

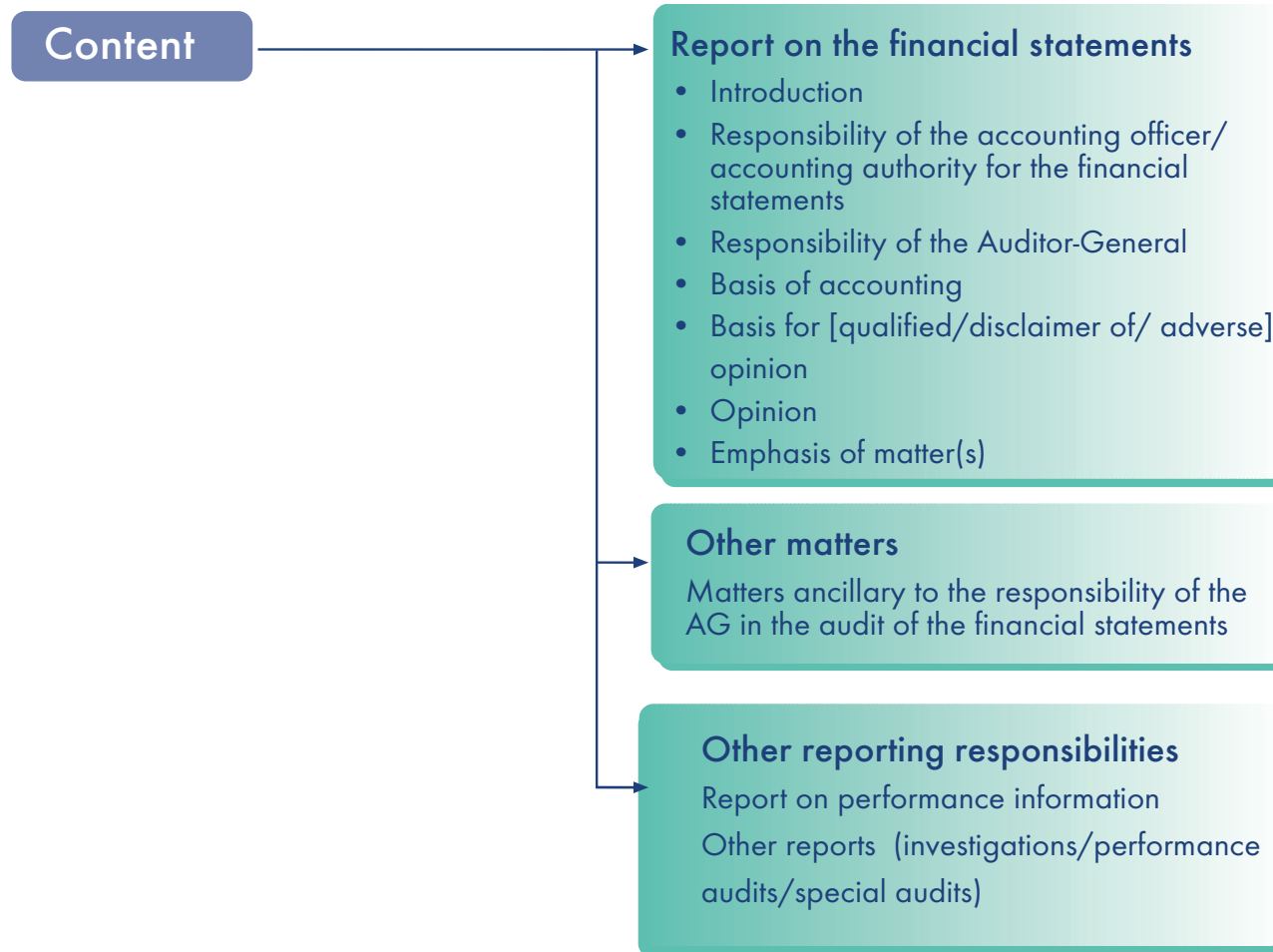
Audit communication and reporting



A U D I T O R - G E N E R A L

Report of the Auditor-General

to Parliament or the Provincial Legislature on the financial statements and performance information

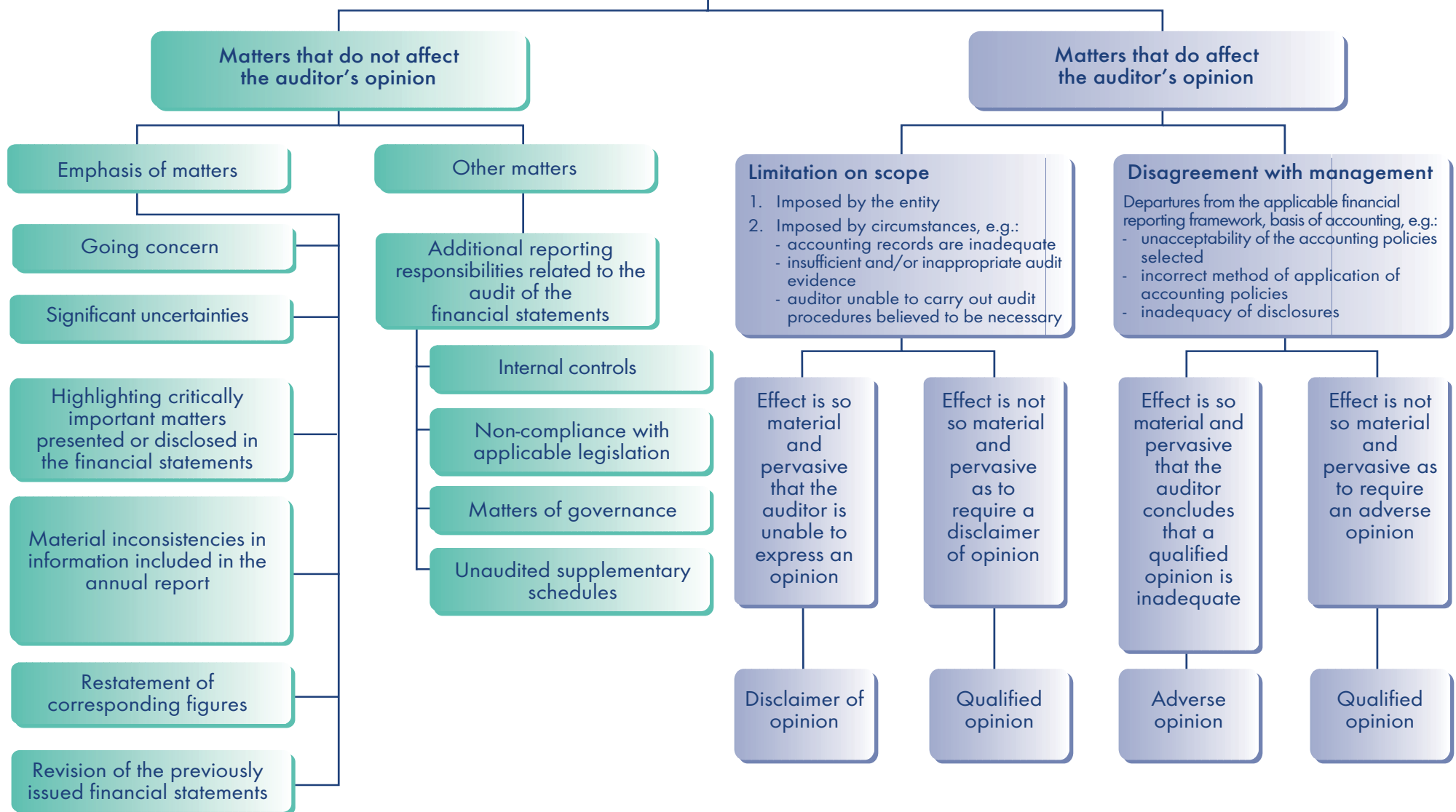


Our reputation promise

The Auditor-General has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector, thereby building public confidence.

Modification of the audit opinion

Modification of the audit opinion: This decision tree illustrates the circumstances under which the audit report would be modified.



Glossary of auditing terms

A

Accuracy (Ac) assertion – Amounts and other data relating to recorded transactions and events have been recorded appropriately (as well as disclosed fairly).

Adverse opinion – An adverse opinion is expressed when the effect of a disagreement with management regarding departures from the financial reporting framework/basis of accounting is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

Analytical procedures – Evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Appropriateness – The measure of the quality of evidence, that is, its relevance and reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions.

Assertions – Underlying representations, explicit and implicit, made by management that the financial statements have been prepared to give a true and fair view of the entity's financial affairs in accordance with the applicable financial reporting framework and that the various elements of the financial statements and related disclosures are appropriately recognised, measured, presented and disclosed.

Assertions can be grouped as follows:

Classes of transactions/events	Account balances	AFS presentation and disclosure
occurrence	existence	occurrence, rights and obligations
completeness	completeness	completeness

accuracy	rights and obligations	classification and understandability
cut-off	valuation and allocation	accuracy and valuation
classification		compliance
value-for-money		

Audit evidence – All the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence includes the information contained in the accounting records underlying the financial statements and other information.

Audit matters of governance interest – Those matters that arise from the audit of financial statements and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Audit matters of governance interest include only those matters that have come to the attention of the auditor as a result of the performance of the audit.

Audit of financial statements – The objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework/basis of accounting.

C

Classification (Cl) assertion – Transactions and events have been recorded in the proper accounts.

Comparatives – Comparatives in financial statements may present amounts (such as financial position, results of operations, cash flows) and appropriate disclosures of an entity for more than one period, depending on the framework. The frameworks and methods of presentation are as follows:

(a) Corresponding figures where amounts and other disclosures for the preceding period are included as part of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period (referred

to as “current period figures”). These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures.

(b) Comparative financial statements where amounts and other disclosures for the preceding period are included for comparison with the financial statements of the current period, but do not form part of the current period financial statements.

Completeness (Co) assertion – All transactions, events, assets, liabilities and equity interests that should have been recorded have been recorded.

Compliance (CM) assertion – All activities, financial transactions and disclosed information are in accordance with the relevant laws, legislation, regulations and agreements.

Comprehensive basis of accounting – A comprehensive basis of accounting comprises a set of criteria used in preparing financial statements which applies to all material items and which has substantial support.

Computer-assisted audit techniques – Applications of auditing procedures using the computer as an audit tool (also known as CAATs).

Cutoff (Cu) assertion – Transactions and events have been recorded in the correct accounting period.

D

Disclaimer of opinion – A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence to form an opinion and accordingly is unable to express an opinion on the financial statements.

Disclosure (Di), classification and understandability assertion – Financial information is appropriately presented and described, and disclosures are clearly expressed.

Documentation – The material (working papers) prepared by and for, or obtained and retained by the auditor in connection with the

performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.

E

Emphasis of matter paragraph(s) – An auditor’s report may be modified by adding an emphasis of matter paragraph(s) to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph(s) does not affect the auditor’s opinion on whether the financial statements are fairly presented. The auditor may also modify the auditor’s report by using an emphasis of matter paragraph(s) to report matters other than those affecting the financial statements, such as material inconsistency of other information included in the annual report.

Engagement letter – An engagement letter documents and confirms the auditor’s acceptance of the appointment, the objective and scope of the audit, the extent of the auditor’s responsibilities to the client and the form of any reports.

Error – An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

Existence (Ex) assertion – assets, liabilities and equity interests exist and are not fictitious.

F

Fraud – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of intentional misstatement are relevant to the auditor: misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Fraudulent financial reporting – Involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.

G

Going concern assumption – Under this assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or

regulations or otherwise ceasing its existence. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Governance – Describes the role of persons entrusted with the supervision, control and direction of an entity. Those charged with governance ordinarily are accountable for ensuring that the entity achieves its objectives, financial reporting, and reporting to interested parties. Those charged with governance include management only when it performs such functions.

L

Limitation on scope – A limitation on the scope of the auditor’s work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). A scope limitation may also be imposed by circumstances (for example, when the timing of the auditor’s appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity’s accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed desirable.

M

Management fraud – Fraud involving one or more members of management or those charged with governance.

Management representations – Representations made by management to the auditor during the course of an audit, either unsolicited or in response to specific inquiries.

Material inconsistency – Exists when other information materially contradicts information contained in the audited financial statements. A material inconsistency may mislead the user of the financial statements. An emphasis of matter paragraph is added to the auditor’s report to draw the user’s attention to such material inconsistencies.

Material misstatement of fact – Exists in other information when such information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented.

Material weakness – A weakness in internal control that could result in a material misstatement of the financial statements.

Materiality – Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point.

Misstatement – A misstatement of the financial statements that can arise from fraud or error (also see Fraud and Error).

Modified auditor’s report – An auditor’s report is considered to be modified either if an emphasis of matter paragraph(s) is added to the report or if the opinion is other than unqualified.

N

Non-compliance – Refers to acts of omission or commission by the entity being audited, either intentional or unintentional, that are contrary to the prevailing laws or regulations.

O

Occurrence (Oc) assertion – Transactions and events that have been recorded (as well as disclosed) have occurred and pertain to the entity.

Opinion – The auditor’s report contains a clear written expression of opinion on the financial statements as a whole. An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the applicable financial reporting framework (also see Modified auditor’s report).

Other information/Other matters – Financial or non-financial information (other than the financial statements or the auditor’s report thereon) included – either by law or custom – in the annual report.

Overall audit strategy – Sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

P

Planning – Involves establishing the overall audit strategy for the audit and developing an audit plan, in order to reduce the risk of expressing an inappropriate audit opinion.

Q

Qualified opinion – A qualified opinion is expressed when the

Glossary of auditing terms

auditor concludes that an unqualified opinion cannot be expressed due to the effect of any disagreement with management regarding departures from the applicable financial reporting framework/basis of accounting which result in material misstatement of the financial statements or due to the limitation on scope being not so material and pervasive as to require an adverse opinion or a disclaimer of opinion.

R

Rights and obligations (R&O) assertion – The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

Risk assessment procedures – The audit procedures performed to obtain an understanding of the entity and its environment, including its internal control and to assess the risks of material misstatement at the financial statement and assertion levels.

S

Significance – The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner's report; or, as another example, where the context is a judgement about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.

Significant risk – A risk that requires special audit consideration.

Subsequent events – These are two types of events occurring after period-end:

- (a) Those that provide further evidence of conditions that existed at period-end; and
- (b) Those that are indicative of conditions that arose subsequent to period-end.

These conditions can be either favourable or unfavourable.

Substantive procedures – Audit procedures performed to detect material misstatements at the assertion level; they include:

- (a) Tests of details of classes of transactions, account balances and disclosures; and
- (b) Substantive analytical procedures.

Sufficiency – Sufficiency is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the risk of misstatement and also by the quality of such audit evidence.

T

Tests of control – audit procedures performed to obtain audit evidence about the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

U

Uncertainty – A matter outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

Understanding of the entity and its environment –

The auditor's understanding of the entity and its environment consists of the following aspects:

- (a) Industry, regulatory, and other external factors, including the applicable financial reporting framework.
- (b) Nature of the entity, including the entity's selection and application of accounting policies.
- (c) Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements.
- (d) Measurement and review of the entity's financial performance.
- (e) Internal control.

V

Valuation and allocation (Va) assertion – Assets, liabilities and equity interests are included in the financial statements

at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Value-for-money (VM) assertion – A transaction, event, programme, project, part of project, process, etc. promotes the economical acquisition and efficient and effective use of resources.

Introduction

Different aspects of an entity's internal control may affect the audit. Internal control is a process designed and implemented by those charged with governance and management to address risks that may threaten achievement of the entity's objectives, which include the reliability of financial reporting. The PFMA and MFMA require the accounting officer/authority to ensure that the entity has and maintains effective, efficient and transparent systems of internal control, as well as financial and risk management.

As an integral part of the regularity audit, the Auditor-General obtains an understanding of the internal control at the entity and identifies the root causes of matters reported in both management and audit reports, whether due to material misstatements or limitations placed on the scope of the audit. These root causes are directly related to the system of internal control.

There are five components of internal control; each of which is further divided into detailed elements, which are used in this assessment, as described below.

Components of internal control

- The control environment
 - establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.
- The risk assessment
 - involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.
- Control activities
 - policies, procedures and practices that ensure management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

- Information and communication
 - supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows the entity's employees to carry out their financial reporting duties.
- Monitoring
 - covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Detailed elements

Each component of internal control is further divided into a number of elements, as follows:

Control environment

- Organisational structure (framework within which the entity's activities are planned)
- Assignment of authority and responsibility
- Human resources, such as recruitment, training and other practices
- Integrity and ethical values
- Participation by the accounting officer/authority
- Management's philosophy and operating style ("tone at the top")
- Financial reporting competencies

Risk assessment

- Identification of objectives of the entity to be achieved
- Risk identification
- Risk evaluation, i.e. how significant is the risk
- Risk appetite and response
- Fraud risk

Control activities

- Financial, such as authorisation of transactions and segregation of duties
- Information systems
- Operational controls, such as physical controls
- Integration with risk assessment
- Selection and development of control activities
- Policies and procedures
- Performance measurement and reward for employees to encourage high standards

Information and communication

- Financial reporting information, such as origination of transactions and processing of information
- Internal control information
- Internal communication

Monitoring

- Ongoing monitoring, such as regular management and supervisory activities built into the normal, recurring activities of an entity
- Separate evaluations, such as specific evaluations of critical processes, either as self-assessment or reviews by third parties
- Reporting deficiencies

Communication in the audit process

Those charged with governance

The persons (not necessarily a natural person) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. This may include some executive members of management.

Key role players
at an entity

Management

The persons who have executive responsibility for the conduct of the entity's operations.

Audit process and key communication phases

