a) Paragraph 4, Auditor's Operational Standard, which refers to "reasonable conclusions" and does not limit consideration of the relevance of evidence to any one objective,
b) Paragraph 18, Guideline on Planning, Controlling and Recording, which requires auditors to prepare working papers which "include a summary of all significant matters identified which may require the exercise of judgement", not limited to any one objective.

20. See, however, the discussion in Section 4 of this chapter concerning the possibility that concluding statements of practice are less specific than the practices from which they are derived.

21. This issue is discussed in considerable detail in Chapter 7. In particular, Table 15 in that chapter shows that only 4 "standards" (from a total of 28) are derived by chains of argument which do not include non-standard practices.
1. Auditing Standards and Guidelines, Explanatory foreword, Para 3. See also Appendix B, statements 14.4 and 1.8.


3. Although the Standards and Guidelines are not limited to company audits, there is no evidence to suggest that company audit reports are to be used by anyone other than shareholders. The requirement for the audit report to identify those to whom the report is addressed (statement 13.8), together with the statutory requirement for company auditors to report to shareholders, suggest that the company audit report is not to be considered a public document.

4. It should be emphasised that the purpose of the argument is to derive the requirement for annual company financial statements to be audited on grounds which are consistent with the Standards and Guidelines. Since it is not intended to present a fully developed theory, an operational system has not been specified. Accordingly, only definitions necessary to the derivation of practices have been proposed. In order to develop the theory fully, it would be necessary to examine the terms used in each statement and provide a definition of those which could be misinterpreted.

5. "It is clear that if the function of auditing is to lend credibility to a set of financial statements... it is necessary that the auditor's work itself must be credible". E. Stamp, The Future of Accounting and Auditing Standards, International Centre for Research in Accounting, Occasional Paper 18, 1979, p.4.

6. "Effectiveness" is used here in Barnard's sense: "effectiveness relates to the accomplishment of the... purpose... When a specific desired end is attained we shall say that the action is 'effective'". C. I. Barnard, The Functions of the Executive, Harvard University Press, 1938, p.60.


8. Chambers, Ibid., p.188.

9. H. A. Simon, Administrative Behaviour (2nd ed), The Free Press, 1967, p.14. One of the few cases in which "efficiency" has been used in the management literature other than in its usual engineering sense of optimising the relationship between input and output was by
Barnard. He considered efficiency to be "related to the satisfaction of individual motives". Barnard, Ibid., p.19. Since the concept of efficiency as the optimal relationship between inputs and outputs is far more common in the literature, it is adopted in this thesis. See R. N. Anthony, Planning and Control Systems, Graduate School of Business Administration, Harvard University, 1965, pp.27-28.

10. The notion that efficiency (and economy) relate to the cost/benefit ratio of the audit is supported by the content of the Standards and Guidelines. When considering the sources and amount of evidence needed to achieve the required level of assurance, for example, the auditor "will be influenced by... the relevance, and reliability of evidence [i.e. the benefits]... and the cost and time involved in obtaining it [i.e. the costs]". Paragraph 3, Auditing Guideline on Audit Evidence, Auditing Standards and Guidelines.

11. Although statement 37 is also one structural level below the primary audit requirement it has not been included as a secondary audit objective because it depends on definition and does not, as a result, constitute a more specific audit practice than that from which it has been derived. That is, providing an effective service (statement 37) is the same thing (by definition) as complying with the primary audit requirement (statement 14).
CHAPTER 8

1. The enabling arguments in fact conclude with requirements for an effective, economic and efficient service within an appropriate time-scale. However, those requirements are derived from earlier requirements solely on the basis of definition. As such, they do not depend on propositional functions and can be ignored in attempts to identify the fundamental propositions of U.K. company auditing. This issue is discussed further in Section 2 of this chapter.

2. Statements 1, 2, 3, 4, 6, 7, and 10. There are also three definitions, statements 5, 12 and 13.

3. Given the definition in statement 5 which equates unreliability with those attributes specified in Proposition 2.

4. It should be noted that the introduction of assertions concerning what constitutes a reasonable test of a propositional function is, in effect, the introduction of further propositions. As a result, empirical evidence will be collected in the context of a series of propositions, and apparently refuting evidence could reflect inadequacies in any one of those propositions. This issue is discussed at more length in Chapter 9.


6. Although Lee refers to these statements variously as "foundations" (p.78), "notions" (p.81) and "assumptions" (p.86) they would be referred to as "propositional functions" under the terminology adopted in this thesis (i.e. they are truth-functional).


9. Statements have been eliminated for the following reasons:

<table>
<thead>
<tr>
<th>Statement</th>
<th>Reason</th>
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<tbody>
<tr>
<td>37</td>
<td>by definition of &quot;effective service&quot;</td>
</tr>
<tr>
<td>21, 26</td>
<td>&quot; &quot; &quot; &quot; explicit indication of truth and fairness&quot;.</td>
</tr>
<tr>
<td>25</td>
<td>entailed by statement 21</td>
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<tr>
<td>50</td>
<td>by definition of &quot;appropriate time-scale&quot;</td>
</tr>
<tr>
<td>46</td>
<td>&quot; &quot; &quot; economic service&quot;</td>
</tr>
<tr>
<td>48</td>
<td>&quot; &quot; &quot; efficient service&quot;</td>
</tr>
<tr>
<td>18, 19</td>
<td>&quot; &quot; &quot; reliable&quot; and &quot;true and fair&quot; (i.e. statement 17, although expressed in the form of a propositional function, is true by definition).</td>
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</tbody>
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CHAPTER 9

1. See, for example, R. Schlegel, *Completeness in Science*, Appleton-Century-Crofts, 1967; "we observe in the framework of a theoretical model and fit our facts into that model" (p.9), "even the observation and description of simple objects of ordinary experience cannot be said to be lacking in elements of theoretical construction" (p.11).


5. Although Statement 17 is immediately true by definition, the question of whether the definitions are acceptable remains unanswered. Statement 17 cannot be said to be immediately true in any absolute sense, since its "immediate truth" depends upon the acceptability of the definitions in Statements 5 and 16.


7. Committee on Basic Auditing Concepts, Ibid., p.43.


11. The importance of this problem, with specific examples, has been discussed by T. A. Lee, "Empirical Research into Information Utility and Acceptability", *Accounting and Business Research*, Spring 1975, Pp.140-144.

13. A similar problem is encountered in discovery sampling by auditors, where the auditor is attempting to confirm the proposition that a large population contains no errors. For example, if an auditor is testing a population of 10,000 vouchers which contains one error, the probability of discovering that error, with various sample sizes, is as follows:

<table>
<thead>
<tr>
<th>Sample size</th>
<th>Probability of finding the error</th>
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<tbody>
<tr>
<td>100</td>
<td>1%</td>
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<tr>
<td>1,000</td>
<td>10%</td>
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<tr>
<td>5,000</td>
<td>50%</td>
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<tr>
<td>9,000</td>
<td>90%</td>
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</tbody>
</table>

Under these circumstances, the probability is determined by relating sample size to population size. If the population size is infinite (or indefinitely large), the probability of discovering the unusual event will be very small. See T. W. McRae, "Applying Statistical Sampling in Auditing: Some Practical Problems" in Brasseaux and Edwards (Eds), *Readings in Auditing* (2nd ed.), South-Western, 1973, p.269.

Although it is true that artificial languages have been constructed in which probabilities may be expressed other than zero, these languages contain no universal propositions of the kind found in scientific theories. C. G. Hempel says, for example, that "Carnap...has studied the problem by reference to rigorously formalised model languages whose logical structure is considerably simpler than that required for the purpose of science". *Philosophy of Natural Science*, Prentice-Hall, 1966, p.46.


15. Popper, Ibid. The particular brand of falsificationism discussed here is known as naive falsificationism. Popper did not seriously support the account given here, but opted rather for a more sophisticated methodological falsificationism. The purpose in considering naive falsificationism here (and, indeed, induction) is to identify the issues which must be borne in mind when conducting empirical research in an attempt to determine the truth or otherwise of propositions.
CHAPTER 10


3. Both the "Flint Report" issued by the ICAS in 1980 and the "Programme for Research" issued by the ICAEW in 1982 stress the need for research into basic conceptual issues in accounting.

4. This criticism assumes that the Standards and Guidelines constitute a theory. Whether this is necessarily so is discussed in the next section.
Appendix A

Content of the Auditing Standards and Guidelines

This appendix lists the content of each paragraph in the Auditing Standards and Guidelines in the form of single statements. The appendix is structured as follows:

Column 1: Reference to the Standards and Guidelines
This column refers to the paragraph within the Standards and Guidelines from which the statement is derived. Abbreviations used are:

- EF: Explanatory foreword
- GT: Glossary of terms
- OS: Auditing Standard: The auditors' operational standard
- PCR: Auditing Guideline: Planning, controlling and recording
- AS: Auditing Guideline: Accounting systems
- AE: Auditing Guideline: Audit evidence
- IC: Auditing Guideline: Internal controls
- RFS: Auditing Guideline: Review of financial statements
- ARS: Auditing Standard: The audit report
- QS: Auditing Standard: Qualifications in audit reports
- ARE: Auditing Guideline: Audit report examples

Column 2: Statements derived from the Standards and Guidelines.
The statements within the Standards and Guidelines are specified. Statement type and cross-reference to
Appendix B are indicated in brackets after statement. Reference to statement type and Appendix B are of the form:

[statement type:Appendix B paragraph no.]

Abbreviations used to indicate statement type are:

A: Administrative statement
Dn: Definition
Pf: Propositional function
Rl: Rule
Sc: Statement of scope
Ex: Example
Pm: Permission

A suffix (O) indicates that the statement appears in the operational system (section 14 of Appendix B).

The letter "N" for Appendix B paragraph number indicates that the paragraph does not appear in Appendix B.
Explanatory foreword.

EF1 This explanatory foreword explains the scope and authority of Auditing Standards and Auditing Guidelines.

[A:N]

EF1 The explanatory foreword should be read in conjunction with the Standards and Guidelines to which it forms a collective preface.

[A:N]

EF2 An "audit" is the independent examination of and expression of opinion on the financial statements of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligation.

[Dn:1.12]

EF2 Management is responsible for the preparation and presentation of financial statements.

[Pf:10.85]

EF2 In companies, directors are responsible for the preparation and presentation of financial statements.

[Pf:10.85]

EF2 The auditor is responsible for reporting on the financial statements as presented by management.

[Pf:1.1]

EF3 "Auditing Standards" are prescriptions of basic principles and practices which members are expected to follow in the conduct of an audit.

[Dn(0):14.4]

EF3 Auditors should comply with approved Auditing Standards whenever an audit is carried out, unless otherwise indicated in the Standard.

[Rl:1.18]

EF3 Each Auditing Standard will consist of a text to which there may be added an explanatory note.

[A:N]

EF3 "Explanatory notes" have the same status and purpose as Auditing Guidelines.

[Dn(0):14.6]
A code of rules sufficiently elaborate to cater for all situations and circumstances which an auditor might encounter
a) could not provide for innovations in business and financial practice,
b) might hinder necessary development and experimentation in auditing practice, and
c) would be impractical.

The auditor must exercise judgement in the observance of Auditing Standards.

The auditor must exercise judgement in determining audit procedures necessary to afford a reasonable basis for his opinion.

The auditor must exercise his judgement to determine the wording of his report.

"Auditing Guidelines" give guidance on
a) procedures by which Standards may be applied,
b) application of Standards to specific financial statement items,
c) techniques currently being used, and
d) audit problems relating to specific areas.

"Auditing Guidelines" do not prescribe basic principles and practices

Existing pronouncements on auditing matters should be considered as having the same status as Auditing Guidelines.

Existing pronouncements will remain in force until withdrawn.

Auditing Standards and Guidelines are likely to be regarded by the law as indicative of good practice.

Auditing Standards and Guidelines may be taken into account by the law when considering the adequacy of the auditor's work.
Management is responsible for prevention and detection of irregularities and fraud.

An adequate internal control system provides management with reasonable assurance that its responsibility for prevention and detection of irregularities and fraud will be discharged.

The auditor has no responsibility to search specifically for fraud unless required by statute or the specific terms of his engagement.

Material irregularities or fraud, unless adequately disclosed, may distort the information in the financial statements.

The auditor should recognise the possible effects of material irregularities or fraud which are not adequately disclosed.

The auditor should plan his audit so that he has a reasonable expectation of detecting material misstatements resulting from irregularities or fraud.

Apparent failures by members to observe Auditing Standards may be enquired into, and disciplinary action may result.

The personal standards contained in Ethical Guides are relevant to the work of an auditor.

Auditors will be expected to observe Auditing Standards in the audit of any financial statements for a period commencing on or after the date specified in the Standard.

For the most part, Auditing Standards will represent only the formalisation of existing good practice.
EF14 A glossary of certain terms used in the explanatory foreword, in the Auditing Standards and in the Auditing Guidelines forms an appendix to this explanatory foreword. [A:N]

EF14 The glossary of terms may be extended as subsequent Standards and Guidelines are published. [A:N]

EF15 Auditing Standards may not be appropriate to the audit of financial statements prepared in overseas territories solely for local purposes where different requirements of law or general practice prevail. [Pf(O):14.9]

EF15 Where overseas financial statements are to be incorporated into U.K. or Irish financial statements the audit of the overseas enterprise should conform to Auditing Standards in so far as this is necessary to ensure that the audit of the U.K. or Irish financial statements as a whole is in accordance with Auditing Standards. [R1(O):14.10]

EF16 The U.K. accountancy profession has agreed to incorporate the principles on which the UEC Auditing Statements and IFAC Auditing Guidelines are based into its own Auditing Standards and Guidelines. [Pf(O):14.13]
Glossary of Terms

GT1  See EF2

GT2 A "joint audit" is where two or more auditors are responsible for an audit engagement and jointly produce an audit report to the client. [Dn(O):14.26]

GT3 An "auditor" is a) an individual or firm carrying out an audit b) the partners of such individual or in such firm c) the audit staff acting within delegated authority. [Dn(O):14.1]

GT4 "Audit staff" are those members of the auditor's staff who take a direct part in an audit engagement. [Dn(O):14.27]

GT5 The "enterprise" is the body corporate or other organisation on the financial statements of which the auditor is reporting. [Dn(O):14.3]

GT6 "Financial statements" consist of a) balance sheets b) profit and loss accounts c) other statements within the scope of the audit opinion [Dn(O):14.2]

GT7 The "reporting partner" is the partner in a firm responsible for the conduct of the audit. [Dn(O):14.29]

GT8 An "internal control system" is a system of controls established by management and designed to a) ensure business is carried on in an efficient and orderly manner b) ensure adherence to management policies c) safeguard assets d) secure completeness and accuracy of records [Dn:5.12]

GT8 An "internal control" is an individual component of an internal control system [Dn(O):14.33]
"Compliance tests" are tests which seek to provide audit evidence that internal control procedures are being applied as prescribed throughout the audit period. [Dn:10.24]

"Substantive tests" are tests which seek to provide evidence as to the completeness, accuracy and validity of the information contained in the accounting records or in the financial statements. [Dn:5.24]

The purposes of ensuring internal control have been applied as prescribed throughout the audit period and ensuring financial statements are complete, accurate and valid are sometimes achieved concurrently. [Pf:10.30]

"Approved Auditing Standards" are those Standards approved by the profession which are effective for the period covered by the financial statements on which the auditor is reporting. [Dn(0):14.5]
Auditing Standard: The auditor’s operational standard

OS1 The Auditing Standard: The auditor’s operational standard applies whenever an audit is carried out.
[Sc(0):14.14]

OS2 An auditor should adequately plan his work.
[R1:7.4]

OS2 An auditor should adequately control his work
[R1:8.6]

OS2 An auditor should adequately record his work
[R1:9.11]

OS3 The auditor should ascertain the nature of the accounting system.
[R1:11.19]

OS3 The auditor should assess the adequacy of the accounting system.
[R1:5.23]

OS4 The auditor should obtain sufficient relevant and reliable audit evidence to enable him to draw reasonable conclusions therefrom.
[R1:4.21]

OS5 If the auditor wishes to rely on internal controls, he should ascertain the system of internal control.
[R1:10.14]

OS5 If the auditor wishes to rely on internal controls, he should evaluate internal control.
[R1:10.12]

OS5 If the auditor wishes to rely on internal controls he should perform compliance tests on their operation.
[R1:10.27]

OS6 The auditor should conduct a review of the financial statements.
[R1:12.2]

OS6 The auditor must have a reasonable basis for his opinion on the truth and fairness of financial statements.
[R1:4.17]
The Auditing Standard: The auditor's operational standard is effective for the audit of financial statements relating to accounting periods starting on or after 1 April 1980.

[Sc(0):14.14]
PCR1 The Auditing Guideline: Planning, controlling and recording gives guidance on how para 2 of the Auditor's Operational Standard may be applied, and should be read in conjunction with the explanatory foreword including the glossary of terms.
[A: N]

PCR2 In order to carry out an effective and efficient audit it is necessary that it be
a) planned
b) controlled, and
c) recorded
at each stage of its progress
[Pf: 1.9, 7.3, 8.5, 9.7]

PCR2 Planning, controlling and recording are not mutually exclusive.
[Pf: 9.32]

PCR3 The need to plan exists regardless of the size of the enterprise concerned.
[R1: 7.13]

PCR3 The need to control exists regardless of the size of the enterprise concerned.
[R1: 8.37]

PCR3 The need to record exists regardless of the size of the enterprise concerned.
[R1: 9.31]

PCR3 The auditor needs to consider all of the procedures described in the Auditing Guideline: Planning, controlling and recording.
[R1: 2.7]

PCR3 The smaller the enterprise, the less will be the work involved in implementing the procedures in the Auditing Guideline: Planning, controlling and recording.
[Pf: N]

PCR4 The form and nature of audit planning will be affected by:
a) size and complexity of the enterprise
b) commercial environment of the enterprise
c) method of processing transactions
d) reporting requirements to which the enterprise is subject
[R1: 7.12]
PCR4 The auditor should aim to provide an effective and economic service within an appropriate time-scale. [R1:1.10]

PCR5 An "adequate audit plan" is one which:
   a) establishes intended means of achieving objectives
   b) assists the direction and control of the auditor's work
   c) helps to ensure that attention is devoted to critical aspects of the audit
   d) helps to ensure that the work is completed expeditiously. [Dn:7.2]

PCR6 If an auditor does not understand:
   a) the nature of the business
   b) the organisation of the business
   c) the method of operation of the business
   d) the industry
he will be unable to appreciate which events and transactions are likely to have a significant effect on the financial statements. [Pf:7.37]

PCR6 If an auditor is unable to appreciate which events and transactions are likely to have a significant effect on the financial statements, he will be unable to plan his work adequately. [Pf:7.36]

PCR7 The auditor should consider
   a) the outline approach to the audit
   b) the extent to which he wishes to rely upon internal controls
   c) any aspects of the audit which need particular attention
   [R1:7.15]

PCR7 The auditor should take into account any additional work agreed to in planning the audit. [R1:7.34]

PCR8 The auditor should consider preparatory procedures for the audit. [R1:7.22]
The auditor should:

a) Review matters raised in previous audits which may have continuing relevance
b) Assess the effects of any relevant changes in legislation or accounting practice
c) Review interim or management accounts where available and consulting with management and staff to consider current trading circumstances, changes in business and changes in management
d) Identify any significant changes in the enterprise's accounting procedures

An example of significant changes in the enterprise's accounting system is the introduction of a new computer-based system.

The auditor should consider the timing of significant phases of the preparation of the financial statements.

The auditor should consider the extent to which analyses and summaries can be prepared by the enterprise's employees.

The auditor should consider the relevance and quality of internal audit.

The auditor will need to determine

a) the number of staff required for the audit
b) the experience and skills required for the audit.

The auditor will need to consider the timing of audit visits.

The auditor will need to brief all staff regarding;

a) the enterprise's affairs
b) the nature and scope of the audit work to be carried out.

The preparation of a memorandum setting out the outline audit approach may be helpful.
PCR11 Joint auditors should consult in order to decide
a) allocation of work
b) procedures for control and review of work.
[R1:7.8]

PCR12 Different firms of auditors have different
management structures.
[Pf:8.25]

PCR12 The Auditing Guideline: Planning, controlling
and recording should be interpreted in the
context of the structure of each particular
audit firm.
[R1(O):14.30]

PCR12 The Auditing Guideline: Planning, controlling
and recording has been written on the basis that
the audit is carried out by a reporting partner
and his staff.
[Sc(O):14.31]

PCR13 The reporting partner needs to satisfy himself
that audit work is performed to an acceptable
standard.
[R1:8.9]

PCR13 "Adequate audit control" is where;
a) audit staff are directed and supervised
b) audit work done by audit staff is reviewed.
[Dn:8.14, 8.4]

PCR13 Degree of supervision required depends upon;
a) complexity of the assignment
b) experience of audit staff
c) proficiency of audit staff.
[R1:8.23]

PCR14 Matters which depend upon the organisation of
the audit firm and the degree of delegation of
audit work cannot be precisely specified.
[Pf:8.29]

PCR14 The nature of procedures needed to control an
audit and the need for formalisation depend upon
the organisation of the audit firm and the
degree of delegation of work.
[Pf:8.27]

PCR14 The nature of procedures needed to control an
audit and the need for formalisation cannot be
precisely specified.
[Pf:8.30]
The auditor should design and apply audit control procedures to ensure
a) work is allocated to staff who have appropriate training, experience and proficiency
b) responsibilities and objectives are clearly understood by audit staff of all levels
c) working papers provide an adequate record of work done and conclusions reached
d) audit work is reviewed by more senior persons in the audit firm.

The auditor should inform all audit staff of matters identified during the planning stage which may affect the nature, extent or timing of procedures they are to perform.

The auditor should instruct all audit staff to bring significant accounting or auditing problems to the attention of those to whom they are responsible.

Review of audit work will
a) ensure that the work was adequately performed
b) confirm that the results obtained support the conclusions reached.

Control of the audit work is particularly required during the final stages of an audit.

Pressure on the auditor is greatest during the final stages of an audit.

"Adequate audit control" ensures that mistakes and omissions do not occur.

An audit completion checklist will help provide control during the final stages of an audit.

The auditor should consider consulting a partner, a senior colleague or another practitioner where difficult questions of principle or judgement have arisen which may affect the audit opinion.
PCR16 If another practitioner is consulted, confidentiality must be maintained.
[R1:6.5]

PCR17 The auditor should consider how the overall quality of audit work can best be monitored and maintained within his firm.
[R1:8.31]

PCR18 See PCR13

PCR18 Detailed working papers are generally the only means of enabling the reporting partner to satisfy himself that delegated work has been properly performed.
[Pf:9.10]

PCR18 "Working papers" provide
a) details of problems encountered
b) evidence of work performed
c) evidence of conclusion drawn from the work performed.
[Dn:9.3]

PCR18 The preparation of working papers encourages the auditor to adopt a methodical approach.
[Pf:9.]

PCR19 "Adequate working papers" contain information which is sufficiently complete and detailed to
a) enable an experienced auditor with no previous connection with the audit subsequently to ascertain from them what work was performed, and
b) support the conclusions reached.
[Dn:9.14]

PCR19 The preparation of audit work papers as the audit progresses will ensure that details and problems are not omitted.
[Pf:9.25]

PCR19 The auditor should prepare audit work papers as the audit progresses.
[R1:9.26]
The auditor should record:

a) a summary of significant matters requiring judgement
b) a summary of conclusions reached by the auditor
c) details of information received where difficult questions of principle or of judgement have arisen
d) conclusions reached by management and the auditor where difficult questions of principle or of judgement have arisen.

The auditor's judgement may be questioned in areas of the audit where difficult questions of principle or judgement have arisen.

To be able to:

a) tell what facts were known when a conclusion was reached and
b) demonstrate that a conclusion was reasonable is important.

Audit work papers typically contain:

a) information of continuing importance to the audit
b) audit planning information
c) assessment of the accounting system
d) review and evaluation of internal controls, where appropriate
e) details of work carried out
f) details of errors/exceptions found
g) details of conclusions drawn
h) evidence of proper review of audit staff
i) working papers supporting the financial statements
j) a summary of significant points affecting the financial statements and the audit report, showing how these points were dealt with.

Use of standardised working papers may improve the efficiency with which they are prepared and reviewed.

Proper use of standardised working papers will:

a) help to instruct audit staff
b) facilitate delegation of audit work
c) provide the means of controlling the quality of audit work.
PCR23 It is improper to use standardised working papers without regard to the need to exercise professional judgement. [Rl:9.24]

PCR24 Working papers are the property of the auditor. [Pf:N]

PCR24 The auditor should adopt procedures to ensure safe custody of working papers. [Rl:9.29]

PCR24 The auditor should adopt procedures to ensure confidentiality of working papers. [Rl:9.30]
Auditing Guideline: Accounting systems

AS1 The Auditing Guideline: Accounting systems gives guidance on how para 3 of the Auditor's Operational Standard may be applied and should be read in conjunction with the explanatory foreword to Auditing Standards and Guidelines including the glossary of terms [A:N]

AS2 The auditor will need to determine the nature of audit tests as part of his audit planning. [R1:7.10]

AS2 As part of his audit planning, the auditor will need to consider
a) the overall design of the accounting system
b) the adequacy of the accounting records. [R1:11.2]

AS3 Legislation or regulations often give auditors a separate and distinct responsibility to form an opinion on the adequacy of the accounting records. [Pf:11.3]

AS3 The auditor will need to consider his specific duties relating to accounting records in audits governed by legislation. [R1:11.4]

AS4 In order to
a) control the business
b) safeguard the assets
c) prepare financial statements
d) comply with legislation,
management requires complete and accurate accounting and other records. [Pf:11.11]

AS5 An accounting system which does not provide for
a) orderly assembly of accounting information
b) appropriate analyses
will not enable financial statements to be prepared. [Pf:11.5]

AS5 The adequacy of a particular accounting system depends upon the size, nature and complexity of the enterprise. [Pf:11.16]
The simplest accounting system may only need to consist of an analysed cash book and a list of unpaid invoices.

A company manufacturing several different products and operating through a number of dispersed locations may need a complex accounting system to enable information required for financial statements to be assembled.

The nature of internal controls in an enterprise depends upon the size and nature of the business concerned.

There is frequently a need for internal controls in an accounting system.

Internal control provides assurance that:

a) all transactions have been recorded
b) errors or irregularities have become apparent
c) assets and liabilities exist and are recorded at correct amounts.

Evaluating the accounting system in practice will probably be carried out concurrently with evaluating the internal control system.

The auditor will need to obtain an understanding of the enterprise as a whole.

The auditor will need to obtain an understanding of how the accounting system reflects the assets, liabilities and transactions of the enterprise.

Ascertaining and recording the accounting system will enable the auditor to assess the adequacy of the accounting system as a basis for the preparation of financial statements.

See OS3
AS9 The auditor will need to record the accounting system.
[R1:11.20]

AS9 The extent to which the auditor should record the accounting system and the method used will depend on the complexity and nature of the system and on the degree of reliance he plans to place on internal controls.
[R1:11.27]

AS9 The more detailed the record of the accounting system, the easier it is to evaluate internal control and to plan audit tests.
[Pf:11.23]

AS9 The greater the reliance to be placed on internal control, the more detailed the record of the accounting system must be.
[R1:11.25]

AS9 The record of the accounting system may take the form of narrative notes, flowcharts or checklists or a combination of them.
[Ex(0):14.35]

AS10 The auditor should consider tracing a small number of transactions through the accounting system.
[R1:11.35]

AS10 Tracing a small number of transactions through the accounting system will aid the recording of the system.
[Pf:11.34]

AS10 Tracing a transaction through the accounting system will confirm that there is no reason to suppose that the accounting system does not operate in the manner recorded.
[Pf:11.33]

AS10 Tracing transactions through the accounting system is particularly appropriate where the enterprise has prepared the record of the accounting system.
[R1:11.37]

AS11 The auditor needs to confirm that the accounting system has operated as laid down throughout the audit period.
[R1:11.32]
AS11 Compliance tests may provide evidence that the accounting system has operated as laid down throughout the period. [Pf:11.38]

AS11 Substantive tests may provide indirect evidence that the accounting system has been operating as laid down throughout the period. [Pf:11.39]
Auditing Guideline: Audit evidence

AE1 The Auditing Guideline: Audit evidence gives guidance on how para 4 of the auditor's Operational Standard may be applied, and should be read in conjunction with the explanatory foreword to Auditing Standards and Guidelines including the glossary of terms. [A:N]

AE2 "Audit evidence" is information obtained by the auditor in arriving at the conclusions on which he bases his opinion on the financial statements [Dn(O):14.19]

AE2 The auditor's opinion as to the truth and fairness of financial statements is based on evidence. [Pf:4.18]

AE2 Audit evidence may be obtained from
a) the accounting system and underlying documentation
b) tangible assets
c) management and employees
d) customers, suppliers and other third parties who have dealings with or knowledge of the enterprise or its business [Pf:5.36]

AE3 The auditor should exercise judgement in determining the sources and amount of evidence needed to achieve the required level of assurances. [R1:4.23]

AE3 In determining the sources and amount of evidence required, the auditor will be influenced by;
a) materiality of the matter
b) relevance of the evidence
c) reliability of the evidence
d) cost/time in obtaining evidence [R1:5.37, 5.38, 5.40]

AE3 Auditors will often obtain evidence from several sources in order to obtain the necessary assurance. [R1:5.35]

AE4 The auditor can rarely be certain of the validity of the financial statements. [Pf:4.15]
See OS4

In determining what constitutes sufficient relevant and reliable evidence, the auditor is influenced by:
   a) the nature of the business
   b) the nature of the industry
   c) the degree of risk of misstatement through error/irregularity
   d) the persuasiveness of the evidence.

The degree of likelihood of misstatement through errors or irregularities is influenced by:
   a) nature and materiality of the items concerned
   b) auditor's experience of the reliability of management, staff and records
   c) financial position of the company
   d) possible management bias.

The auditor should consider the relevance of audit evidence in relation to the objective of forming an opinion and reporting on the financial statements.

The auditor needs to obtain evidence to enable him to draw reasonable conclusions as to whether:
   a) all assets have been recorded
   b) all liabilities have been recorded
   c) all recorded assets exist
   d) all recorded liabilities exist
   e) all recorded assets are owned
   f) all recorded liabilities are owed
   g) stated accounting policies have been applied
   h) the basis of application of accounting policies is acceptable
   i) the basis of application of accounting policies is consistent
   j) the recorded assets are properly disclosed
   k) the recorded liabilities are properly disclosed
   l) the recorded capital and reserves are properly disclosed
   m) all income has been recorded
   n) all expenses have been recorded
   o) all recorded income transactions occurred
   p) all recorded expense transactions occurred
   q) recorded income is properly disclosed
   r) recorded expenses are properly disclosed
AE6 The reliability of audit evidence is dependent upon the particular circumstances. [Pf:5.26]

AE6 Documentary evidence is more reliable than oral evidence. [Pf:5.29]

AE6 Evidence obtained outwith the enterprise is more reliable than evidence obtained within the enterprise. [Pf:5.28]

AE6 Evidence originated by the auditor is more reliable than evidence originated by others. [Pf:5.27]

AE7 Auditors should consider whether conclusions drawn from evidence of different types are consistent with one another. [R1:5.33]

AE7 Inconsistent evidence from a number of sources means that the reliability of all sources remains in doubt until the inconsistency is resolved. [Pf:5.31]

AE7 Consistent evidence from a number of sources is more reliable than consistent evidence from a single source. [Pf:5.30]

AE8 See GT9

AE9 The auditor may rely on appropriate evidence from substantive testing or on reliable internal control and reduced substantive testing when forming his opinion. [Pm:10.5]

AE9 As reliability of internal control increases, the extent of substantive testing may be reduced. [Pm:10.52]

AE9 Audit procedures appropriate when internal control is to be relied upon are set out in the Auditing Guideline: Internal controls [A:N]

AE10 "Inspection" is reviewing or examining records, documents or tangible assets [Dn(0):14.21]
Inspection of records and documents provides evidence of varying degrees of reliability depending upon their nature and source. [Pf:5.44]

Existence of tangible assets may be established by inspection of those assets. [Pf:5.41]

Ownership, cost or value of tangible assets may not be established by inspection of those assets. [Pf:5.42]

"Observation" is looking at an operation or procedure being performed by others with a view to determining the manner of its performance. [Dn(0):14.22]

Observation of an activity provides reliable evidence as to the manner of performance at the time of observation but not at any other time. [Pf:5.48]

"Enquiry" is seeking relevant information from knowledgeable persons inside or outside the enterprise, whether formally or informally, orally or in writing. [Dn(0):14.23]

The reliability of evidence obtained by enquiry depends on the competence, experience, independence and integrity of the respondent. [Pf:5.49]

"Computation" is checking the arithmetical accuracy of accounting records or performing independent calculations. [Dn(0):14.24]

Audit testing may be carried out by

a) inspection
b) observation
c) enquiry
d) computation
e) analytical review procedures

"Analytical review procedures" consist of studying significant ratios, trends and other statistics and investigating unusual or unexpected variations. [Dn(0):14.25]
The nature of analytical review procedures and the manner of their documentation depend upon:

a) the circumstances of each audit
b) the nature, accessibility and relevance of data available.

The auditor should decide on the comparisons he intends to make in an analytical review.

The auditor should determine expected variations to be disclosed by analytical review.

The auditor should investigate unusual or unexpected variations disclosed by analytical review.

The auditor should investigate expected variations which do not occur in the analytical review.

The auditor should verify and evaluate explanations to determine whether they are consistent with his understanding of the business and with his general knowledge.

Explanations may indicate a change in the business or the possibility of misstatements in the financial statements.

If explanations indicate a change in the business of which the auditor was previously unaware, he should reconsider the adequacy of his audit approach.

If explanations indicate the possibility of misstatements in the financial statements, the auditor will need to extend his testing to determine whether the financial statements do include material misstatements.
Auditing Guideline: Internal controls

IC1 The Auditing Guideline: Internal controls gives guidance on how para 5 of the Auditor's Operational Standard may be applied, and should be read in conjunction with the explanatory foreword including the glossary of terms.

IC2 The decision as to how much reliance to place on internal control will have to be made at an early stage.

IC2 The decision as to how much reliance to place on internal control will be kept under review as the audit proceeds.

IC2 The auditor may decide to place more or less reliance upon internal controls, depending on the results of his examination.

IC3 See GT8

IC4 Management is responsible for deciding the extent of internal control which is appropriate to the enterprise.

IC4 The internal control systems on which the auditor may seek to rely will vary between enterprises and from one part of the enterprise to another.

IC4 The internal control system of an enterprise will depend upon
a) nature, size and volume of transactions
b) degree of personal control exercised by management
c) geographical distribution of the enterprise
d) results of cost/benefit analysis
e) many other factors

IC5 The operating procedures and methods of recording and processing transactions used by small enterprises often differ significantly from those of large enterprises.
Many of the internal controls which would be relevant to the larger enterprise are not practical, appropriate or necessary in the small enterprise. [Pf:10.94]

The closer the personal contact between management and the operation of the enterprise itself, the less the need to depend upon formal internal controls. [Pf:10.96]

The management of small enterprises has closer personal contact with the operation of the enterprise itself than does the management of larger enterprises. [Pf:10.97]

Managements of small enterprises have less need to depend on formal internal controls than do managements of large enterprises. [Pf:10.98]

The most elaborate system of internal control cannot:

a) guarantee efficient administration
b) guarantee the completeness and accuracy of the records
c) prevent fraudulent collusion. [Pf:10.75, 10.76, 10.82]

Internal controls are particularly ineffective over those holding positions of authority or trust. [Pf:10.77]

Internal controls depending upon segregation of duties can be avoided by collusion. [Pf:10.78]

Authorisation controls can be abused by the person in whom the authority is vested. [Pf:10.79]

Management is frequently in a position to override controls which it has itself set up. [Pf:10.80]

The competence and integrity of the personnel operating the controls may be ensured by selection and training [Pf:N]
IC6 The competence and integrity of the personnel operating the controls may alter due to pressure exerted both within and without the enterprise [Pf:10.81]

IC6 Human error may undermine the effective operation of internal controls. [Pf:10.74]

IC7 The degree of reliance which may be placed on the information contained in the accounting records may be determined by evaluating and testing internal control. [Pf:10.11]

IC7 The auditor may limit substantive testing where he obtains reasonable assurance by means of compliance tests that the internal controls are effective in ensuring the completeness and accuracy of the accounting records and the validity of entries therein. [Pm:10.52]

IC8 The most effective internal control system has inherent limitations. [Pf:10.03]

IC8 The auditor may not rely solely on the operation of the internal control system as a basis for his opinion on the financial statements. [R1:10.84]

IC9 In some enterprises the auditor may be unable to determine whether all the transactions have been reflected in the accounting records unless there are effective internal controls [Pf:5.15]

IC10 See IC4

IC10 An appendix contains a description of the main types of internal controls on which the auditor may seek to rely. [A:N]

IC11 The auditor will need to ascertain and record the internal control system. [R1:10.14]

IC11 Ascertaining and recording the internal control system are necessary to a preliminary evaluation of the effectiveness of the system and to decide the extent of the reliance thereon. [Pf:1.13]
IC11 Recording the internal control system will normally be carried out concurrently with recording the accounting system. [Pf:11.28]

IC11 The auditor may find it helpful to trace one or two transactions through the internal control system. [Pf:10.15]

IC12 The use of documentation designed to help identify the internal controls on which the auditor may wish to rely will assist the evaluation of internal controls. [Pf:10.15]

IC12 Documentation which helps to identify internal controls on which the auditor may wish to rely can take a variety of forms. [Pf:N]

IC12 Documentation which helps to identify internal controls on which the auditor may wish to rely might be based on questions asking either: a) whether controls exist which meet specified overall control objectives, or b) whether there are controls which prevent or detect particular specified errors or omissions [R1:10.18]

IC13 If a) the preliminary evaluation of internal control indicates that there are controls which meet the objective which the auditor has identified, and b) the auditor wishes to rely on those controls, the auditor should design and carry out compliance tests. [R1:10.19]

IC13 If the preliminary evaluation discloses material weaknesses in, or the absence of internal controls, the auditor will move directly to designing and carrying out substantive tests. [R1:10.20]

IC14 The auditor is not entitled to place any reliance on internal controls based solely on his preliminary evaluation [R1:10.21]

IC14 See OS5, GT9
IC14 The auditor should note that compliance tests are tests of controls, not of the transaction which may be the medium used for the test. [R1:1.29]

IC14 The auditor should record and investigate all exceptions revealed by compliance testing, regardless of the amount involved in the particular transaction. [R1:10.44]

IC14 An "exception" in compliance testing is where an internal control has not operated correctly. [Dn(0):14.34]

IC15 If compliance testing discloses no exceptions, the auditor has a reasonable basis for reliance on the effective functioning of those controls tested. [Pf:10.40]

IC15 If compliance testing discloses no exceptions, the auditor can limit his substantive tests on the relevant information in the accounting records [Pm:10.52]

IC15 As the quality of internal control increases, the reliance which may be placed by the auditor on internal control increases. [Pf:10.7]

IC16 The auditor should determine the reasons for exceptions in compliance testing [R1:10.44]

IC16 The auditor needs to assess whether exceptions in compliance testing are a) isolated departures, or b) representative of many departures and whether they are suggestive of errors in the accounting records. [R1:10.42]

IC16 The auditor must confirm the validity of explanations which suggest that exceptions discovered in compliance testing are only isolated departures. [R1:10.48]

IC16 The validity of explanations which suggest that exceptions discovered in compliance testing are only isolated departures may be confirmed by carrying out further tests. [Pf:10.49]
IC16 An auditor may not rely on an internal control if exceptions in compliance testing indicate, and explanations or further tests confirm, that the control being tested was not operating properly throughout the period. [R1:10.38]

IC16 The auditor is unable to restrict his substantive testing where:
   a) a control was not operating properly throughout the period, and
   b) no alternative control on which to rely may be identified. [R1:10.53]

IC16 Before relying on an alternative control, the auditor must carry out suitable compliance tests on it. [R1:10.27]

IC17 If reliance is to be placed on internal controls, the auditor should ensure that internal controls were operating effectively throughout the audit period. [R1:10.23]

IC17 Compliance tests carried out at an interim date prior to the year-end need to be supplemented by:
   a) tests of controls for the remainder of the year, or
   b) alternative procedures which enable the auditor to gain adequate assurance as to the reliability of the accounting records during the period which has not been subject to compliance tests. [R1:10.27]

IC17 When determining other procedures to be adopted, the auditor should consider:
   a) results of earlier compliance tests
   b) whether there has been any change to internal control
   c) the length of the period to be subjected to test
   d) nature and size of amounts involved
   e) substantive tests to be carried out. [R1:10.35]
IC18 If a) the auditor wishes to rely on internal controls, and  
b) the internal control system has changed during the year under review,  
the auditor will have to evaluate and test those internal controls both before and after the change  
[R1:10.32, 10.33]

IC19 Internal audit is an element of internal control.  
[Pf:10.58]

IC19 The extent to which the external auditor is able to take account of the work of the internal auditor will depend on his assessment of the effectiveness of the internal audit function.  
[Pf:10.60]

IC19 In assessing the effectiveness of the internal audit function, the external auditor will be concerned with  
a) the internal auditor's independence  
b) the qualifications and experience of the internal audit staff  
c) the scope, extent, direction and timing of internal audit tests  
d) the evidence of internal audit work done and the review of that work  
e) the influence of internal audit reports on management actions  
[R1:10.64]

IC20 Where internal audit is relevant and effective, the auditor may be able to reduce the level of tests carried out.  
[Pf:10.61]

IC21 The auditor should, as soon as practicable, report significant weaknesses in internal control to enterprise management.  
[R1:10.67]

IC21 When reporting weaknesses in internal control to management, the auditor should indicate that those weaknesses are only those which have come to his attention during the course of the audit and that they may not be all the weaknesses which may exist.  
[R1:10.71]
IC22  Reporting weaknesses in internal control does not absolve
    a) auditors from their duty to consider the effect of weaknesses in internal control on
       the extent of audit work and on the audit opinion
    b) management from their responsibility to maintain adequate internal control.
       [Pf:10.68]

ICX  Appendix: Types of internal controls.
     [Ex(0):14.36]
Auditing Guideline: Review of financial statements

RFS1 The Auditing Guideline: Review of financial statements gives guidance on how para 6 of the Auditor's Operational Standard may be applied, and should be read in conjunction with the explanatory foreword, including the glossary of terms.

[A:N]

RFS2 The auditor is required to form an opinion on the enterprise's financial statements as a whole.

[PF:1.1]

RFS2 The auditor should carry out an overall review which will enable him to determine whether:
   a) acceptable accounting policies, consistently applied and appropriate to the business have been used
   b) the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the enterprise
   c) disclosure is adequate, classification and presentation of information is suitable
   d) statutory and other regulations have been complied with in presenting financial statements
   e) he is able to form an opinion on the financial statements

[Dn, R1:12.1, 12.2]

RFS3 The auditor needs to take account of the materiality of matters under review in an overall review of the financial statements.

[R1:12.23]

RFS3 in an overall review of the financial statements, the auditor needs to take account of the confidence which other audit work has given him in the accuracy and completeness of the financial statements.

[R1:12.1, 12.25]

RFS4 Skill and imagination are needed to recognise the matters to be examined in carrying out an overall review of the financial statements.

[PF:12.29]

RFS4 Sound judgement is needed to interpret information obtained in an overall review of the financial statements.

[PF:12.28]
RFS4 The overall review should be carried out by someone who has the necessary experience and skill.
[Rl:12.31]

RFS5 An overall review of financial statements is not sufficient to give the auditor a reasonable basis for his opinion on the financial statements.
[Pf:12.21]

RFS5 The overall review of the financial statements provides valuable support for conclusions arrived at as a result of other audit work.
[Pf:12.26]

RFS5 Apparent inconsistencies identified in the overall review of the financial statements could indicate areas in which material errors, omissions or irregularities may have occurred which have not been disclosed by other auditing procedures.
[Pf:12.22]

RFS6 The auditor should review the accounting policies adopted to determine whether they a) comply with SSAP's or, in the absence thereof, are otherwise acceptable; b) are consistent with those of the previous period c) are consistently applied throughout the enterprise d) are disclosed in accordance with the requirements of SSAP2
[Rl:12.4]

RFS7 The auditor should consider common usage and authoritative support when considering whether the accounting policies adopted are acceptable.
[Rl:12.6]

RFS8 See RFS2

RFS9 See OS6

RFS9 The auditor should compare the information in the financial statements with other available data.
[Rl:12.8]
RFS9 If the auditor's knowledge of the activities of the enterprise and of the business which it operates is inadequate, the auditor will be unable to determine whether particular items in the financial statements are abnormal.

[PF:12.12]

RFS9 If the auditor is unable to determine whether particular items in the financial statements are abnormal, the overall review of the financial statements will not be effective.

[PF:12.11]

RFS9 Background information about the activities of the enterprise and of the business which it operates should be available in the auditor's working papers as a result of his planning and earlier audit procedures.

[PF:9.16, 12.9]

RFS10 The auditor should consider whether the conclusions which a reader might draw from the information in the financial statements are justified and consistent with the circumstances of the business of the enterprise.

[R1: 12.16]

RFS10 The auditor should consider whether

RFS11 a) the financial statements reflect the substance of the underlying transactions and balances and not merely their form

b) the presentation of the information has not been unduly influenced by management's desire to present facts in a favourable or unfavourable light

c) the financial statements adequately reflect information and explanations obtained and conclusions reached during the audit.

[R1: 12.18]

RFS12 The auditor should consider whether his review has disclosed any new factors which affect the presentation or accounting policies adopted.

[R1:12.24]

RFS12 An example of a factor which may affect the presentation of financial information is where the review of the financial statements as a whole discloses that the enterprise has liquidity problems. Under these circumstances, the auditor should consider whether or not the financial statements should have been prepared on a going concern basis.

[Ex(0):14.37]
The auditor should review the financial statements to ensure compliance with the requirements of statutes, SSAP's and other applicable regulations [Dn, R1:12.1, 12.2]

A checklist or other aide-memoir may be helpful in ensuring that SSAP's, statutory and other regulations have been complied with in presenting financial statements. [Pf:12.19]
Auditing Standard: The audit report.

ARS0 The Auditing Standard: The audit report should be read in conjunction with the explanatory foreword including the glossary of terms. [A:N]

ARS0 Qualifications in audit reports are dealt with in the Auditing Standard: Qualifications in audit reports. [A:N]

ARS0 Examples of audit reports which conform to the Auditing Standard: The audit report are given in the Auditing Guideline: Audit report examples. [A:N]

ARS0 The considerations which arise when reporting other than as to the truth and fairness of financial statements will be dealt with subsequently. [A:N]

ARS1 The Auditing Standard: The audit report applies to audits in which an opinion on truth and fairness of financial statements is given. [Sc(O):14.15]

ARS1 The Auditing Standard: The audit report is not intended to override statutory exemptions granted to some enterprises, but is intended to apply to audit reports relating to such enterprises in other respects. [Sc(O):14.15]

ARS2 The audit report should identify those to whom it is addressed. [R1:13.8]

ARS2 The audit report should identify the financial statements to which it relates [R1:13.9]

ARS3 The auditor should refer expressly in his report to whether the audit was conducted in accordance with approved auditing standards. [R1:13.10]

ARS3 The auditor should refer expressly in his report to whether, in his opinion, the financial statements give a true and fair view of the state of affairs, profit or loss and, where applicable, source and application of funds. [R1:13.2, 4.4]
ARS3 The auditor should refer expressly in his report to any matters prescribed by legislation or other requirements. [R1:13.1]

ARS4 The Auditing Standard: The audit report is effective for the audit of financial statements relating to accounting periods starting on or after 1 April 1980 [Sc(O):14.15]

ARS5 See EF3

ARS5 See ARS3

ARS5 See GT10

ARS6 The majority of audit reports are issued under the Companies Acts. [Pf:N]

ARS6 Companies Acts normally require the auditor to report his opinion as to the truth and fairness of the financial statements and require the use of the words "true and fair view" [Pf:4.3]

ARS6 The phrase "true and fair view" has been retained in the Auditing Standard: The audit report. [A:N]

ARS6 When expressing an opinion that the financial statements give a true and fair view, the auditor should be satisfied that all relevant SSAP's have been complied with (except where they are inapplicable because they are impracticable, where they would be inappropriate, or where they would give a misleading view). [Dn, R1:13.14, 4.8]

ARS6 Situations in which SSAP's would be inappropriate, or would give a misleading view are exceptional. [Pf:4.9]

ARS6 When expressing an opinion that the financial statements give a true and fair view, the auditor should be satisfied that any significant accounting policies not covered by SSAP's are appropriate. [R1:13.15]
ARS7 The auditor should refer in his report to the accounting convention used in preparing the financial statements if he considers it necessary to avoid misunderstanding. [R1:13.12]

ARS8 The auditor should not refer to specific aspects of the financial statements in the body of his report. [R1:13.19]

ARS8 References to specific aspects of the financial statements in the body of the audit report may be misconstrued as being a qualification. [Pf:13.18]

ARS8 In rare circumstances the reader of financial statements will obtain a better understanding if his attention is drawn to important matters. [Pf:13.20]

ARS8 Examples of circumstances in which the reader will obtain a better understanding if his attention is drawn to important matters would be where there is an unusual event, accounting policy or condition, awareness of which is fundamental to an understanding of the financial statements. [Ex(0):14.38]

ARS9 The audit report should not create the impression that a qualification is intended when it is not. [R1:13.17]

ARS9 The auditor should use a separate paragraph to give references intended as emphasis of matter. [R1:13.23]

ARS9 Separate paragraphs giving references intended as emphasis of matter should be introduced with a phrase such as "We draw attention to..." [R1:13.31]

ARS9 The auditor should not refer in the opinion paragraph to a paragraph which contains references intended as emphasis of matter. [R1:13.25]

ARS9 The auditor should not use emphasis of matter to rectify a lack of appropriate disclosure in the financial statements. [R1:13.27]
ARS9 The auditor should not regard emphasis of matter as a substitute for a qualification.
[R1:13.29]

ARS10 The auditor should comply with reporting requirements imposed by legislation and any other reporting requirements relevant to the financial statements.
[R1:4.2]

ARS10 The auditor should note that the Companies Acts of Great Britain, Northern Ireland and the Republic of Ireland contain different reporting requirements.
[R1:N]

ARS11 An example of an audit report which is appropriate to a company incorporated in Great Britain which meets the requirements of the audit reporting standard where the auditor is able to issue an unqualified opinion.
[Ex(O):14.39]

ARS12 An example of an unqualified audit report appropriate to a company incorporated in Ireland is given, together with other examples of audit reports in the Auditing Guideline: Audit report examples.
[A:N]
Auditing Standard: Qualifications in audit reports.

QS0 The Auditing Standard: Qualifications in audit reports should be read in conjunction with the explanatory foreword including the glossary of terms and the Auditing Standard: The audit report. [A:N]

QS0 Examples of audit reports which conform to the Auditing Standard: Qualifications in audit reports are given in the Auditing Guideline: Audit report examples. [A:N]

QS0 The considerations which arise when reporting other than as to the truth and fairness of financial statements will be dealt with subsequently. [A:N]

QS1 If the auditor is unable to report affirmatively on;
   a) whether approved auditing standards have been followed
   b) whether the financial statements are true and fair
   c) other matters prescribed by legislation or other requirements,
   he should issue a qualified report. [R1:13.33]

QS1 In a qualified audit report, the auditor should refer to all material matters about which he has reservations. [R1:13.59]

QS1 The auditor should give all reasons for qualification. [R1:13.58]

QS1 The auditor should quantify the effect of a qualification on the financial statements where this is relevant and practicable [R1:13.62]

QS1 Auditors may need to refer to non-compliance with relevant legislation and other requirements. [R1:13.60]

QS2 A qualified audit report should leave the reader in no doubt as to its meaning and its implications for an understanding of the financial statements [R1:13.62]
QS2 If the forms of qualification in the Auditing Standard: Qualified audit reports are used, qualified audit reports will be consistently understood unless to do so would be misleading. [Pf:13.66]

QS2 Auditors should use the forms of qualification in the standard on qualified audit reports unless to do so would be misleading. [R1:13.67]

QS3 An "uncertainty" occurs when the auditor is prevented from forming an opinion on a matter [Dn(O):14.41]

QS3 A "disagreement" occurs where the auditor is able to form an opinion on a matter but this conflicts with the view given by the financial statements. [Dn(O):14.42]

QS3 If the auditor
QS7 a) is uncertain about a material matter
b) is in disagreement about a material matter
he should issue a qualified report. [R1:13.36]

QS3 A "fundamental matter" is one which
QS22 a) would undermine the view given by the financial statements taken as a whole, or
b) would render the financial statements totally misleading or meaningless as a whole. [Dn:13.34]

QS4 A "disclaimer" opinion is where the auditor states that he is unable to form an opinion as to whether the financial statements give a true and fair view. [Dn:13.43]

QS4 If the auditor is uncertain about a fundamental matter he should issue a disclaimer opinion. [R1:13.45]

QS4 An "adverse" opinion is where the auditor states that in his opinion the financial statements do not give a true and fair view. [Dn:13.46]

QS4 If the auditor disagrees about a fundamental matter he should issue an adverse opinion. [R1:13.48]
QS4 A "subject to" opinion is where the auditor effectively disclaims an opinion on a particular matter which is not considered fundamental.

[DN:13.49]

QS4 If the auditor is uncertain about a material, non-fundamental matter he should issue a subject to opinion.

[R1:13.51]

QS4 An "except" opinion is where the auditor expresses an adverse opinion on a particular matter which is not considered fundamental.

[DN:13.52]

QS4 If the auditor disagrees about a material, non-fundamental matter, he should issue an except opinion.

[R1:13.54]

QS5 The Auditing Standard: Qualifications in audit reports is effective for the audit of financial statements relating to accounting periods starting on or after 1 April 1980.

[SC(0):14.16]

QS6 A "qualified audit report" is where, in order to convey clearly the results of his audit, the auditor needs to depart from the form of wording normally used for unqualified audit reports.

[DN(0):14.40]

QS6 Qualified audit reports are occasionally necessary.

[Pf:N]

QS6 See QS1, QS2

QS6 The audit standard on qualified audit reports develops a consistent use of language to distinguish types of qualification appropriate to different circumstances

[Pf:13.64]

QS6 If a consistent use of language is developed to distinguish types of qualification appropriate to different circumstances, qualified audit reports will be more understandable.

[Pf:13.63]

QS7 See QS3
Uncertainties may be caused by
a) limitations in the scope of the audit
b) inherent uncertainties.
[Pf: 13.41]

A "limitation in the scope of the audit" arises when the auditor is unable to obtain all the information and explanations he considers necessary for the purpose of the audit.
[Dn: 13.39]

Examples of scope limitations are;
a) inability to carry out an audit procedure considered necessary.
b) the absence of proper accounting records
[Ex(0): 14.43]

An "inherent uncertainty" arises when it is not possible to reach an objective conclusion as to the outcome of a situation due to the circumstances themselves.
[Dn: 13.40]

Examples of inherent uncertainties may relate to;
a) major litigation
b) the outcome of long-term contracts,
c) doubts about the ability of the enterprise to continue as a going concern.
[Ex(0): 14.44]

An inherent uncertainty will not normally arise when the auditor is able to obtain adequate evidence to support estimates and to use his experience to reach an opinion as to their reasonableness.
[Dn: 13.40]

An example of a situation in which the auditor is able to obtain adequate evidence to support estimates and to use his experience to reach an opinion as to their reasonableness is the collectability of debts or the realisability of stock.
[Ex(0): 14.45]

A qualified audit report describes the effect of uncertainties on the opinion.
[R1: 13.73]

A qualified audit report does not distinguish the effects of uncertainties arising from a limitation of scope from those which are inherent.
[R1: 13.73]
QS9  The cause of uncertainties will be described other than in the opinion paragraph of a qualified audit report.

QS10  Disagreement may be caused by
a) failure to comply with SSAP's
b) adoption of inappropriate accounting policies
c) compliance with SSAP's not resulting in a true and fair view
d) disagreement as to facts or amounts
e) disagreement as to disclosure
f) failure to comply with legislation.

QS10  See ARS6

QS11  The auditor needs to obtain the same degree of assurance in order to give an unqualified opinion on the financial statements of both large and small enterprises.

QS11  The operating procedures and methods of recording and processing transactions used by small enterprises often differ significantly from those of large enterprises.

QS11  Many of the controls which would be relevant to the large enterprise are not practical, appropriate or necessary in the small enterprise

QS11  The most effective form of internal control for small enterprises is generally the close involvement of the directors or proprietors.

QS11  Close involvement of directors or proprietors in small enterprises will enable them to override controls and purposely to exclude transactions from the records.

QS11  In circumstances where internal control may be overridden and transactions purposely excluded from the records there may be insufficient evidence as to operation of controls and completeness of the records.
QS11 In small enterprises there may be insufficient evidence as to operation of controls and completeness of records. [Pf:10.102]

QS12 In many situations it may be possible to reach a conclusion that will support an unqualified opinion by combining the evidence obtained from substantive testing of transactions with a careful review of costs and margins. [Pf:12.26]

QS12 There may be inadequate evidence to support an opinion on the financial statements. [Pf:13.44]

QS12 Businesses in which most transactions are for cash and there is no regular pattern of costs and margins, are examples of where there may be inadequate evidence to support an opinion on the financial statements. [Ex(0):14.46]

QS13 There will be situations where the evidence available to the auditor is insufficient to enable him to express an unqualified opinion but this uncertainty is not so great as to justify a total disclaimer of opinion. [Pf:13.78]

QS13 If evidence is insufficient for an unqualified opinion but a disclaimer is not justified, the auditor may rely on management assurances, provided that steps have been taken to obtain all the evidence which can reasonably be obtained and that a) there exists a good system of internal control b) there is no evidence of inaccurate management assurances. [Pm:13.81]

QS13 Where the auditor relies on management assurances because of insufficient evidence, a "subject to" opinion should be used. [R1:13.82]

QS14 See QS1

QS14 The auditor should not use references to the notes to the accounts as a substitute for a description of the basic circumstances in the audit report. [R1:13.62]
A qualification on one matter should not be regarded as a reason for omitting other unrelated qualifications which otherwise would have been reported. [R1:13.59]

Auditors should decide upon the manner in which the reasons for qualification are disclosed. [R1:13.68]

Qualified audit reports should be clear. [R1:13.62]

A separate explanatory paragraph before the opinion paragraph is likely to be the clearest method of outlining the facts giving rise to a qualification. [Pf:13.69]

The auditor will need to consider whether the circumstances which give rise to a qualification impinge upon his statutory duty to report. [R1:13.83]

Examples of circumstances giving rise to a qualification and impinging upon the auditor's statutory duty to report would be:

a) where shortcomings in the sales records mean that proper accounting records have not been maintained
b) where the scope of the audit is limited and the auditor has not obtained all the information and explanations he considers necessary. [Ex(0):14.47]

SSAP 10 requires that a funds statement be provided except under certain specified circumstances. [Pf:13.74]

The omission of a funds statement from accounts to which SSAP 10 applies is a particular problem for the auditor. [Pf:13.76]

Failure to provide a funds statement does not justify a qualified audit report on the profit and loss account and the balance sheet. [Pf:13.75]
QS19 The omission of a funds statement should be reported by adding a separate paragraph following the opinion paragraph. [R1:13.77]

QS19 An example of the way in which the omission of a funds statement may be reported. [Ex(O):14.48]

QS20 The auditor should consider whether a matter is material in the context of the financial statements on which he is proposing to report in deciding whether to issue a qualified report. [R1:13.38]

QS20 A "material matter" is one which is likely to influence the user of the financial statements. [Dn:3.4]

QS20 An item may be material in the context of
a) financial statements as a whole
b) the balance sheet
c) the profit and loss account
d) individual items within the financial statements. [Pf:3.7]

QS20 An item may be considered material in
a) relative terms
b) absolute terms [Pf:3.8]

QS21 The auditor should not qualify his opinion in respect of immaterial matters. [R1:13.37]

QS22 The auditor should consider whether a material matter is also fundamental in deciding what type of opinion to issue. [R1:13.55]

QS22 See QS3

QS22 The auditor must consider the combined effect of all uncertainties and disagreements. [R1:13.56]

QS23 The adverse opinion and the disclaimer of opinion are the extreme forms of the two main categories of qualification of opinion arising from disagreement and uncertainty. [Dn:13.43, 13.46]
An "except" or "subject to" opinion will be appropriate in most situations where an unqualified report cannot be given. [R1:13.85]

The "adverse" opinion and the "disclaimer" opinion should be regarded as measures of last resort. [R1:13.86]
Auditing Guideline: Audit report examples.

AREO The Auditing Guideline: Audit report examples gives examples of audit reports which will meet the requirements of the Auditing Standard: The audit report and the Auditing Standard: Qualifications in audit reports. [A:N]

AREO The audit report examples guideline should be read in conjunction with the explanatory foreword including the glossary of terms [A:N].

AREO The examples in the Auditing Guideline: Audit report examples are intended merely to illustrate possible forms of wording for use in different circumstances. [Pf(O):14.49]

AREO The auditor must express qualifications in terms chosen to fit the particular circumstances to which they relate. [Rl:13.72]

AREO The suggestion of standard forms of qualification is impracticable and may result in misleading audit reports. [Pf:13.5]

AREO The examples are fictitious and deliberately simplified. [Pf(O):14.50]

AREO In practice, if circumstances call for a qualified audit report they will often be far more complex than the illustrations given. [Pf(O):14.50]

AREO In practice, qualified audit reports may need to contain lengthy explanations in order to make the position clear. [Pf(O):14.50]

AREO For the purposes of the examples it is assumed throughout that the matters in question are judged to be material. [Sc(O):14.50]

ARE1-17 Examples of audit reports. [Ex(O):14.49]
Appendix B

A Theory of Company Auditing

This appendix contains the formal system of a theory of company auditing which has been identified on the basis of the content of the Auditing Standards and Guidelines as reflected in Appendix A. The appendix is structured as follows;

Column 1: Statement Number and Reference to Standards and Guidelines

The number of each statement within the theory is in the form:
"section number.statement number". An asterisk indicates an auditing standard.

References to the paragraph within the Standards and Guidelines from which the statement is derived use the following abbreviations;

EF: Explanatory foreword
GT: Glossary of terms
OS: Auditing Standard: The auditors' operational standard
PCR: Auditing Guideline: Planning, controlling and recording
AS: Auditing Guideline: Accounting systems
AE: Auditing Guideline: Audit evidence
IC: Auditing Guideline: Internal controls
RFS: Auditing Guideline: Review of financial statements
ARS: Auditing Standard: The audit report
Column 2: Statements within the theory of company auditing.

Statements within the formal system of the theory are followed by reference numbers of earlier statements which were used as the basis for deriving the relevant statement. Where more than one grouping of reference numbers is given, the statement has been derived in more than one way. Where no numbers are given, the statement is an assumption not based on earlier statements within the theory.
Section 1  Company Audits.

1.0  The auditor should adopt those actions necessary in order to achieve the primary and secondary audit objectives.

1.1  The primary objective of the auditor is to:

RFS2  a) form an opinion, and
EF2    b) report on the financial statements of a company.

1.2  In order to form an opinion on the financial statements it is necessary to conduct an independent examination of those financial statements.

1.3  The auditor should conduct an independent examination of the financial statements.

[1.0, 1.1, 1.2]

1.4  The auditor should report on the financial statements of a company.

[1.0, 1.1]

1.5  A secondary objective of the auditor is to comply with statutory regulations governing the audit.

1.6  The auditor should comply with statutory regulations governing the audit.

[1.0, 1.5]

1.7  A secondary objective of the auditor is to comply with the terms of his engagement unless to do so would contravene statutory regulations.

1.8  The auditor should comply with the terms of his engagement unless to do so would contravene statutory regulations.

[1.0, 1.7]

1.9  A secondary objective of the auditor is to provide an effective, economic and efficient service within an appropriate time-scale.

PCR2  The auditor should provide an effective, economic and efficient service within an appropriate time-scale.

[1.0, 1.9]

1.11  An "audit" is the adoption of procedures by the auditor to achieve primary and secondary audit objectives.
1.12 An "audit" is an independent examination of and expression of opinion on the financial statements of a company by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligation. [1.3, 1.4, 1.6, 1.8, 1.11]

1.13 A secondary objective of the auditor is to ensure that it is possible to conduct a successful defence if a legal action is brought against him in which his judgement is questioned.

1.14 The auditor should adopt procedures which will ensure that it is possible to conduct a successful defence if a legal action is brought against him in which his judgement is questioned [1.0, 1.13]

1.15 In order to defend himself if his judgement is questioned, it is necessary for the auditor to adopt good practice.

1.16 Auditing Standards are statements of existing good practice.

1.17 Auditing Standards are likely to be regarded by the law as indicative of good practice and taken into account when considering the adequacy of the auditor's work.

1.18 The auditor should comply with approved Auditing Standards whenever an audit is carried out, unless otherwise indicated in Section 14: Operational. [1.14, 1.15, 1.16, 1.17]

1.19 In order to:
   a) assist the auditor to defend himself if his judgement is questioned, and
   b) help to ensure that an effective economic and efficient service is provided within an appropriate time-scale
   it is necessary for the auditor to adopt the personal standards contained in Ethical Guides.

1.20 The auditor should adopt the personal standards contained in Ethical Guides. [1.10, 1.14, 1.19]
To search specifically for fraud is not an objective of the auditor unless required by statute or the specific terms of his engagement. [1.1, 1.5, 1.7, 1.9, 1.13]

The auditor should not search specifically for fraud unless required by statute or the specific terms of his engagement. [1.0, 1.21]
Section 2  Auditor Judgement.

2.1  A code of rules sufficiently elaborate to cater for all situations and circumstances which an auditor might encounter
  a) could not provide for innovations in business and financial practice,
  b) might hinder necessary development and experimentation in auditing practice, and
  c) would be impractical.

2.2  Auditing standards
  a) provide for innovations in business and financial practice
  b) do not hinder necessary development and experimentation in auditing practice
  c) are practical

2.3  Auditing standards are not a code of rules sufficiently elaborate to cater for all situations and circumstances which an auditor might encounter.
  [2.1, 2.2]

2.4  Where there is not a code of rules sufficiently elaborate to cater for all situations and circumstances which an auditor might encounter, it is necessary to exercise judgement.

2.5  When complying with approved auditing standards, the auditor should exercise judgement.
  [1.18, 2.3, 2.4]

2.6  Auditing Guidelines, explanatory notes and existing pronouncements on auditing assist the auditor in the exercise of his judgement.

2.7  The auditor should consider the content of Auditing Guidelines, explanatory notes and existing pronouncements when observing Auditing Standards.
  [2.5, 2.6]
Section 3 Materiality.

3.1 In order for the auditor's service to be effective it is necessary that the audit report be useful.

3.2 The auditor should ensure that the audit report is useful

[1.10, 3.1]

3.3 In order to ensure that the audit report is useful, it is necessary that the auditor be concerned only with matters which would be likely to influence the user of the financial statements.

3.4 In companies, shareholders are users of financial statements.

3.5 Matters which are likely to influence the shareholder user are "material" matters.

3.6 The auditor should be concerned only with material matters.

[3.2, 3.3, 3.4, 3.5]

3.7 The auditor should judge whether a matter is material

[2.5, 3.6]

3.8 Shareholders could be influenced by

[QS20]

a) the financial statements as a whole
b) the balance sheet
c) the profit and loss account
d) individual items within the financial statements.

3.9 Shareholders could be influenced by items in

[QS20]

a) relative terms
b) absolute terms

3.10 The auditor should consider whether an item in the context of

a) the financial statements as a whole
b) the balance sheet
c) the profit and loss account
d) individual items within the financial statements

is material in

a) relative terms
b) absolute terms

[3.5, 3.7, 3.8, 3.9]
Section 4 Truth and Fairness

4.1 In order to ensure that the audit report is useful, it is necessary that the auditor
a) forms his opinion, and
b) reports his opinion
on the truth and fairness of the financial statements.

4.2 The auditor should comply with reporting
ARS10 requirements imposed by legislation.
[1.4, 1.6]

4.3 Companies Acts normally require the auditor to
ARS6 form and report his opinion as to whether the
financial statements give a "true and fair" view

4.4 In the audit of companies, the auditor should
a) form his opinion, and
b) report his opinion
on the truth and fairness of the financial statements.
[4.2, 4.3]
[3.2, 4.1]

4.5 Financial statements are "true and fair" if;
a) acceptable accounting policies are used
b) accounting policies are consistently applied
c) accounting policies are appropriate to the business
d) disclosure is adequate
e) classification and presentation of information is suitable.
f) statutory and other regulations have been complied with in presenting financial statements
g) they are not misleading
h) they are not meaningless
i) they are complete, accurate and valid
j) the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company.
The auditor should conduct an independent examination to determine whether, in respect of a company's financial statements,

a) acceptable accounting policies are used
b) accounting policies are consistently applied
c) accounting policies are appropriate to the business
d) disclosure is adequate
e) classification and presentation of information is suitable
f) statutory and other regulations have been complied with in presenting financial statements.
g) they are not misleading
h) they are not meaningless
i) they are complete, accurate and valid
j) the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company.

"Acceptable accounting policies" are those which accord with SSAP's unless SSAP's are inapplicable or inappropriate.

Financial statements which are not prepared using SSAP's are not true and fair unless SSAP's are inapplicable or inappropriate.

Situations in which SSAP's are inapplicable or inappropriate are exceptional.

Situations in which financial statements are prepared using SSAP's and are not true and fair are exceptional.

The auditor should conduct an independent examination to determine whether financial statements have been prepared in accordance with SSAP's or whether SSAP's are inapplicable or inappropriate.

"Acceptable accounting policies" are those which, if SSAP's are inapplicable, are appropriate.
4.13 The auditor should conduct an independent examination to determine whether, in situations where SSAP's are inapplicable, accounting policies adopted are appropriate. [4.6, 4.12]

4.14 In order to ensure that the audit report is useful, it is necessary that the auditor either be certain about the truth and fairness of the financial statements or have a reasonable basis for his opinion.

4.15 The auditor can rarely be certain of the validity of the financial statements. [4.5, 4.15]

4.16 The auditor can rarely be certain of the truth and fairness of the financial statements. [4.5, 4.15]

4.17 The auditor should have a reasonable basis for his opinion on the truth and fairness of financial statements. [3.2, 4.14, 4.16]

4.18 In order to obtain a reasonable basis for his opinion on the truth and fairness of financial statements it is necessary for the auditor to collect evidence by conducting an independent examination.

4.19 The auditor should conduct an independent examination. [1.3] [4.17, 4.18]

4.20 A "reasonable basis" for the auditor's opinion consists of evidence which is a) sufficient, b) relevant, and c) reliable

4.21 The auditor should obtain sufficient relevant and reliable evidence to give him a reasonable basis for his opinion. [4.17, 4.20]

4.22 In order to determine whether a) sufficient relevant and reliable audit evidence has been obtained, and b) what procedures to adopt for the collection of evidence it is necessary for the auditor to exercise judgement.
4.23 The auditor should judge the sufficiency, relevance and reliability of audit evidence, and determine what procedures to adopt for the collection of evidence.

[4.21, 4.22]
Section 5 Evidence.

5.1 In order to judge whether he has sufficient relevant and reliable evidence it is necessary for the auditor to take into account
a) the nature of the business
b) the nature of the industry
c) the degree of risk of misstatement through errors or irregularities
d) the persuasiveness of the evidence.

5.2 When judging whether he has sufficient relevant and reliable audit evidence, the auditor should take into account
a) the nature of the business
b) the nature of the industry
c) the degree of risk of misstatement through errors or irregularities
d) the persuasiveness of the evidence. [4.23, 5.1]

5.3 The degree of risk of misstatement through errors or irregularities depends upon
a) the nature and materiality of the items concerned
b) the auditor's experience of the reliability of management, staff or records
c) the financial position of the company
d) possible management bias

5.4 When judging whether he has sufficient relevant and reliable audit evidence, the auditor should take into account
a) the nature and materiality of the items concerned
b) the auditor's experience of the reliability of management, staff or records
c) the financial position of the company
d) possible management bias [5.2, 5.3]
5.5 Evidence which does not enable the auditor to determine whether, inter alia,
a) acceptable accounting policies, consistently applied and appropriate to the business have been used
b) the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company
c) disclosure is adequate, classification and presentation of information is suitable
d) statutory and other regulations have been complied with in presenting financial statements,
e) the financial statements are complete and accurate
is not sufficient to give him a reasonable basis for his opinion on the truth and fairness of the financial statements.
[4.5]

5.6 The auditor should collect evidence which will enable him to determine whether;
a) acceptable accounting policies, consistently applied and appropriate to the business have been used
b) the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company
c) disclosure is adequate, classification and presentation of information is suitable
d) statutory and other regulations have been complied with in presenting financial statements
e) the financial statements are complete and accurate
[4.6, 5.5]
[4.21, 5.5]

5.7 Evidence which has no relation to the attainment of any audit objective is not relevant.

5.8 The auditor should consider whether evidence has any relation to the objective of forming an opinion on the truth and fairness of the financial statements.
[1.1, 4.21, 5.7]
5.9 Financial statements in which
a) some assets, liabilities, income or expenses have not been recorded
b) some recorded assets or liabilities do not exist
c) some recorded income or expense transactions did not occur
d) some recorded assets are not owned
e) some recorded liabilities are not owed
f) stated accounting policies have not been applied
g) the basis of application of accounting policies is not consistent and acceptable
h) the recorded assets, liabilities, capital and reserves, income and expenses are not properly disclosed
are not complete, accurate or valid.

5.10 Evidence which enables the auditor to determine whether
a) all assets have been recorded
b) all liabilities have been recorded
c) all recorded assets exist
d) all recorded liabilities exist
e) all recorded assets are owned
f) all recorded liabilities are owed
g) stated accounting policies have been applied
h) the basis of application of accounting policies is acceptable
i) the basis of application of accounting policies is consistent
j) the recorded assets are properly disclosed
k) the recorded liabilities are properly disclosed
l) the recorded capital and reserves are properly disclosed
m) all income has been recorded
n) all expenses have been recorded
o) all recorded income transactions occurred
p) all recorded expense transactions occurred
q) recorded income is properly disclosed
r) recorded expenses are properly disclosed
is relevant to the objective of forming an opinion on the truth and fairness of the financial statements.
[4.5, 5.9]
5.11 The auditor should obtain evidence to enable him to determine whether
   a) all assets have been recorded
   b) all liabilities have been recorded
   c) all recorded assets exist
   d) all recorded liabilities exist
   e) all recorded assets are owned
   f) all recorded liabilities are owed
   g) stated accounting policies have been applied
   h) the basis of application of accounting policies is acceptable
   i) the basis of application of accounting policies is consistent
   j) the recorded assets are properly disclosed
   k) the recorded liabilities are properly disclosed
   l) the recorded capital and reserves are properly disclosed
   m) all income has been recorded
   n) all expenses have been recorded
   o) all recorded income transactions occurred
   p) all recorded expense transactions occurred
   q) recorded income is properly disclosed
   r) recorded expenses are properly disclosed

5.12 An "internal control system" is a system of controls established by the directors and
designed to
   a) ensure business is carried on in an efficient and orderly manner
   b) ensure adherence to management policies
   c) safeguard assets
   d) secure completeness and accuracy of records

5.13 As the quality of internal control increases, the likelihood that the financial statements are true and fair increases

5.14 Evidence about the quality of internal control is relevant to the objective of forming an opinion on the truth and fairness of the financial statements.

5.15 In some companies the auditor might be unable to determine whether all the transactions have been reflected in the accounting records unless there are effective internal controls.

5.16 In some companies the auditor might be able to obtain sufficient relevant and reliable evidence without collecting evidence about the quality of internal control.
5.17 In some companies the auditor should collect evidence about the quality of internal control [4.21, 5.14, 5.15]

5.18 In some companies the auditor may collect evidence about the quality of internal control [4.21, 5.14, 5.16]

5.19 An "accounting system" is a system which provides directors with information to enable them to
   a) control the business
   b) safeguard the assets
   c) prepare the financial statements
   d) comply with legislation in presenting financial statements.

5.20 As the adequacy of the accounting system increases, the likelihood that the financial statements are true and fair increases. [4.5, 5.19]

5.21 Evidence about the adequacy of the accounting system is relevant to the objective of forming an opinion on the truth and fairness of the financial statements. [5.7, 5.20]

5.22 Sufficient relevant and reliable audit evidence cannot be obtained without collecting evidence about the adequacy of the accounting system.

5.23 The auditor should collect evidence about the adequacy of the accounting system. [4.21, 5.21, 5.22]

5.24 "Substantive tests" are tests which seek to provide evidence as to the completeness, accuracy and validity of the information generated by the accounting system or in the financial statements.

5.25 The auditor should conduct substantive tests. [5.23, 5.24]

5.26 The reliability of evidence is dependent upon the particular circumstances

5.27 Evidence originated by the auditor is more reliable than evidence originated by others.

5.28 Evidence obtained outwith the company is more reliable than evidence obtained within the company.
5.29 Documentary evidence is more reliable than oral evidence.

5.30 Consistent evidence from a number of sources is more reliable than consistent evidence from a single source.

5.31 Inconsistent evidence from a number of sources means that the reliability of all sources remains in doubt.

5.32 Consistent evidence of a number of different types is more reliable than consistent evidence of a single type.

5.33 The auditor should consider:
   a) source of evidence
   b) type of evidence
   c) consistency of evidence
   d) the particular circumstances when judging the reliability of evidence.

5.34 The greater the number of sources of evidence, the more likely is the evidence to be reliable.

5.35 The auditor should obtain evidence from several sources in order to obtain a reasonable basis for his opinion.

5.36 Audit evidence can be obtained from:
   a) the accounting system and underlying documentation
   b) tangible assets
   c) directors and employees
   d) customers, suppliers and other third parties who have dealings with or knowledge of the company or its business
   and can be collected by
      a) inspection
      b) observation
      c) enquiry
      d) computation
      e) analytical review procedures

5.37 In determining sources and amount of evidence necessary for a reasonable basis for his opinion, the auditor should take into account the materiality of the matter.

[4.21, 5.26, 5.27, 5.28, 5.29, 5.30, 5.31, 5.32]
5.38 In determining sources and amount of evidence necessary for a reasonable basis for his opinion, the auditor should take into account the relevance and reliability of the evidence.

[4.23, 5.36]

5.39 In order to provide an effective, efficient and economic service within an appropriate time-scale, it is necessary that the auditor takes into account cost and time factors in determining sources and amounts of evidence necessary for a reasonable basis for the audit opinion.

5.40 The auditor should take into account cost and time factors in determining sources and amounts of evidence necessary for a reasonable basis for the audit opinion.

[1.10, 5.36, 5.39]

5.41 Existence of tangible assets can be established by inspection of those assets.

5.42 Ownership, cost or value of tangible assets will not necessarily be established by inspection of those assets.

5.43 Inspection of tangible assets provides reliable evidence as to existence but not necessarily as to ownership, cost or value.

[5.36, 5.41, 5.42]

5.44 Inspection of records and documents provides evidence of varying degrees of reliability, depending on the nature and source of those records and documents.

[5.26, 5.27, 5.28]

5.45 When judging the reliability of evidence obtained by inspection of records and documents, the auditor should consider the nature and source of the documents.

[4.23, 5.36, 5.44]

5.46 The manner of performance of an activity at time \( t(0) \) can be established by observation at time \( t(0) \).

5.47 The manner of performance of an activity at a time other than \( t(0) \) cannot be established by observation at time \( t(0) \).
5.48 Observation of an activity provides reliable evidence as to the manner of performance at the time of observation but not at any other time. [5.36, 5.46, 5.47]

5.49 The reliability of evidence obtained by enquiry depends on the competence, experience, independence and integrity of the respondent.

5.50 When judging the reliability of evidence obtained by enquiry, the auditor should consider the competence, experience, independence and integrity of the respondent. [4.23, 5.36, 5.49]

5.51 The auditor should decide the specific procedures to be adopted in an analytical review. [4.23, 5.36]

5.52 Whether specific analytical review procedures are appropriate depends upon; a) the circumstances of each audit, and b) the nature, accessibility and relevance of data available.

5.53 In deciding the nature of analytical review procedures and the manner of their documentation, the auditor should consider; a) the circumstances of each audit, and b) the nature, accessibility and relevance of data available. [5.51, 5.52]

5.54 If the auditor does not investigate unusual or unexpected variations occurring in an analytical review, reliable evidence will not be obtained.

5.55 The auditor should investigate unusual or unexpected variations. [4.21, 5.54]

5.56 In order to investigate unusual or unexpected variations it is necessary to determine expected variations.

5.57 The auditor should determine expected variations to be disclosed by analytical review. [5.55, 5.56]

5.58 An expected variation which does not occur is an unusual variation.
The auditor should investigate expected 
AE13 variations which do not occur. 
[5.55, 5.58]

In order to investigate unusual or unexpected 
variations it is necessary to seek explanations.

The auditor should seek explanations for unusual 
or unexpected variations. 
[5.55, 5.60]

Explanations which are inconsistent with the 
AE13 auditor's understanding of the business and his 
general knowledge could indicate a change in the 
business or the possibility of misstatements in 
the financial statements.

The auditor should verify and evaluate 
AE13 explanations to determine whether they are 
consistent with his understanding of the 
business and with his general knowledge. 
[4.6, 5.61, 5.62]

If explanations indicate a change in the 
business of which the auditor was previously 
unaware, the audit approach could be inadequate.

If explanations indicate a change in the 
business of which the auditor was previously 
unaware, he should reconsider the adequacy of 
the audit approach. 
[5.62, 5.63, 5.64]

If explanations indicate the possibility of 
AE13 misstatements in the financial statements, the 
auditor should conduct tests to determine 
whether the financial statements do include 
material misstatements. 
[3.6, 4.6, 5.62]

The auditor should obtain sufficient relevant 
QS11 and reliable audit evidence to give him a 
reasonable basis for his opinion regardless of 
the size of the company concerned. 
[4.21]
Section 6  Consultation with other auditors

6.1 The auditor's judgement could be questioned in PCR20 areas of the audit where difficult questions of principle or judgment have arisen.

6.2 Consultation with another experienced accountant will assist the auditor to defend himself if his judgement is questioned.

6.3 When difficult questions of principle or PCR16 judgement arise the auditor should consider consulting another experienced accountant [1.14, 6.1, 6.2]

6.4 Details of an audit are confidential.

6.5 When another accountant is consulted, the PCR16 auditor should ensure that confidentiality is maintained. [6.3, 6.4]
Section 7  Planning.

7.1 In order to provide an effective, economic and efficient service within an appropriate time-scale, it is necessary to have the means of:
   a) establishing intended means of achieving objectives.
   b) assisting the direction and control of the audit work
   c) helping to ensure that attention is devoted to critical aspects of the audit.
   d) helping to ensure that the work is completed expeditiously.

7.2 An audit in which:
   a) intended means of achieving objectives are established
   b) the direction and control of the audit work is assisted
   c) means are adopted which help to ensure that attention is devoted to critical aspects of the audit
   d) means are adopted which help to ensure that the work is completed expeditiously is an "adequately planned audit".

7.3 In order to provide an effective, economic and efficient service within an appropriate time-scale, it is necessary to conduct an "adequately planned audit".

7.4 The auditor should adequately plan the audit.

7.5 The auditor should adequately plan a joint audit.

7.6 Consultation between joint auditors to decide:
   a) allocation of work
   b) procedures for control and review
will
   a) establish the intended means of achieving audit objectives
   b) assist in the direction and control of work.

7.7 A joint audit without consultation to decide:
   a) allocation of work
   b) procedures for control and review
is not adequately planned.

[7.1, 7.2, 7.3, 7.4, 7.5, 7.6, 7.7]
7.8 Joint auditors should consult in order to decide
a) allocation of work
b) procedures for control and review
[7.5, 7.7]

7.9 Determination by the auditor of the nature of
audit tests will establish the intended means of
achieving objectives.

7.10 When planning the audit, the auditor should
determine the nature of audit tests.
[7.2, 7.4, 7.9]

7.11 Consideration by the auditor of the
a) size and complexity of the company
b) commercial environment of the company
c) method of processing transactions
d) reporting requirements to which the company
is subject
will
a) assist in the direction and control of work
b) help to ensure attention is devoted to
critical aspects of the audit.

7.12 When planning the audit, the auditor should take
into account the
a) size and complexity of the company
b) commercial environment of the company
c) method of processing transactions
d) reporting requirements to which the company
is subject
[7.2, 7.4, 7.11]

7.13 The auditor should adequately plan the audit
whatever the size of the company concerned.
[7.4]

7.14 Consideration by the auditor of
a) the outline approach to the audit
b) the extent to which he wishes to rely on
internal controls
c) any aspects of the audit which need
particular attention
will
a) establish the intended means of achieving
objectives
b) help to ensure attention is devoted to
critical aspects of the audit.
7.15 When planning the audit, the auditor should consider
    a) the outline approach to the audit
    b) the extent to which he wishes to rely on internal controls
    c) any aspects of the audit which need particular attention
    [7.2, 7.4, 7.14]

7.16 Reviewing matters raised in previous audits which could have a continuing relevance will assist in the direction and control of the work.

7.17 Assessing the effects of any relevant change in legislation or accounting practice will help to ensure attention is devoted to critical aspects of the audit.

7.18 Reviewing interim or management accounts and consulting with directors and staff to consider current trading circumstances will assist in the direction and control of work.

7.19 Identifying any significant changes in the company's accounting procedures will help to ensure that attention is devoted to critical aspects of the audit.

7.20 When planning the audit, the auditor should consider
    a) review matters raised in previous audits which could have a continuing relevance
    b) assess the effects of any relevant change in legislation or accounting practice
    c) review interim or management accounts and consult with directors and staff to consider current trading circumstances
    d) identify any significant changes in the company's accounting procedures.
    [7.2, 7.4, 7.16, 7.17, 7.18, 7.19]

7.21 a) reviewing matters raised in previous audits which could have a continuing relevance
    b) assessing the effects of any relevant change in legislation or accounting practice
    c) reviewing interim or management accounts and consulting with directors and staff to consider current trading circumstances
    d) identifying any significant changes in the company's accounting procedures constitute "preparatory procedures".

7.22 When planning the audit, the auditor should consider preparatory procedures.
    [7.20, 7.21]
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7.23 Consideration by the auditor of the timing of significant aspects of the audit will help to ensure that the work is completed expeditiously.

7.24 Phases of the preparation of the financial statements are significant aspects of the audit.

7.25 When planning the audit, the auditor should consider the timing of significant phases of the preparation of the financial statements. [7.2, 7.4, 7.23, 7.24]

7.26 Audit visits are a significant aspect of the audit.

7.27 When planning the audit, the auditor should consider the timing of audit visits. [7.2, 7.4, 7.23, 7.26]

7.28 In order to provide an effective, economic and efficient service within an appropriate time-scale, it is necessary to minimise the work carried out by the auditor.

7.29 Work carried out by the auditor will be minimised by seeking to place reliance on documents and evidence generated by others and tests carried out by others.

7.30 Consideration by the auditor of the extent to which reliance can be placed on analyses and summaries prepared by the company's employees will help to ensure that the work is completed expeditiously.

7.31 When planning the audit, the auditor should consider the extent to which reliance can be placed on analyses and summaries prepared by the company's employees. [1.10, 7.28, 7.29] [7.2, 7.4, 7.30]

7.32 Determination by the auditor of a) the number of audit staff required b) the experience and skills required will help to ensure expeditious completion of work.

7.33 When planning the audit, the auditor should determine a) the number of staff required for the audit b) the experience and skills required for the audit [7.2, 7.4, 7.32]
Taking into account any additional work agreed to will assist the direction and control of audit work.

When planning the audit, the auditor should take into account any additional work agreed to. [7.2, 7.4, 7.34]

In order to help ensure that attention is devoted to critical aspects of the audit, it is necessary to appreciate which events and transactions are likely to have a significant effect on the financial statements.

If the auditor is unable to appreciate which events and transactions are likely to have a significant effect on the financial statements he will be unable to plan the audit adequately. [7.2, 7.36]

The auditor's appreciation of events and transactions likely to have a significant effect on the financial statements requires an understanding of:
   a) the nature of the business
   b) the organisation of the company
   c) the method of operation of the business
   d) the industry

The auditor should acquire an understanding of:
   a) the nature of the business
   b) the organisation of the company
   c) the method of operation of the business
   d) the industry
[7.4, 7.37, 7.38]

If financial statements contain material misstatements, they are inaccurate.

Material misstatements are likely to have a significant effect on the financial statements. [3.5, 4.5, 7.40]

Material misstatements could be caused by irregularities or fraud.

Irregularities or fraud could have a significant effect on the financial statements [7.41, 7.42]

Items which could have a significant effect on the financial statements are critical aspects of the audit.
7.45 In planning the audit, the auditor should appreciate the effects of irregularities or fraud.

[7.2, 7.4, 7.43, 7.44]

7.46 The auditor should plan his audit so that he has a reasonable expectation of detecting material misstatements resulting from irregularities or fraud.

[7.42, 7.45]
Section 8  Controlling

8.1 In order to provide an effective, economic and efficient service within an appropriate time-scale, it is necessary to have the means of monitoring and maintaining the overall quality of audit work.

8.2 In order to monitor the overall quality of audit work it is necessary to conduct a review of audit work.

8.3 In order to maintain the overall quality of audit work it is necessary to prevent mistakes and omissions.

8.4 An audit in which

PCR13 a) audit work is reviewed, and
PCR15 b) mistakes and omissions are prevented

is an "adequately controlled audit".

8.5 In order to provide an effective, economic and efficient service within an appropriate time-scale, it is necessary to conduct an "adequately controlled audit".

[8.1, 8.2, 8.3, 8.4]

8.6 The auditor should adequately control the audit.

* [1.10, 8.5]

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8.7 Mistakes and omissions can be caused by

a) inadequately performed audit work
b) reaching audit conclusions without support of the results obtained
c) inadequate staff
d) inadequate understanding of work by staff
e) inadequate working papers

8.8 An audit in which

a) audit work is adequately performed
b) results obtained support the conclusions reached
c) staff is adequate
d) staff have an adequate understanding of work
e) working papers are adequate

is an "adequately controlled audit".

[8.4, 8.7]

8.9 The reporting partner should satisfy himself

PCR13 that audit work is adequately performed
PCR18 [8.6, 8.8]
8.10 Review of audit work will ensure that
PCR14 a) audit work is adequately performed
b) results obtained support the conclusions reached.

8.11 The auditor should review audit work.
PCR14 [8.9, 8.10]
[8.6, 8.8, 8.10]

8.12 The auditor should adopt procedures to ensure
PCR14 a) adequate staff
b) adequate understanding of work by staff
c) adequate working papers
[8.6, 8.8]

8.13 Direction and supervision of audit staff will ensure
a) staff is adequate
b) staff have adequate understanding of audit work

8.14 Direction and supervision of audit staff are
PCR13 important elements of adequate audit control.
[8.8, 8.13]

8.15 The auditor should direct and supervise audit staff.
[8.6, 8.14]

8.16 Direction of audit staff requires
a) briefing of staff regarding the company's affairs
b) briefing of staff regarding the nature and scope of the audit work
c) instructing staff to bring significant problems to the attention of the senior.

8.17 The auditor should
PCR10 a) brief all staff regarding the company's affairs
b) brief all staff regarding the nature and scope of the audit work
PCR14 c) instruct all audit staff to bring significant problems to the attention of the senior.
[8.15, 8.16]

8.18 Briefing of staff regarding the nature and scope of the audit work includes informing staff of matters affecting the nature, extent or timing of procedures.
8.19 The auditor should inform all audit staff of PCR14 matters affecting the nature, extent or timing of procedures. [8.17, 8.18]

8.20 When informing all audit staff of matters PCR10 affecting the nature, extent or timing of procedures, it could be helpful to prepare a memorandum setting out the outline audit approach.

8.21 The auditor should consider preparing a memorandum setting out the outline audit approach. [8.19, 8.20]

8.22 If the auditor does not take account of a) complexity of the assignment b) experience of audit staff c) proficiency of audit staff it will not be possible to supervise audit staff

8.23 When supervising audit staff, the auditor should PCR13 take account of a) complexity of the assignment b) experience of audit staff c) proficiency of audit staff [8.15, 8.22]

8.24 Organisation of firms and degree of delegation of work depend upon the management structures of audit firms.

8.25 Different firms of auditors have different management structures.

8.26 Different firms of auditors have different organisations and different degrees of delegation of work. [8.24, 8.25]

8.27 The nature of procedures needed to control an audit and the need for formalisation depend upon a) the organisation of the audit firm b) the degree of delegation of work

8.28 The nature of procedures needed to control an audit and the need for formalisation will differ between firms of auditors. [8.26, 8.27]
8.29 To specify precisely the nature of procedures needed to control an audit and the need for formalisation would require that control procedures and the need for formalisation be the same for different firms of auditors.

8.30 The nature of procedures needed to control an audit and the need for formalisation cannot be precisely specified. [8.28, 8.29]

8.31 The auditor should exercise judgement to determine how the overall quality of audit work can be monitored and maintained within his firm. [1.10, 2.4, 8.1, 8.30]

8.32 Pressure on the auditor is greatest during the final stages of an audit.

8.33 Mistakes and omissions are most likely when pressure on the auditor is greatest.

8.34 The auditor should exercise particular control during the final stages of an audit. [8.4, 8.6, 8.32, 8.33]

8.35 An audit completion checklist can help provide control during the final stages of an audit.

8.36 The auditor should consider using an audit completion checklist during the final stages of an audit. [8.34, 8.35]

8.37 The auditor should control the audit whatever the size of the company concerned. [8.6]
Section 9  Recording

9.1 Evidence of
   a) what facts were known when a conclusion was reached and
   b) the reasonableness of the conclusion reached in areas where difficult questions of principle or judgement have arisen will enable the auditor to defend himself if his judgement is questioned.

9.2 To be able to
   PCR20  a) tell what facts were known when a conclusion was reached and
   b) demonstrate that a conclusion was reasonable is important.
   [1.13, 6.1, 9.1]

9.3 Evidence of
   a) what facts were known when a conclusion was reached
   PCR18  b) the reasonableness of the conclusion reached
   c) details of problems encountered
   d) details of work performed
   e) quality of work performed.
   constitutes an "adequate record of audit work".

9.4 An adequate record of audit work will enable the auditor to defend himself if his judgement is questioned
   [9.1, 9.3]

9.5 In order to provide an effective, economic and efficient service within an appropriate time-scale it is necessary to have
   a) a methodical approach to the audit
   b) efficiency in the preparation and review of audit working papers

9.6 The need to prepare an adequate record of the
   PCR18  audit encourages the auditor to adopt a methodical approach.

9.7 In order to provide an effective, economic and efficient service within an appropriate time-scale it is necessary to prepare an adequate record of the audit.
   [9.5, 9.6]

9.8 The reporting partner should satisfy himself that delegated work has been properly performed.
   [8.9]
9.9 Evidence of the quality of audit work performed will enable the reporting partner to satisfy himself that delegated work has been properly performed.

9.10 An adequate record of audit work will enable the reporting partner to satisfy himself that delegated work has been properly performed. [9.3, 9.9]

9.11 The auditor should prepare an adequate record of audit work.

9.12 Adequate working papers are an essential component of an adequate record of audit work.

9.13 The auditor should prepare adequate working papers. [9.11, 9.12]

9.14 Working papers which do not contain information which is sufficiently complete and detailed to a) enable an experienced auditor with no previous connection with the audit subsequently to ascertain from them what work was performed and b) to support the conclusions reached are not "adequate working papers". [9.3, 9.12]

9.15 In order to enable an experienced auditor with no previous connection with an audit subsequently to ascertain from the working papers what work was performed and to support the conclusions reached, working papers must contain a) a summary of significant matters requiring judgement b) a summary of conclusions reached by the auditor c) details of information received d) conclusions reached by management e) all details and problems encountered f) details of work carried out g) details of errors/exceptions and work done h) details of audit plans i) details of the company and the business it operates
Audit work papers which do not contain
RFS9 a) a summary of significant matters requiring
judgement
b) a summary of conclusions reached by the
auditor
c) details of information received
d) conclusions reached by management
e) all details and problems encountered
f) details of work carried out
g) details of errors/exceptions and work done
h) details of audit plans
i) details of the company and the business it
operates
are not adequate.
[9.14, 9.15]

The auditor should record
PCR20 a) a summary of significant matters requiring
judgement
b) a summary of conclusions reached by the
auditor
c) details of information received
d) conclusions reached by management
e) all details and problems encountered
f) details of work carried out
g) details of errors/exceptions and work done
h) details of audit plans
i) details of the company and the business it
operates
[9.13, 9.16]

Use of standardised working papers could improve
PCR22 the efficiency with which they are prepared and
reviewed

Use of standardised working papers could improve
the extent to which the auditor provides an
effective, economic and efficient service within
an appropriate time-scale.
[9.5, 9.18]

The auditor may use standardised working papers.
[1, 10, 9.19]

An audit in which
a) audit staff are not instructed
b) the delegation of audit work is not
facilitated
c) there is no means of controlling the quality
of audit work
is not an adequately controlled audit.
[8.8]
9.22 "Proper" use of standardised working papers will
PCR22 a) help to instruct audit staff
b) facilitate delegation of audit work
c) provide the means of controlling the quality
of audit work

9.23 If the auditor uses standardised working papers,
he should use those papers properly.
[8.6, 9.20, 9.21, 9.22]

9.24 The auditor should not use standardised working
PCR23 papers without regard to the need to exercise
professional judgement.
[2.5, 9.20]

9.25 The preparation of audit work papers as the
PCR19 audit progresses will ensure that details and
problems are not omitted.

9.26 The auditor should prepare audit work papers as
PCR19 the audit progresses.

9.27 The auditor should adopt procedures to ensure
PCR24 confidentiality of working papers.
[6.4, 9.17]

9.28 In order to
PCR24 a) enable him to defend himself if his judgement
is questioned
b) ensure that he is providing an effective,
economic and efficient service within an
appropriate time-scale
it is necessary that the auditor has access to
his working papers.

9.29 In order to ensure access to working papers, it
is necessary to adopt procedures to ensure safe
custody of those papers.

9.30 In order to ensure confidentiality of working
papers, it is necessary to adopt procedures to
ensure safe custody of those papers.

9.31 The auditor should adopt procedures to ensure
PCR24 safe custody of working papers.
[1.10, 1.14, 9.28, 9.29]
[9.27, 9.30]

9.32 The auditor should record the audit whatever the
PCR3 size of the company concerned.
[9.11]

9.33 Planning, controlling and recording are not
PCR2 mutually exclusive
[7.2, 8.4, 9.3]
Section 10 Internal Control.

10.1 Evidence that
a) all transactions have been recorded
b) errors or irregularities have become apparent
c) assets and liabilities exist and are recorded at correct amounts
constitutes evidence about the adequacy of an accounting system.
[5.19]

10.2 The presence of an adequate internal control system provides an assurance that
a) all transactions have been recorded
b) errors or irregularities have become apparent
c) assets and liabilities exist and are recorded at correct amounts.
[5.12]

10.3 The presence of an adequate internal control system constitutes evidence about the adequacy of an accounting system.
[10.1, 10.2]

10.4 Audit work will be minimised by seeking to place reliance upon relevant internal controls.
[7.29, 10.3]

10.5 It is possible for the auditor to obtain sufficient relevant and reliable evidence from
a) substantive testing or
b) reliance upon adequate, relevant internal controls together with reduced substantive testing.
[5.15, 5.16, 5.24]

10.6 The auditor may rely on adequate, relevant internal controls and reduced substantive testing
[5.23, 10.23]
[1.10, 7.28, 10.4]
[4.21, 10.5]

10.7 As the quality and relevance of internal controls increase the reliability of those controls increases.

10.8 As the reliability of internal controls increases, the reliability of the information generated by the accounting system increases.
[10.3]
10.9  The quality and relevance of internal controls can be determined by identifying and evaluating those controls.

10.10 The reliability of internal controls can be determined by identifying and evaluating those controls. [10.7, 10.9]

10.11 The reliability of the information generated by IC7 the accounting system can be determined by identifying and evaluating relevant internal controls. [10.8, 10.10]

10.12 If the auditor wishes to rely on internal OS5 controls, he should identify and evaluate relevant controls. [5.17, 5.18, 10.6, 10.10] [5.23, 10.6, 10.11]

10.13 In order to identify relevant controls it is necessary to ascertain and record the internal control system.

10.14 If the auditor wishes to rely on internal OS5 controls he should ascertain and record the internal control system. IC11 [10.12, 10.13]

10.15 Ascertaining and recording the internal control system are facilitated by IC11 a) tracing one or two transactions through the IC12 system b) using documentation designed to help identify relevant controls.

10.16 If the auditor wishes to rely on internal controls he should consider a) tracing one or two transactions through the system b) using documentation designed to help identify relevant controls. [10.14, 10.15]

10.17 "Relevant controls" are those which a) meet specified overall control objectives or b) prevent or detect particular specified errors or omissions
10.18 If the auditor wishes to rely on internal controls he should consider using documentation designed to help identify controls which
a) meet specified overall control objectives or
b) prevent or detect particular specified errors or omissions
[10.16, 10.17]

10.19 If the auditor
IC12 a) identifies relevant controls, and
b) wishes to rely on those controls, he should evaluate those controls
[10.12]

10.20 If the auditor
IC13 a) fails to identify relevant controls or
b) does not wish to rely on those controls, he should move directly to substantive tests.
[4.21, 10.5]

10.21 The auditor should not rely on relevant internal controls solely on the basis of identifying those controls
[10.19]

10.22 In order to evaluate internal controls it is necessary to conduct tests to ensure that they are operating as prescribed throughout the period.

10.23 If the auditor wishes to rely on internal controls, he should conduct tests to ensure they have been operating as prescribed throughout the period.
[10.12, 10.22]

10.24 "Compliance tests" are tests which seek to provide audit evidence that internal controls are operating as prescribed throughout the period.

10.25 Substantive tests can provide indirect evidence that internal controls have been operating as prescribed throughout the period.
[5.12, 5.24]

10.26 Other procedures are available to provide evidence that internal controls have been operating as prescribed throughout the period.
10.27 If the auditor wishes to rely on internal controls he should conduct:
IC14  a) compliance tests,
IC16  b) substantive tests
IC17  c) other procedures
OS5   [10.23, 10.24, 10.25, 10.26]

10.28 If the auditor considers compliance tests to be a test of transactions rather than of controls, he will fail to evaluate internal controls.

10.29 The auditor should note that compliance tests are tests of controls, not of transactions. [10.19, 10.28]

10.30 The purposes of ensuring internal controls have been operating as prescribed throughout the audit period and ensuring financial statements are complete, accurate and valid can be achieved concurrently. [5.24, 10.25]

10.31 Internal control systems can change through time.

10.32 If the auditor wishes to rely on internal controls he should evaluate those controls both before and after changes occur. [10.12, 10.31]

10.33 If the auditor wishes to rely on internal controls he should test those controls both before and after changes occur. [10.27, 10.32]

10.34 If the auditor does not consider:
a) results of earlier compliance tests
b) whether there has been any change to internal control
c) the length of the period to be subjected to test
d) nature and size of amounts involved
e) substantive tests to be carried out.
It will not be possible to determine other procedures to be adopted to ensure that internal controls were operating as prescribed throughout the period.
10.35 When determining other procedures to be adopted, the auditor should consider:

a) results of earlier compliance tests
b) whether there has been any change to internal control
c) the length of the period to be subjected to test
d) nature and size of amounts involved
e) substantive tests to be carried out.

[10.27, 10.34]

10.36 If there are many departures from the internal control system and/or there are errors in the accounting records, the internal control system is of low quality.

10.37 If exceptions in compliance testing are representative of many departures from those controls tested and/or are suggestive of errors in the accounting records, then those controls tested are likely to be of low quality.

[10.24, 10.36]

10.38 An auditor should not rely on internal controls if exceptions in compliance testing are representative of many departures from those controls tested and/or are suggestive of errors in the accounting records.

[10.6, 10.7, 10.37]

10.39 If compliance testing discloses no exceptions or if exceptions are isolated departures, then those controls tested are likely to be of higher quality.

[10.24, 10.36]

10.40 If compliance testing discloses no exceptions, or if exceptions are isolated departures, the auditor has a reasonable basis for reliance on the effective functioning of those controls tested.

[10.7, 10.39]

10.41 An auditor may rely on internal controls if compliance testing of those controls discloses no exceptions or if exceptions are isolated departures.

[10.6, 10.40]
10.42 The auditor should assess whether exceptions in IC16 compliance testing are:
   a) isolated departures, or
   b) representative of many departures, and whether they are suggestive of errors in the accounting records.
   [10.6, 10.38, 10.41]

10.43 In order to assess whether exceptions in compliance testing are isolated departures, representative of many departures or suggestive of errors in the accounting records it is necessary to record and investigating all exceptions.

10.44 The auditor should record and investigate all IC4 exceptions revealed by compliance testing. IC16 [10.42, 10.43]

10.45 In order to investigate exceptions revealed by compliance testing it is necessary to seek explanations for those exceptions.

10.46 The auditor should seek explanations for all exceptions revealed by compliance testing. [10.44, 10.45]

10.47 Invalid explanations do not enable exceptions revealed by compliance testing to be investigated.

10.48 The auditor should confirm the validity of IC16 explanations for exceptions discovered in compliance testing. [10.44, 10.47]

10.49 In order to confirm the validity of explanations for exceptions discovered in compliance testing it is necessary to carry out further tests.

10.50 The auditor should carry out further tests to confirm the validity of explanations for exceptions discovered in compliance testing. [10.48, 10.49]

10.51 As reliance upon internal controls increases, the level of substantive testing necessary to obtain sufficient relevant and reliable evidence decreases. [10.5]
The auditor may restrict substantive testing where exceptions in compliance testing are not representative of many departures from those controls tested and/or are suggestive of errors in the accounting records. [4.21, 10.41, 10.51]

The auditor should carry out unrestricted substantive testing where exceptions in compliance testing are representative of many departures from those controls tested and/or are suggestive of errors in the accounting records. [10.52]

Audit work will be minimised by making an early decision as to how much reliance is to be placed on internal controls.

The auditor should decide how much reliance to place on internal controls at an early stage. [1.10, 7.28, 10.6, 10.54]

The auditor should keep the decision as to how much reliance to place on internal controls under review as the audit proceeds. [10.31, 10.38, 10.40, 10.55]

The auditor may decide to place more or less reliance on internal controls, depending on the results of his examination. [10.37, 10.39, 10.56]

Internal audit is an element of the internal control system.

The auditor may place reliance upon the work of the internal auditor. [10.6, 10.58] [1.10, 7.28, 7.29]

As the relevance and quality of internal audit increases, the reliability of internal audit increases. [10.7, 10.58]

The auditor might be able to reduce the level of substantive tests carried out where internal audit is of high quality and relevant. [10.51, 10.58, 10.60]

If the auditor wishes to place reliance on internal audit he should assess the relevance and quality of internal audit. [10.59, 10.60, 10.61]
10.63 If the auditor does not consider
a) the internal auditor's independence
b) the qualifications and experience of the internal audit staff
c) the scope, extent, direction and timing of internal audit tests
d) the evidence of internal audit work done and the review of that work
e) the influence of internal audit reports on the actions of directors and employees

he will be unable to assess the relevance and quality of internal audit.

10.64 If the auditor wishes to rely on internal audit IC19 he should consider
a) the internal auditor's independence
b) the qualifications and experience of the internal audit staff
c) the scope, extent, direction and timing of internal audit tests
d) the evidence of internal audit work done and the review of that work
e) the influence of internal audit reports on the actions of directors and employees

[10.62, 10.63]

10.65 Action to improve the quality of internal control will mean that the auditor is more able to provide an effective, economic and efficient service within an appropriate time-scale if the auditor wishes to place reliance upon the internal control system.

[7.28, 10.4, 10.7]

10.66 Reporting significant weaknesses in the internal control system to the directors will improve the quality of that system.

10.67 The auditor should report significant weaknesses IC21 in the internal control system to the directors if the auditor wishes to place reliance upon the internal control system.

[1.10, 10.6, 10.65, 10.66]

10.68 Reporting weaknesses in internal control does not absolve
a) auditors from their duty to consider the effect of weaknesses in internal control on the extent of audit work and on the audit opinion
b) directors from their responsibility to maintain adequate internal control.
10.69 If the auditor reports weaknesses in internal control he should consider the effect of those weaknesses on the extent of audit work and on the audit opinion.

10.70 If directors believe that weaknesses reported by the auditor are all the weaknesses which exist, they could fail to discharge their responsibility to maintain adequate internal control.

10.71 When reporting weaknesses in internal control to directors, the auditor should indicate that those weaknesses might not be all the weaknesses which could exist.

10.72 The auditor may rely solely on the internal control system as a basis for his opinion on the financial statements if that system has no inherent limitations.

10.73 An internal control system which
a) guarantees efficient administration
b) guarantees the completeness and accuracy of the records
c) prevents fraud and errors has no inherent limitations.

10.74 Human error can undermine the effective operation of internal controls.

10.75 The most elaborate system of internal control cannot guarantee efficient administration.

10.76 The most elaborate system of internal control cannot guarantee the completeness and accuracy of the records.

10.77 Internal controls are particularly ineffective over those holding positions of authority or trust.

10.78 Internal controls depending upon segregation of duties can be avoided by collusion.

10.79 Authorisation controls can be abused by the person in whom authority is vested.
Directors are frequently in a position to override controls which they have themselves set up.

The competence and integrity of the personnel operating the controls can alter due to pressure exerted both within and without the company.

The most elaborate system of internal control cannot prevent fraud.

The most elaborate internal control system has inherent limitations.

The auditor should not rely solely on the internal control system as a basis for his opinion on the financial statements.

Directors are responsible for the preparation of financial statements and the presentation of the information included therein.

b) prevention and detection of irregularities and fraud.

An assurance that:

- all transactions have been recorded
- errors or irregularities have become apparent
- assets and liabilities exist and are recorded at the correct amounts

will provide directors with reasonable assurance that their responsibilities for the preparation and presentation of financial statements and for the prevention and detection of irregularities and fraud will be discharged.

Adequate internal control provides directors with reasonable assurance that their responsibilities for the preparation and presentation of financial statements and for the prevention and detection of irregularities and fraud will be discharged.

There is frequently a need for internal control systems in accounting systems.
Directors are responsible for deciding the extent of internal control which is appropriate to the company. [5.12, 10.85, 10.87]

The directors' decision as to the extent of internal control which is appropriate to the company will be influenced by:
- nature, size and volume of transactions
- degree of personal control exercised by management
- geographical distribution of the company
- results of cost/benefit analysis
- many other factors

The internal control system of a company depends upon:
- nature, size and volume of transactions
- degree of personal control exercised by management
- geographical distribution of the company
- results of cost/benefit analysis
- many other factors

Internal controls within smaller companies often differ significantly from those of larger companies.

Many internal controls relevant to larger companies are not practical, appropriate or necessary in smaller companies.

The internal control systems on which the auditor could seek to rely vary widely.

In companies where directors have close personal contact with or involvement in the operation of the company itself there is a smaller need for an elaborate internal control system.
10.97 The directors of smaller companies have closer personal contact with the operation of the company itself than do the directors of larger companies.

10.98 Directors of larger companies have a greater need than directors of smaller companies to rely on an elaborate internal control system. [10.96, 10.97]

10.99 In companies without an elaborate internal control system, directors could be able to override controls and purposely to exclude transactions from the records.

10.100 Directors of smaller companies could be able to override controls and purposely to exclude transactions from the records. [10.98, 10.99]

10.101 In circumstances where internal controls could be overridden and transactions purposely excluded from the records there might be insufficient evidence as to operation of controls and completeness of the records.

10.102 In smaller companies there might be insufficient evidence as to operation of controls and completeness of records. [10.100, 10.101]
Section 11 Accounting Systems

11.1 In order to judge the adequacy of an accounting system it is necessary to consider
a) the overall design of the accounting system
b) the adequacy of the accounting records

11.2 When judging the adequacy of an accounting system, the auditor should consider
a) the overall design of the accounting system
b) the adequacy of the accounting records.
[5.23, 11.1]

11.3 Statutes often give auditors specific duties in relation to the accounting records.

11.4 The auditor should consider his specific duties relating to accounting records in audits governed by legislation.
[1.6, 11.3]

11.5 In order to enable true and fair financial statements to be prepared, it is necessary that an accounting system provides
a) orderly assembly of accounting information
b) appropriate analyses
c) complete and accurate information

11.6 An accounting system which does not provide
a) orderly assembly of accounting information
b) appropriate analyses
c) complete and accurate information
is not an "adequate accounting system".
[5.20, 11.5]

11.7 When judging the adequacy of an accounting system, the auditor should determine whether that system provides
a) orderly assembly of accounting information
b) appropriate analyses
c) complete and accurate information
[5.23, 11.6]

11.8 In order to determine whether an accounting system provides complete and accurate information it is necessary to collect evidence that
a) all transactions have been recorded
b) errors or irregularities have become apparent
c) assets and liabilities exist and are recorded at correct amounts.
When judging the adequacy of an accounting system, the auditor should collect evidence that:
a) all transactions have been recorded
b) errors or irregularities have become apparent
c) assets and liabilities exist and are recorded at correct amounts

[11.7, 11.8]

The auditor may rely on relevant internal controls to provide evidence that the accounting system provides complete and accurate information.

[10.2, 10.6, 11.9]

In order to:

a) control the business
b) safeguard the assets
c) prepare financial statements
d) comply with legislation,

it is necessary for the directors to have complete and accurate accounting and other records.

Directors are responsible for instituting an adequate accounting system.

[5.19, 10.85, 11.11]

An accounting system consisting of an analysed cash book and a list of unpaid invoices could be adequate in a small company.

A complex accounting system could be necessary in a company manufacturing several different products and operating through a number of dispersed locations.

In order to determine whether a particular accounting system is able to provide:

a) orderly assembly of accounting information
b) appropriate analyses
c) complete and accurate information

it is necessary to consider the size, nature and complexity of the company.

[11.13, 11.14]

In order to judge the adequacy of a particular accounting system it is necessary to consider the size, nature and complexity of the company.

[11.6, 11.15]

The auditor should consider the size, nature and complexity of the company.

[5.23, 11.16]
11.18 In order to determine whether the accounting system provides
a) orderly assembly of accounting information
b) appropriate analyses
c) complete and accurate information
it is necessary to
a) ascertain and record the accounting system
b) evaluate the accounting system.

11.19 The auditor should ascertain the accounting system.
[11.7, 11.18]

11.20 The auditor should record the accounting system.
[11.7, 11.18]

11.21 In order to record the accounting system, it is necessary to obtain an understanding of how the accounting system reflects the assets, liabilities and transactions of the company.

11.22 The auditor should obtain an understanding of how the accounting system reflects the assets, liabilities and transactions of the company.
[11.20, 11.21]

11.23 The more detailed the record of the accounting system, the easier it is to evaluate internal controls and to plan audit tests.

11.24 The easier it is to evaluate internal controls and to plan audit tests, the better is the indication of the reliability of relevant internal controls.

11.25 The greater the reliance to be placed on internal controls, the more detailed should the auditor record the accounting system.
[11.10, 11.23, 11.24]

11.26 The more complex the accounting system, the more difficult it is to record the accounting system.

11.27 When recording the accounting system, the auditor should consider
a) the complexity of the system
b) the degree of reliance to be placed upon internal control.
[11.20, 11.25, 11.26]
11.28 Recording the accounting system will normally be carried out concurrently with recording the internal control system. [5.12, 5.19]

11.29 The auditor should evaluate the accounting system [5.23] [11.7, 11.18]

11.30 Evaluating the accounting system will normally be carried out concurrently with evaluating the internal control system. [5.12, 5.19, 10.88]

11.31 In order to evaluate the accounting system, it is necessary to conduct tests to confirm that it has operated as prescribed throughout the period.

11.32 The auditor should confirm that the accounting system has operated as prescribed throughout the period. [11.29, 11.31]

11.33 Tracing a small number of transactions through the accounting system confirms that there is no reason to suppose that the accounting system has not operated as prescribed throughout the period.

11.34 Tracing a small number of transactions through the accounting system will aid the recording of the system.

11.35 The auditor should consider tracing a small number of transactions through the accounting system. [11.20, 11.34] [11.32, 11.33]

11.36 The less reliable the record of the accounting system, the more appropriate it is to trace a small number of transactions through the system.

11.37 The auditor should trace transactions through the accounting system where the management has prepared the record of the accounting system [5.27, 11.35, 11.36]

11.38 Compliance tests can provide evidence that the accounting system has operated as prescribed throughout the period. [10.3, 10.24]
11.39 Substantive tests can provide indirect evidence that the accounting system has been operating as prescribed throughout the period.

[5.24]

11.40 When determining whether the accounting system has operated as prescribed throughout the period, the auditor should consider the results of compliance and substantive tests.

Section 12  Review of Financial Statements

12.1 The process of collecting evidence which will enable the auditor to determine whether acceptable accounting policies, consistently applied and appropriate to the business have been used:
   a) the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company;
   b) disclosure is adequate, classification and presentation of information is suitable;
   c) statutory and other regulations have been complied with in presenting financial statements;
   e) the financial statements are complete and accurate, is called an "overall review of the financial statements".

12.2 The auditor should conduct an overall review of the financial statements.

12.3 In order to determine whether acceptable accounting policies, consistently applied and appropriate to the business have been used it is necessary to review the accounting policies adopted.

12.4 The auditor should review the accounting policies adopted to determine their:
   a) acceptability
   b) consistency
   c) appropriateness

12.5 Accounting policies which are in common usage and which have authoritative support are "acceptable accounting policies".

12.6 The auditor should consider common usage and authoritative support for accounting policies adopted.

12.7 In order to determine whether the results of operations, state of affairs and all other items of information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company it is necessary to compare the information in the financial statements with other available data.

12.8 The auditor should compare the information in the financial statements with other available data.

[5.6, 12.7]

12.9 "Other available data" includes a) the auditor's knowledge of the activities of the company and of the business which it operates, and b) the results of other audit work.

12.10 The auditor should compare the information in the financial statements with his knowledge of the activities of the company and of the business which it operates.

[12.8, 12.9]

12.11 If the auditor is unable to determine whether particular items in the financial statements are abnormal, the comparison with other available data will not provide evidence about whether the results of operations, state of affairs and all other information contained within the financial statements are compatible with each other and with the auditor's knowledge of the company.

12.12 If the auditor's knowledge of the activities of the company and of the business which it operates is inadequate, the auditor will be unable to determine whether particular items in the financial statements are abnormal.

12.13 The auditor should have adequate knowledge of the activities of the company and of the business it operates.

[12.10, 12.11, 12.12]

12.14 The auditor should compare the information in the financial statements with the information contained in the audit working papers.

[9.17, 12.10]
12.15 In order to determine whether disclosure is adequate, and whether classification and presentation of information is suitable it is necessary to consider whether the conclusions which a reader might draw from the information in the financial statements are justified and consistent with the circumstances of the business of the company.

12.16 The auditor should consider whether the conclusions which a reader might draw from the information in the financial statements are justified and consistent with the circumstances of the business of the company.

[5.6, 12.15]

12.17 The conclusions which a reader might draw from the information contained in the financial statements will be justified and consistent with the circumstances of the business of the company only if
a) the financial statements reflect the substance of the underlying transactions and balances and not merely their form
b) the presentation of the information has not been unduly influenced by the directors' desire to present facts in a favourable or unfavourable light
c) the financial statements adequately reflect information and explanations obtained and conclusions reached during the audit.

[12.16, 12.17]

12.18 The auditor should consider whether
a) the financial statements reflect the substance of the underlying transactions and balances and not merely their form
b) the presentation of the information has not been unduly influenced by the directors' desire to present facts in a favourable or unfavourable light
c) the financial statements adequately reflect information and explanations obtained and conclusions reached during the audit.

[12.16, 12.17]

12.19 A checklist or other aide-memoir can be helpful in determining whether statutory and other regulations have been complied with in presenting financial statements.

12.20 The auditor should consider using a checklist or other aide-memoir.

[5.6, 12.19]
12.21 An overall review of financial statements is not sufficient to give the auditor a reasonable basis for his opinion on the financial statements. [5.5, 12.1]

12.22 The overall review of the financial statements could disclose
a) material errors, omissions or irregularities
b) factors which affect the presentation or accounting policies adopted. [12.1]

12.23 The auditor should consider the materiality of matters under review in an overall review of the financial statements. [3.6]

12.24 The auditor should consider whether the overall review has disclosed
a) material errors, omissions or irregularities
b) factors which affect the presentation or accounting policies adopted. [5.6, 12.22]

12.25 The auditor should take account of other audit work when reviewing the financial statements. [12.8, 12.9]

12.26 The overall review of the financial statements provides support for conclusions arrived at as a result of other audit work. [1.2, 4.5, 12.22]

12.27 The auditor should consider whether the conclusions arrived at as a result of other audit work are supported by the overall review. [5.6, 12.26]

12.28 Sound judgement is needed to interpret information obtained in an overall review of the financial statements.

12.29 Skill and imagination are needed to recognise the matters to be examined in carrying out an overall review of the financial statements.

12.30 Sound judgement and imagination are developed through experience.

12.31 The auditor should ensure that the overall review is carried out by someone who has adequate experience and skill. [8.12, 12.28, 12.29, 12.30]
Section 13 Audit Reporting

13.1 The auditor should provide a report in which he refers expressly to any matters prescribed by ARS3 legislation or other requirements.
[1.4, 4.2]

13.2 The auditor should provide a report in which he refers expressly to whether, in his opinion, the financial statements give a true and fair view of the state of affairs, profit or loss and, where applicable, source and application of funds.
[1.4, 4.3, 13.1]
[1.4, 4.4]

13.3 If the audit report is misleading it will not be useful.

13.4 The auditor should provide an audit report which is not misleading.
[3.2, 13.3]

13.5 The use of a standardised audit report could be AREO misleading.

13.6 The auditor should exercise his judgement to determine the wording of his report.
[2.5, 13.4, 13.5]

13.7 An audit report which does not
a) identify those to whom it is addressed
b) identify the financial statements to which it relates
c) refer to whether the audit was conducted in accordance with approved auditing standards could be misleading.

13.8 The auditor should identify in his report those to whom the report is addressed.
ARS2 [13.4, 13.7]

13.9 The auditor should identify in his report the financial statements to which the report relates
ARS2 [13.4, 13.7]

13.10 The auditor should refer in his report expressly to whether the audit was conducted in accordance with approved auditing standards.
ARS3 [13.4, 13.7]
13.11 An audit report which does not refer to the accounting convention used in preparing the financial statements could result in misunderstandings.

13.12 The auditor should refer in his report to the accounting convention used in preparing the financial statements if he considers that not to do so could result in misleading financial statements.

13.13 An "unqualified opinion" is one in which the auditor is able to report that a) the financial statements are true and fair b) approved auditing standards have been followed c) other statutory provisions have been satisfied

13.14 The auditor should satisfy himself that all relevant SSAP's have been complied with (except where inappropriate) before giving an unqualified opinion.

13.15 The auditor should satisfy himself that any significant accounting policies not covered by SSAP's are appropriate before giving an unqualified opinion.

13.16 An audit report which creates the impression that a qualification is intended when it is not could be misleading.

13.17 The auditor should ensure that his report does not create the impression that a qualification is intended when it is not.

13.18 References to specific aspects of the financial statements in the main reporting paragraph could create the impression that a qualification is intended when it is not.

13.19 The auditor should not refer to specific aspects of the financial statements in the main reporting paragraph of an unqualified report.

13.20 An audit report which does not refer to specific aspects of the financial statements could, in rare circumstances, be misleading.
13.21 The auditor should, in rare circumstances, refer to specific aspects of the financial statements. [13.4, 13.20]

13.22 An "emphasising paragraph" is one which refers to specific aspects of the financial statements.

13.23 The auditor should ensure that an emphasising ARS9 paragraph is separate from the main reporting paragraph. [13.19, 13.21, 13.22]

13.24 References to an emphasising paragraph in the main reporting paragraph could create the impression that a qualification is intended when it is not.

13.25 The auditor should not refer to an emphasising ARS9 paragraph in the main reporting paragraph. [13.17, 13.23, 13.24]

13.26 If an emphasising paragraph is used to rectify a lack of appropriate disclosure in the financial statements, the audit report could be misleading.

13.27 The auditor should not use the emphasising ARS9 paragraph to rectify a lack of appropriate disclosure in the financial statements. [13.4, 13.26]

13.28 If an emphasising paragraph is used as a substitute for a qualification the audit report could be misleading.

13.29 The auditor should not use an emphasising ARS9 paragraph as a substitute for a qualification. [13.4, 13.28]

13.30 If an emphasising paragraph is not introduced with a phrase such as "We draw attention to...", it could create the impression that a qualification is intended when it is not.

13.31 The auditor should introduce an emphasising ARS9 paragraph with a phrase such as "We draw attention to..." [13.17, 13.30]
13.32 If the auditor is unable to report that
   a) the financial statements are true and fair
   b) approved auditing standards have been followed
   c) other statutory provisions have been satisfied
   to issue an unqualified report would be misleading.
   [13.13]

13.33 If the auditor is unable to report that
   a) the financial statements are true and fair
   b) approved auditing standards have been followed
   c) other statutory provisions have been satisfied
   he should issue a qualified report.
   [13.4, 13.32]

13.34 A "fundamental matter" is one which, if incorrect, would render the financial statements totally misleading or meaningless as a whole.

13.35 The truth and fairness of financial statements is a material, fundamental matter.
   [4.5, 13.34]

13.36 If the auditor
   a) is unable to form an opinion as to whether
   b) is of the opinion that the financial statements do not give a true and fair view,
   c) is unable to form an opinion about a material, non-fundamental matter,
   d) disagrees about a material non-fundamental matter
   he should issue a qualified report.
   [4.5, 13.33]

13.37 The auditor should not issue a qualified report in respect of immaterial matters.
   [3.6]
   [13.35, 13.36]

13.38 The auditor should consider whether a matter is material in deciding whether to issue a qualified report.
   [3.6, 13.37]

13.39 A "limitation in the scope of an audit" arises when the auditor is unable to obtain all the information and explanations he considers necessary for the purpose of the audit.
13.40 An "inherent uncertainty" arises when it is not possible to reach an objective conclusion as to the outcome of a situation due to the circumstances themselves, but does not arise when the auditor is able to obtain adequate evidence to support estimates and to use his experience to reach an opinion as to their reasonableness.

13.41 Uncertainties can be caused by
a) limitations in the scope of the audit
b) inherent uncertainties.
[13.39, 13.40]

13.42 Disagreement can be caused by
a) failure to comply with SSAP’s
b) adoption of inappropriate accounting policies
c) compliance with SSAP’s not resulting in a true and fair view
d) disagreement as to facts or amounts
e) disagreement as to disclosure
f) failure to comply with legislation.
[4.5, 13.35]

13.43 A "disclaimer" opinion is where the auditor states that he is unable to form an opinion as to whether the financial statements give a true and fair view.

13.44 If the auditor is uncertain about a fundamental matter, he will be unable to form an opinion as to whether the financial statements give a true and fair view.
[4.5, 13.34]

13.45 If the auditor is uncertain about a fundamental matter he should issue a "disclaimer" opinion.
[13.36, 13.43, 13.44]

13.46 An "adverse opinion" is where the auditor states that he is of the opinion that the financial statements do not give a true and fair view.

13.47 If the auditor disagrees about a fundamental matter, he will be of the opinion that the financial statements do not give a true and fair view.
[4.5, 13.34]

13.48 If the auditor disagrees about a fundamental matter he should issue an "adverse" opinion.
[13.36, 13.46, 13.47]
A "subject to" opinion is where the auditor states that the financial statements are true and fair, subject to a particular material, non-fundamental matter about which he is unable to form an opinion.

If the auditor is unable to form an opinion about a material, non-fundamental matter, he will be of the opinion that the financial statements give a true and fair view, subject to that matter. [4.5, 13.34]

If the auditor is uncertain about a material, non-fundamental matter he should issue a "subject to" opinion. [13.36, 13.49, 13.50]

An "except" opinion is where the auditor states that the financial statements give a true and fair view, except for a particular material, non-fundamental matter with which he disagrees.

If the auditor disagrees with a material, non-fundamental matter, he will be of the opinion that the financial statements give a true and fair view, except for that matter. [4.5, 13.34]

If the auditor disagrees about a material, non-fundamental matter, he should issue an "except" opinion. [13.36, 13.52, 13.53]

The auditor should consider whether a material matter is also fundamental in deciding what type of opinion to issue. [13.45, 13.48, 13.51, 13.54]

The auditor should consider the combined effect of all uncertainties and disagreements. [13.36, 13.45, 13.48, 13.51, 13.54]

Audit reports which do not identify the factors which caused uncertainties or disagreement could be misleading.

The auditor should give all reasons for qualification in a qualified report. [13.4, 13.57]
13.59 The auditor should refer to all material matters about which he has reservations in a qualified report. [3.6, 13.4, 13.57]

13.60 The auditor should refer in his report to non-compliance with relevant legislation and other requirements. [13.42, 13.59]

13.61 Qualified audit reports which

a) are not understandable
b) leave the reader in doubt as to its meaning and implications for an understanding of the financial statements
c) do not quantify the effect of a qualification on the financial statements where this is relevant and practicable
d) use references to the notes to the accounts as a substitute for a description of the basic circumstances in the audit report could be misleading.

13.62 The auditor should issue qualified audit reports which

a) are understandable
b) leave the reader in no doubt as to its meaning and implications for an understanding of the financial statements
c) quantify the effect of a qualification on the financial statements where this is relevant and practicable
d) do not use references to the notes to the accounts as a substitute for a description of the basic circumstances in the audit report. [13.4, 13.61]

13.63 Professional pronouncements which develop a consistent use of language to distinguish types of qualification appropriate to different circumstances will make qualified audit reports more understandable.

13.64 The audit standard on qualified audit reports develops a consistent use of language to distinguish types of qualification appropriate to different circumstances.

13.65 Audit reports which are consistently understood leave the reader in no doubt as to their meaning and implications for an understanding of the financial statements.
13.66 If the standard on qualified audit reports is followed qualified audit reports will be consistently understood.

13.67 The auditor should follow the standard on qualified audit reports unless to do so would be misleading.

13.68 The auditor should decide upon the manner in which the reasons for qualification are disclosed.

13.69 A separate explanatory paragraph before the opinion paragraph is likely to be the clearest method of outlining the facts giving rise to a qualification.

13.70 The auditor should use a separate explanatory paragraph to outline the facts giving rise to a qualification.

13.71 If qualifications are not expressed in terms chosen to fit the particular circumstances to which they relate, the audit report could be misleading.

13.72 The auditor should express qualifications in AREO terms chosen to fit the particular circumstances to which they relate.

13.73 In a qualified audit report the auditor should describe the effect of uncertainties on the opinion in an opinion paragraph, and describe the cause of the uncertainty in a separate explanatory paragraph.

13.74 SSAP 10 requires that a funds statement be provided.

13.75 Failure to provide a funds statement does not justify a qualified audit report on the profit and loss account and the balance sheet.

13.76 The omission of a funds statement from accounts to which SSAP 10 applies is a particular problem for the auditor.
13.77 The omission of a funds statement should be reported by adding a separate paragraph following the opinion paragraph. [13.19, 13.21, 13.76]

13.78 There will be situations where the evidence available to the auditor is insufficient to enable him to express an unqualified opinion but this uncertainty is not so great as to justify a total disclaimer of opinion.

13.79 Management assurances can be unreliable. [5.27, 5.28, 5.29]

13.80 If the auditor has taken steps to obtain all the evidence which can reasonably be obtained and
a) there exists a good system of internal control
b) there is no evidence of inaccurate management assurances
management assurances can be reliable. [5.30, 5.32, 13.79]

13.81 If evidence is inadequate for an unqualified opinion but a disclaimer is not justified, the auditor may rely on management assurances, provided there exists a good system of internal control and there is no evidence of inaccurate management assurances. [4.21, 13.78, 13.80]

13.82 If the auditor relies on management assurances, a "subject to" opinion should be issued. [13.51, 13.81]

13.83 The auditor should consider whether the circumstances which give rise to a qualification impinge upon his statutory duty to report. [13.1, 13.33]

13.84 In most circumstances the auditor will have sufficient evidence not to give an "adverse" opinion or a "disclaimer" opinion.

13.85 The auditor should issue an "except" or "subject to" opinion in most circumstances where an unqualified report cannot be given. [13.45, 13.48, 13.51, 13.54, 13.84]

13.86 The auditor should consider the "adverse" opinion and the "disclaimer" opinion to be measures of last resort. [13.84, 13.85]
Section 14 Operational

14.1 An "auditor" is
GT3 a) an individual or firm carrying out a company audit
b) the partners of such individual or in such firm
c) the audit staff acting within delegated authority.

14.2 "Financial statements" consist of
GT6 a) balance sheets
b) profit and loss accounts
c) other statements within the scope of the audit opinion.

14.3 The "company" is the body corporate on the financial statements of which the auditor is reporting.

14.4 "Auditing Standards" are prescriptions of basic principles and practices which auditors are expected to follow in the conduct of an audit. They are indicated within this theory by an asterisk

14.5 "Approved Auditing Standards" are those Standards approved by the U.K. profession which are effective for the period covered by the financial statements on which the auditor is reporting.

14.6 "Auditing Guidelines", "explanatory notes" and "existing pronouncements on auditing" are statements which give guidance on
EF3 a) procedures by which Standards can be applied,
EF6 b) application of Standards to specific financial statement items,
c) techniques currently being used, and
EF5 d) audit problems relating to specific areas and do not prescribe basic principles and practices. They include statements of practices derived within this theory after the derivation of Standards.

14.7 The propositions on which auditing Standards are based are true in respect of the U.K. and Ireland.

14.8 Auditing Standards are applicable to the U.K. and Ireland only.
[14.7]
14.9 Auditing Standards might not be appropriate to the audit of overseas financial statements.

14.10 Where overseas financial statements are to be incorporated into U.K. or Irish financial statements the auditor should ensure that the audit of the overseas company conforms to the Auditing Standards in so far as this is necessary to ensure that the audit of the U.K. or Irish financial statements as a whole is in accordance with the Standards.

14.11 An objective of the U.K. auditing profession is to avoid the introduction of inconsistent international company audit practices.

14.12 If U.K. Auditing Standards conflict with Auditing Standards in other countries, inconsistent international company audit practices could be introduced.

14.13 The U.K. auditing profession has agreed to incorporate the principles on which the UEC Auditing Statements and IFAC Auditing Guidelines are based into its own Auditing Standards.

14.14 The Auditor's Operational Standard applies to all audits under the U.K. Companies Acts, relating to accounting periods starting on or after 1 April 1980.

14.15 The Auditor's Reporting Standard applies to all audits under the U.K. Companies Acts, relating to accounting periods starting on or after 1 April 1980, but does not override statutory exemptions granted to some companies.

14.16 The Auditor's Qualified Reporting Standard applies to all audits under the U.K. Companies Acts, relating to accounting periods starting on or after 1 April 1980.

14.17 The auditor should comply with the Auditor's Operational Standard, the Auditor's Reporting Standard and the Auditor's Qualified Reporting Standard in all audits under the U.K. Companies Acts, relating to accounting periods starting on or after 1 April 1980.
14.18 Apparent failures by members of the U.K. 
EF11 auditing profession to observe Auditing 
Standards could be enquired into and 
disciplinary action could result.

14.19 "Audit evidence" is information obtained by the 
AE2 auditor in arriving at the conclusions on which 
he bases his opinion on the financial statements 

14.20 "Audit tests" are the procedures implemented by 
authors in order to collect audit evidence.

14.21 "Inspection" is reviewing or examining records, 
AE10 documents or tangible assets.

14.22 "Observation" is looking at an operation or 
AE10 procedure being performed by others with a view 
to determining the manner of its performance.

14.23 "Enquiry" is seeking relevant information from 
AE10 knowledgeable persons inside or outside the 
company, whether formally or informally, orally 
or in writing.

14.24 "Computation" is checking the arithmetical 
AE10 accuracy of accounting records or performing 
independent calculations.

14.25 "Analytical review procedures" consist of 
AE11 studying significant ratios, trends and other 
statistics and investigating unusual or 
unexpected variations.

14.26 A "joint audit" is where two or more auditors 
GT2 are responsible for an audit engagement and 
jointly produce an audit report to the client.

14.27 "Audit staff" are those members of the auditor's 
GT4 staff who take a direct part in the audit 
engagement.

14.28 An example of a "significant change in a 
PCR8 company's accounting procedures" is the 
introduction of a new computer-based system.

14.29 The "reporting partner" is the partner in a firm 
GT7 responsible for the conduct of the audit.

14.30 When interpreting Section 7: Planning, Section 
PCR12 8: Controlling and Section 9: Recording, the 
auditor should take into account the structure 
of the audit firm concerned.

[8.25]
14.31 The propositions in Section 7: Planning, Section PCR12 8: Controlling and Section 9: Recording are true in cases where an audit is carried out by a reporting partner and his staff.

14.32 An example of the contents of audit working PCR21 papers is;
   a) information of continuing importance to the audit
   b) audit planning information
   c) assessment of the accounting system
   d) review and evaluation of internal controls, where appropriate
   e) details of work carried out
   f) details of errors/exceptions found
   g) details of conclusions drawn
   h) evidence of proper review of audit staff
   i) working papers supporting the financial statements
   j) a summary of significant points affecting the financial statements and the audit report, showing how these points were dealt with.

14.33 An "internal control" is an individual component GT8 of an internal control system.

14.34 An "exception" in compliance testing is where IC14 internal control has not operated correctly.

14.35 Examples of records of an accounting system are;
   a) narrative notes
   b) flowcharts
   c) checklists
   d) a combination of a) to c).

14.36 Examples of internal controls (see appendix to ICX the Auditing Guideline: Internal controls)

14.37 An example of a factor which could affect the RFS12 presentation of financial information is where the review of the financial statements as a whole discloses that the company has liquidity problems. Under these circumstances the auditor should consider whether or not the financial statements should have been prepared on a going concern basis.
Examples of circumstances in which the reader will obtain a better understanding if his attention is drawn to important matters would be where there is an unusual event, accounting policy or condition, awareness of which is fundamental to an understanding of the financial statements.

An example of an audit report which is appropriate to a company incorporated in Great Britain which meets the requirements of the audit reporting standard where the auditor is able to issue an unqualified opinion (See Auditing Standards and Guidelines)

A "qualified audit report" is an audit report which departs from the wording normally used for unqualified audit reports.

An "uncertainty" is when the auditor is prevented from forming an opinion on a matter.

A "disagreement" is when the auditor is able to form an opinion on a matter but this conflicts with the view given by the financial statements.

Examples of "limitations in the scope of the audit" are;

a) inability to carry out an audit procedure considered necessary.

b) the absence of proper accounting records.

d) size or complexity of the audit

Examples of factors which could cause "inherent uncertainties" are;

a) major litigation

b) the outcome of long-term contracts,

c) doubts about the ability of the enterprise to continue as a going concern.

An example of a situation in which the auditor is able to obtain adequate evidence to support estimates and to use his experience to reach an opinion as to their reasonableness is the collectability of debts or the realisability of stock.

An example of circumstances in which there could be inadequate evidence to support an opinion on the financial statements would be in businesses where most transactions are for cash and there is no regular pattern of costs and margins.
Examples of circumstances giving rise to a qualification and impinging upon the auditor's statutory duty to report would be:

a) where shortcomings in the sales records mean that proper accounting records have not been maintained
b) where the scope of the audit is limited and the auditor has not obtained all the information and explanations he considers necessary.

An example of the way in which the omission of a funds statement can be reported (See Auditing Standards and Guidelines).

Examples of audit reports as illustrations of possible forms of wording for use in different circumstances (See Auditing Standards and Guidelines).

The examples of audit reports in the Auditing Standards and Guidelines are based on the following assumptions:

a) matters in question are material
b) lengthy explanations are not necessary in order to make the position clear
c) the circumstances are less complex than will often be the case in practice
d) the circumstances are fictitious and simplified.
Appendix C

A diagrammatic representation of the theory of company auditing

This appendix contains a diagrammatic representation of the formal system of the theory of company auditing which has been identified on the basis of the content of the Auditing Standards and Guidelines and stated in Appendix B.

The transparent pages contain the statements which have been added in order to establish necessary derivations of statements found within the Standards and Guidelines. The opaque pages contain the statements which are to be found within the Standards and Guidelines. Where both premises and conclusion of parts of the argument are to be found within the Standards and Guidelines, the chain of argument is shown on the opaque page. Otherwise, all links between statements are shown on the transparent pages. The extent to which it has been necessary to add further statements, and the purpose of so doing, may be seen by lifting the transparent pages.

Statements which are to be found within an earlier section are shown in circles, and statements which are to be found within the section in question are shown in boxes. Where it has been necessary to continue a section over two pages, the links between those pages are represented by arrows.
To the left of the dotted line on each page are propositional functions, definitions and other non-practical statements from which practices are derived. Derived practices are shown to the right of the dotted line.
Section 1: Company Audits
Section 2: Auditor Judgement
Section 3: Materiality
Section 4: Truth and Fairness
Section 5: Evidence
Section 6: Consultation with other auditors
Section 8: Controlling
Section 9: Recording
Section 12: Review of Financial Statements
Appendix D

Glossary of Technical Terms

Appropriate Procedure

A company audit procedure is appropriate if it results in the attainment of a specified company audit objective.

Enabling Argument

An argument which derives a secondary audit requirement from one or more primary audit requirements and, thereby, derives company audit rules and/or permissions which result in compliance with a primary audit requirement.

Formal System

A theory of company auditing which consists of logically deductive arguments deriving company audit rules and/or permissions.

Fundamental Normative Statement

A statement asserting the desirability of a state of affairs which is used as a premise in arguments deriving company audit rules and/or permissions.

Fundamental Proposition

An assertion which is presupposed to be true by supporters of a theory of company auditing and which a) appears within the hard core of that theory, b) is derived from a propositional function which appears within the hard core of that theory, or c) asserts the existence of conditions which do not prevent compliance with any company audit rule or permission derived within the hard core of that theory.

Hard Core

That part of a company audit theory which is placed beyond dispute by supporters of that theory and which concludes with statements of secondary audit requirements.

Inconsistent Procedures

Two company audit procedures are inconsistent if the implementation of one hinders the implementation of the other.
Inconsistent Objectives

Two company audit objectives are inconsistent if the attainment of one hinders the attainment of the other.

Justified Procedure

A company audit procedure is justified if it is the conclusion of a valid deductive argument containing:

a) fundamental normative statement(s) which have not been shown to be generally unacceptable to those concerned with the company audit process,

b) definition(s) which have not been shown to be generally unacceptable to those concerned with the company audit process,

c) propositions or propositional functions which have not been refuted.

Justifying Argument

A deductive argument appearing within the hard core of a theory of company auditing which concludes with one or more primary audit requirements.

Operational System

A set of statements referring to a theory of company auditing, consisting of statements of scope, definitions and examples, which is intended to promote consistent interpretation of statements and application of rules and/or permissions appearing within that theory.

Permission

A statement appearing within a theory of company auditing which provides that a particular procedure may be implemented if the company auditor so desires.

Primary Audit Objective

The primary audit objectives are to implement the primary audit requirements.

Primary audit requirement

The concluding statement of a justifying argument and the first statement within that chain of argument which specifies a company audit rule.
Proposition

A statement in which
a) the predicate affirms or denies something about the subject, or
b) a relation between objects is asserted, and which is
a) either true or false, and
b) sufficiently specific to be, in principle, verified by the collection of evidence.

Propositional Function

A general truth-functional schema in which
a) the predicate affirms or denies something about the subject, or
b) a relation between objects is asserted, and which is
a) either true or false,
b) insufficiently specific to be verified by the collection of evidence, and
c) able to be converted into a proposition either by specification or quantification of variables.

Protective Belt

That part of a theory of company auditing other than the hard core.

Rule

A statement appearing within a theory of company auditing which provides that a particular procedure should be implemented by the auditor and for which no alternative procedure is given.

Secondary Audit Objective

The secondary audit objectives are to implement secondary audit requirements.

Secondary Audit Requirement

The concluding statement of an enabling argument which establishes the limit of the hard core of a theory of company auditing.

Statement of Scope

An expression of the circumstances under which propositions or propositional functions within a theory of company auditing are held to be true.
Theoretical Framework

A theory which concludes with company audit rules and/or permissions intended to influence the way in which company audits are conducted.

Theory

A set of statements structured according to the rules of deductive logic which derive company audit rules and/or permissions.
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