Lisbon School of Economics & Management
Universidade de Lisboa

Master in Accounting

Advanced Auditing

Telmo Francisco Vieira

(CPA & STATUTORY AUDITOR)

2025/2026

PROFESSOR

Telmo Vieira

- Prof. at ISEG / Univ. de Lisboa
- Certified Public Accountant (CPA) and Statutory Auditor
- President of the Supervisory Board of a bank – Banco BNI EUROPA
- Managing Partner at PremiValor Consulting
- Former Manager at PWC in Corporate Finance department (PT & UK)
- Specialist in Mergers & Acquisitions
- Coordinator of the:

  H - INNOVA HEALTH INNOVATION HUB

  INNCYBER INNOVATION HUB

  H2O & SUSTAINABILITY INNOVATION HUB

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Telmo Vieira

- Coordinator of the Cybersecurity Executive Program at Faculty of Sciences of Lisbon University (FCUL)
- Mentor and Investor on STARTUPS
- Loves sports: tennis, bicycle, skate, longboard, driving 4x4
- Enjoys travelling and explore new places and cultures

➢ Management Consulting and M&A Deal Support Across Key Locations:

Lisbon | London | Madrid | San Francisco | São Paulo | Warsaw

COURSE SYLLABUS

N.º	Subject
1	Introduction
1.1	Course Objectives
2	Financial Auditing
3	Audit reports
4	Professional regulation
5	Audit pillars: materiality, risk and evidence
6	Audit path
7	Client acceptance and acceptance of the commitment
8	Audit planning
8.1	Business knowledge and assessment of the risks of material misstatements
8.2	Internal control system
9	Additional audit procedures and misstatement evidence
10	Assessment and Audit Report

BIBLIOGRAPHY

- ✓ Arens A. A., Elder R. J., Beasley M. S. e Hogan, C. E. (June 12, 2023), *Auditing and assurance services – An Integrated Approach (Global Edition),* **18th Ed**., Pearson, ISBN 9781292448985

- ✓ Arens A. A., Elder R. J., Beasley M. S. e Hogan, C. E. (January 30, 2023), *Auditing and assurance services – An Integrated Approach ,* **18th Ed**., Pearson.

- ✓ Almeida, Bruno José Machado (2022), Manual de Auditoria Financeira - Uma Análise Integrada Baseada no Risco, **4.ª edição**, Escolar Editora,

- ✓ Arens A. A., Elder R. J., Beasley M. S. e Hogan, C. E. (2017), *Auditing and assurance services (Global Edition),* **16th Ed**., Pearson.

- ✓ Almeida, B. (2017), *Manual de Auditoria Financeira*, 2.ª edição, Editora Escolar,

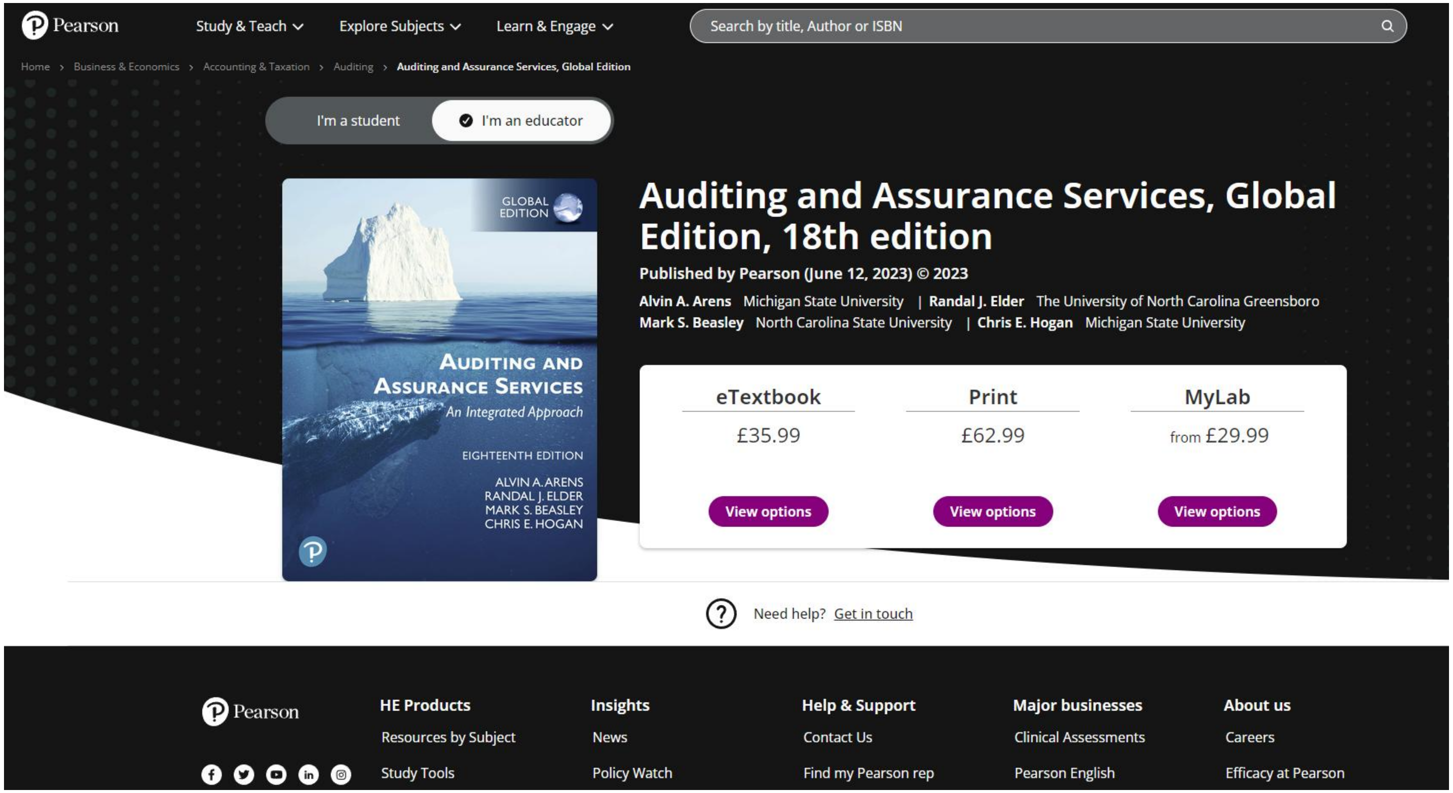
- ✓ Costa, Carlos B. (2017), *Auditoria financeira – teoria e prática*, 11.ª edição, Rei dos Livros.

- ✓ Hayes, R., Gortemaker, H. e Wallage, P. (2014), *Principles of Auditing: An Introduction to International Standards on Auditing*, 3rd Ed., Prentice-Hall.

- ✓ Johnstone, K. M., Gramling, A., e Rittenberg, L. E., (2019), Auditing: a risk based-approach, 11th edition, Cengage Learning.

BIBLIOGRAPHY

Key Textbook for the Course

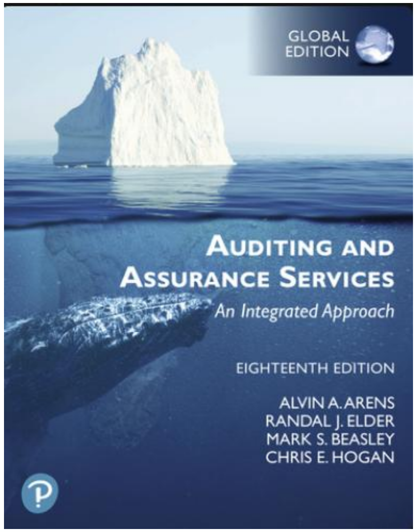


ISBN-13: 9781292448985

Auditing and Assurance Services, Global Edition

Published June 12, 2023

Pearson Education Limited



https://www.pearson.com/en-gb/subject-catalog/p/auditing-and-assurance-services-global-edition/P200000009899/9781292449104

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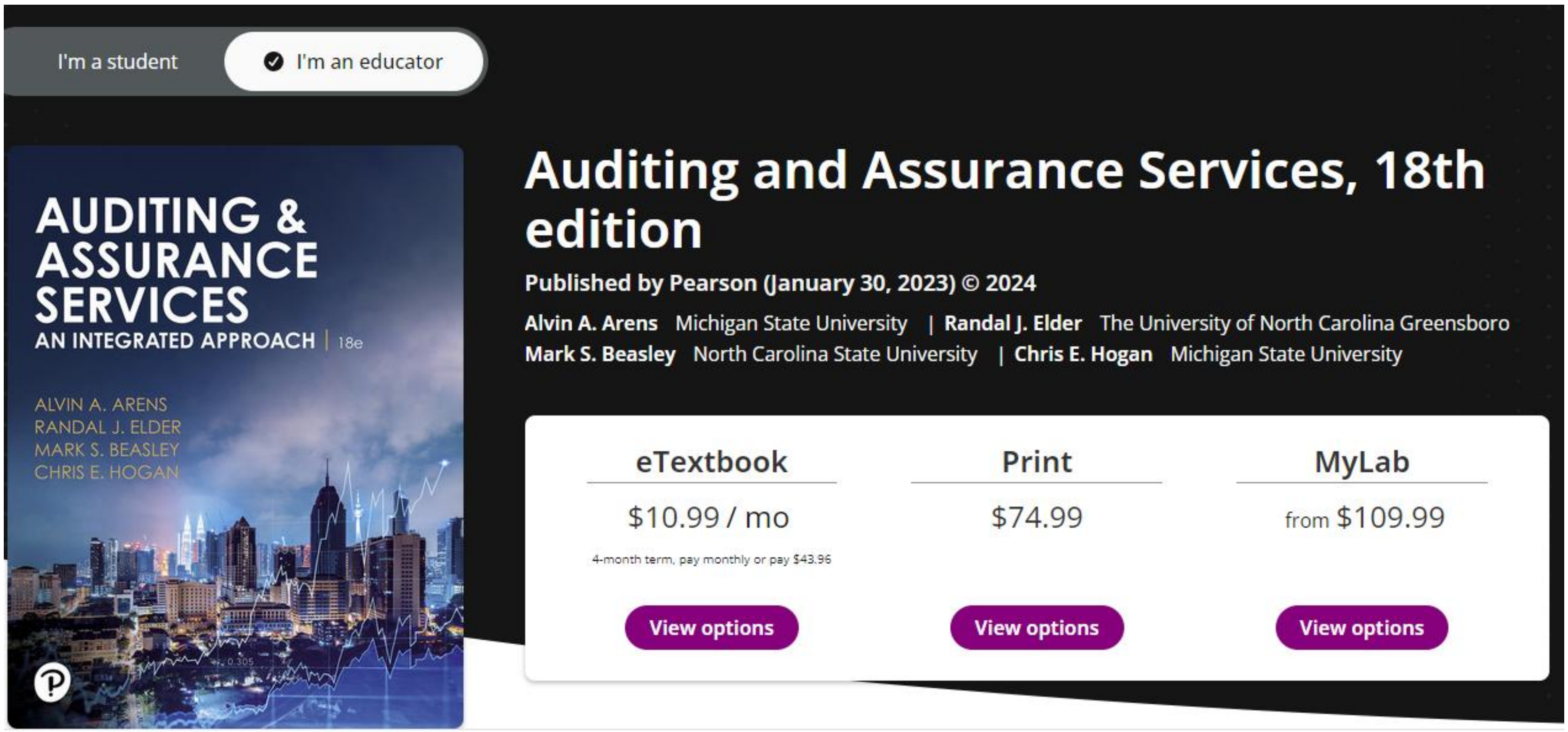


https://www.pearson.com/en-us/subject-catalog/p/auditing-and-assurance-services/P200000010148/9780138103064

EVALUATION

The maximum final grade is 20 which is calculated as follows:

❖ 1st Sitting (**Continuous evaluation)**

✓ Class Participation and Case Study Analysis – 15%

✓ Group work (3 to 5 students) – 25%

✓ Written Individual Exam (1st Sitting) – 60%

Note 1: The exam is closed-book. No consultation of elements allowed.

Note 2: To obtain final approval in the course, students must achieve a minimum grade of 7.5 out of 20 in the 1st Sitting exam.

❖ **2nd Sitting**

Written Individual Exam (**2nd Sitting) -** 100%

EVALUATION

Group work

<u>Assignment</u>: Analysis of a scientific paper that focus on issues that are related to course topics. Assignment should answer the following questions:

- What is the research problem / question being analyzed in the paper?
- What is the econometric model adopted on the paper?
- What are the dependent variable(s) and explanatory variables?
- What are the main conclusions of the study?
- Why is this paper important to auditors and what are the main implications of this study for the profession?
- Clues for future research.

15 minutes presentation in class

IMPORTANT DATES

- ✓ Delivery and discussion of group work assignment: October **28th**, 2025
- ✓ Written exam of the regular assessment period: **December 4th**, 2025, at 09:00
- ✓ Written exam of retake assessment period: **January 5th**, 2026, at 09:00

1. Introduction

Late 20th century and early 21st century is being marked by events that brought Auditor profession to the spotlight: financial scandals, **Arthur Andersen** bankruptcy, pressure for **separation between of consulting and auditing activities**, auditor rotation, **Sarbanes-Oxley Act** of 2002, Directive 2006/43/CE, Regulation (EU) n.º 537/2014 and Directive 2014 /56/EU of European Parliament and Council, new statutes of the **Portuguese Institute of Statutory Auditors (OROC)** – Ordem dos Revisores Oficiais de Contas (Law 140/2015, of 7/9), legal framework of audit supervision and its code of ethics, etc.

On the other hand, auditing is a discipline that intersects with several fields of management, including **taxation, company law, ethics, accounting, statistics**, and **finance**, and more recently, **artificial intelligence** and **cybersecurity**. These connections have contributed to a growing academic interest in the study and investigation of audit-related topics.

1. Introduction

Case Study a.

Based on public information provide 3 recent examples of financial scandals.

Prepare a presentation to share with colleagues.

1. Introduction

❖ Examples of commited fraud

Enron

1. Used *special-purpose entities* (SPE) to decrease their responsibilities and to count **artificial income** for either SPE either Enron.
2. Contracts lasting for several years were accounted for in the first year, reducing costs and oversizing income.

WorldCom

1. **Current expenditures** were accounted as **investments** (with this they transformed the losses they indeed had into profits).
2. **Very large amount of loans** to top executives were not paid by them.

Tyco

1. **Manipuled the accounts** to show high profits.
2. **Non-approved loans** to top executives (these executives used company's money to buy personal property and other assets).

1. Introduction

❖ Studies regarding fraud

Other fraud examples were studied by **Agrawal, Jaffe, and Karpoff (1999)**.

They identified **103 companies** accused of **fraud** present at Wall Street Journal Index between 1981 and 1992. They have also established 103 control companies whose code of economic activity and net sales were similar to that of companies with fraud.

- The companies that were part of fraud's companies sample had significatively more fraud than the ones of the control group in the 2 years before and 2 years after regarding the year of the key event for the study.
- The differences in operating performance around the event of fraud were not statistically different between two groups.

Regarding management rotation they "**didn't find evidence that fraud revelation leads to a subsequent alteration in the leadership structure**" – in the cases which CEO and Chairman are the same person.

They also evaluated the rotation for the tree top positions and the alterations remain non-significant between companies in fraud situation and the ones in the control group.

❖ Studies regarding fraud

During the year of the fraud event, and in the 3 following years, the companies in fraud situation reduce slightly their executive board, reducing simultaneously their internal and external members; on the other hand, the companies in the control group increased slightly their executive board (but not significatively).

- **The authors conclude that the reduced impact from reported frauds in the study may reflect the favorable economic and finantial characteristics for the period 1981-1992.**

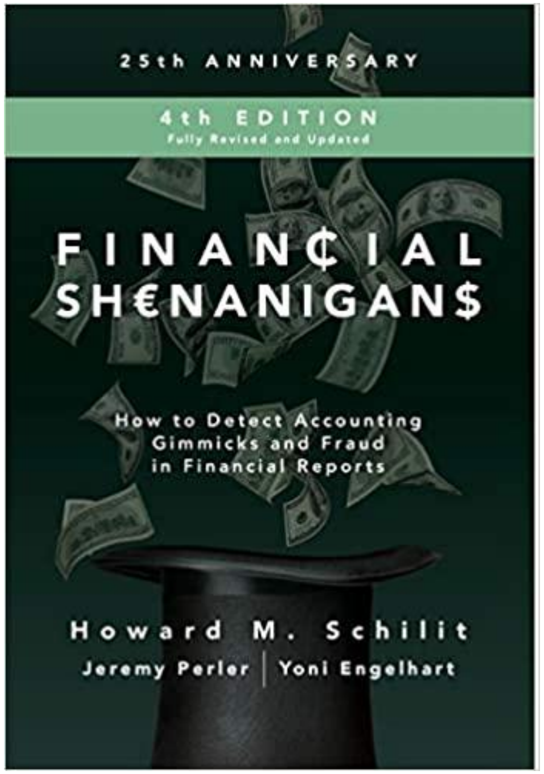
1. Introduction

❖ Some books about corporate fraud

Howard Schilit published in 1993 the first edition of his book: "***Financial Shenanigans in 1993***".

Created an analysis and research center (CFRA) to detect early warning signs in relation to operational problems or accounting "anomalies". In the 2002 edition of his book, he mentions **30 techniques of financial "cheating"** defined as practices that intentionally distort the financial situation or performance reported by a company.

In 2002, a similar book with many other examples was published by Mulford and Comiskey.



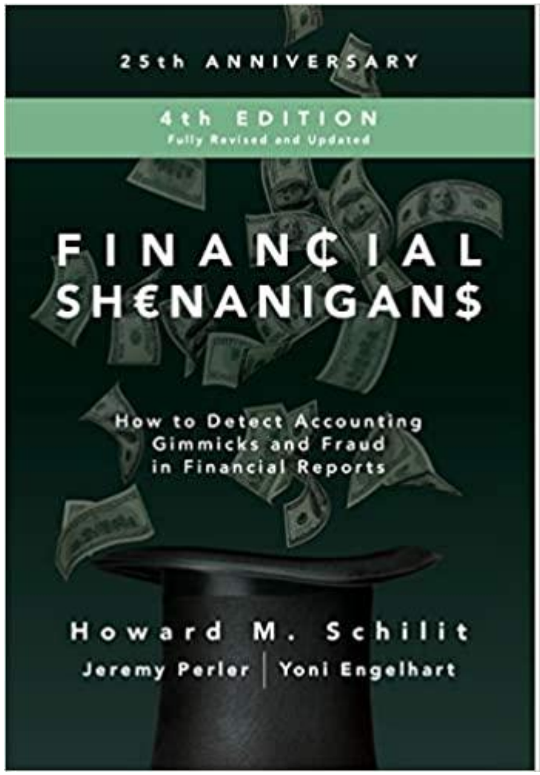
2018 edition

ISBN-13: 978-1260117264
ISBN-10: 126011726Xpj v

These disclosures have **caused outrage** and resulted in **Sarbanes-Oxley Act** (SOA) in July 30th, 2002.

1. Introduction

❖ Some books about corporate fraud



2018 edition

ISBN-13: 978-1260117264
ISBN-10: 126011726Xpj v

Contents

1. Introduction

❖ Sarbanes-Oxley Act

The **Sarbanes-Oxley Act** covers 11 main areas:

1. **PCAOB – Public Company Accounting Oversight Board**

PCAOB is a private nonprofit entity subjected to the regulation and supervision of the SEC.

This organization is responsible for the **supervision of the audit** listed companies and the establishment of standards for audit reports. All audit firms must be registered in the PCAOB.

All companies must report to its audit committee is composed of at least one member who is financial expert under the SEC definition.

1. Introduction

❖ Sarbanes-Oxley Act (cont.)

2. Auditor independence:

- **Audit** firms are prohibited to providing non-audit services such as **consulting.**
- The Audit Partner should rotate at least **each 5 years**.
- **Audit reports** should be directed to the **audit committee** rather than to the management body.
- The auditing firm should not have employed an accounting or financial responsible of the audited company during the period of one year before the audit.

1. Introduction

❖ Sarbanes-Oxley Act (cont.)

3. Certification: The CEO and CFO must be sure that the report is according the SEC requirements and properly presents the financial position of the company (making false statements gives rise to a **prison sentence between 10 and 20 years**);

4. Disclosures: Each annual and quarterly report prepared in accordance with those norms SEC has to disclose all material **off-balance-sheet transactions**.

5. Insider trading: *Insider trading* with the stocks of the company in which they work is considered an event subject to disclosure that must be reported in a *Form 4 within a period of 2 days (*previously was until the 10th day of the month following the realization of the transaction).

6. Conflict of interests: Personal loans are prohibited by companies to administrators and directors;

1. Introduction

❖ Sarbanes-Oxley Act (cont.)

7. Professional responsibility: New regulations establish minimum standards of professional conduct regarding **lawyers** who practice their activity in entities supervised by SEC.

8. Studies and Reports: Must be conducted several studies.

9. Fraud accountability: The elimination, alteration or falsification of registrations is a **crime**.

10. Sanctions: All audit or work papers must be kept for **5 years**. False certifications or reports forgery must result in fines until **5 million dollar** and/or **prison until 20 years**.

11. Authority of SEC: Everyone who had violated the antifraud norms may be prohibited of exercise administrative or management positions.

1. Introduction

Case Study b.

b.1) Search for **Audit proposals** from Audit firms as for example from the **Big 4 firms**.

(to be presented in next class)

Try to find proposals related to European countries or the United States.

b2) From the client's perspective, beyond the standard execution of the **audit assignment**, what **additional aspects** can contribute to creating value for the client's organization?

1. Introduction

Case Study c.

Conduct a preliminary literature search to identify **two to three recent**, peer-reviewed academic articles on **corporate financial fraud** (preferably published within the last five years).

For each article, prepare a 3 to 4 slide PowerPoint summary covering:

(i) research question and context,

(ii) data and methodology,

(iii) key findings and contributions,

(iv) limitations and implications for practice

(to be presented in next class)

1. Introduction

The exercise of functions related to the area of Accounting / Finance requires an understanding of the **audit process**, namely a knowledge of the **methodology** and the ethical implications of the decisions made by the auditor.

The objective of the course is to provide its participants with fundamental skills for a correct application of the **audit methodology**, focusing on the **standards**, **principles** and **practical aspects** of daily life of auditors.

1. Introduction

The topics covered are basic topics for a student who wants to start a career as an auditor.

But also, for any student of the 2nd cycle of Bologna who is interested in auditing companies from an internal or external perspective.

Critical analysis and **communication skills** will be developed through a **case-based discussion** forum and **exercises** that will allow addressing some of the themes exposed in the various sessions.

1.1. Course Objectives

At the end of the course, participants should be able to:

- Understand the **concept of Audit** and the **role of the Auditor**;
- Know some professional **regulation** of the activity of the **Chartered Accountants / Statutory Auditors**;
- Understand how to develop and analyze the **audit evidence** necessary to support the auditor's opinion;
- Know the different **phases** that make up the **auditing process**;
- Recognize the scope of the **different types of opinion** established in the **auditing standards** and be able to prepare the appropriate **final report.**

Example of an evaluation table of Auditors 'proposals concerning audit services

1. Introduction

Importance of information

- Power of information

It is widely accepted that knowledge has become the main force of production in recent decades. In the form of an informational commodity indispensable for a productive power, knowledge is already, and will continue to be, the main - perhaps the main - tool in the world competition for power.

Jean François Lyotard (La Condition Postmoderne: Rapport sur le Savoir, 1979)

- Reliable information

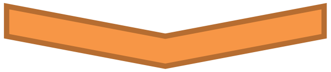
The truth is not simply what we think it is; it is also the circumstances in which it is said, and by whom, why and how it is said.

Václav Havel (Disturbing the Peace - A Conversation with Karel Hvizdala, 1990)

1. Introduction

- Agency Theory (Jensen & Meckling, 1976)

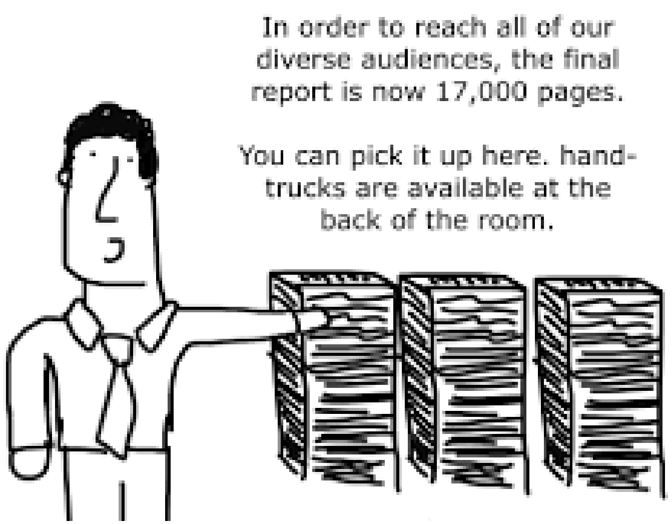
Information asymmetry



Companies prepare information to provide to third parties

1. Introduction

- Duty of accountability



"I like the creative way you manipulate reality. You may be just the man we need to write our corporate annual reports."

1. Introduction

Duty of accountability

Article 65.º CSC – Duty to report

1) The members of the board of directors shall prepare and submit to the competent bodies (General Assembly) of the company the management report, including the non-financial statement or the separate report with this information (if applicable), **the accounts for the financial year** and the other accounting documents provided for by law, for each annual financial year.

2) The preparation of the management report, including the non-financial statement or the separate report (if applicable), **the accounts for the financial year** and the other accounting documents **must** comply with the provisions of the law; the shareholders agreement may supplement, but not derogate from, those legal provisions.

5) The management report, the separate report with the non-financial information (if applicable), **the accounts for the financial year** and other accounting documents must be submitted to the competent body and assessed by it, except in special cases provided for by law, within **three months** of the closing date of each annual financial year, or within five months of the same date in the case of companies which must submit consolidated accounts, or which apply the equity method.

1. Introduction

✘ Duty of accountability

Article 66.º-A CSC – Notes to the accounts

1) Information on the fees invoiced by the Statutory Auditor (ROC)
2) Information on operations with related parties

Article 66.º-B CSC – Non-financial statement (for large companies)

1) Information on environmental, social and worker-related issues, equality between women and men, non-discrimination, respect for human rights, combating corruption and money laundering.

4) The non-financial statement referred to in paragraph 1 shall also include, where appropriate, a reference to the amounts shown in the annual financial statements and additional explanations of those amounts.

1. Introduction

Duty to accounts for issuers with listed securities

Yearly Accounts	Semester Accounts
Annual Report and Accounts • Management report, annual accounts, legal certification of accounts and other accounting documents required by law or regulation; • Report prepared by the auditor; • Statement by the management body that the accounts comply with accounting standards and the management report accurately describes the business and **main risks**; Annual Corporate Governance Report	After a maximum of 3 months from the end of the 1st semester: • Condensed financial statements; • Interim management report; • Statement by the management body that the accounts comply with the accounting standards and the management report faithfully describes the business and the main risks.

Audited information – art.º 8. CVM

- Annual Accounts
- Where the quarterly or half-yearly information has been subject to audit or limited review, the audit or review report shall be included or, if it has not been, this shall be stated.

1. Introduction

Financial statements

Financial statements arise from a series of patrimonial facts that occurred in the life of an entity in each period, and which are reported through the following charts:

Microentities	Small companies	Other companies
• Balance Sheet • Income Statement by Nature • Optional: - Apendix/notes, - Statement of changes in equity - Cash flow Statement	• Balance Sheet • Income Statement by Nature • Apendix/notes • Optional: - Statement of changes in equity - Cash flow Statement	• Balance Sheet • Income Statement by Nature • Statement of changes in equity • Cash Flow Statement • Apendix/notes

1. Introduction

- Main accountability challenge

Quality of information

How users of financial information are assured that the information provided is sufficient, appropriate, transparent and credible?

1. Introduction

✘ Information risk

- There are countless stories of fraudulent financial reporting

Brennan, N. M., & McGrath, M. (2007). FINANCIAL STATEMENT FRAUD: SOME LESSONS FROM US AND EUROPEAN CASE STUDIES. Australian Accounting Review, 17(2), 49-61.

1. Introduction

✘ Information risk

- Parliamentary Inquiry Committee into BES and GES

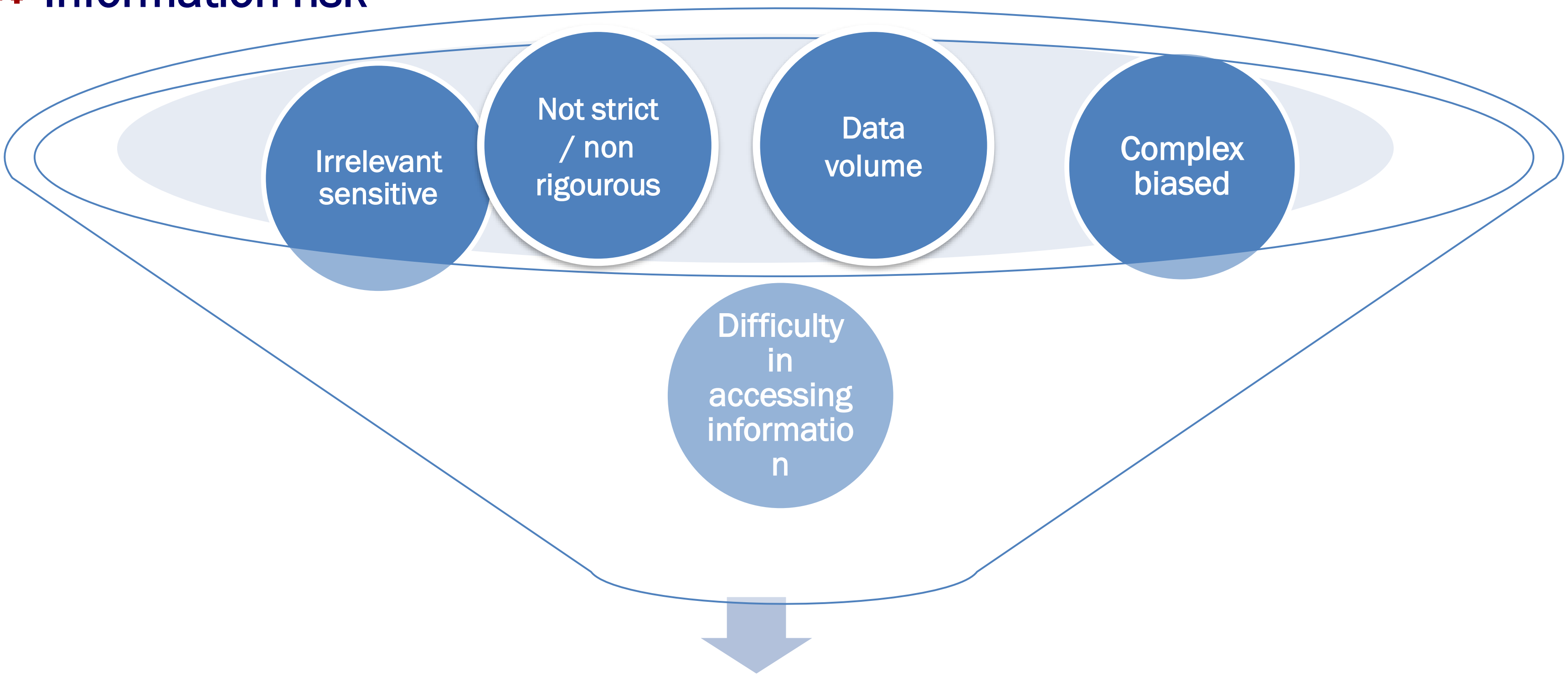
Bank of Portugal

✓ *I speak from experience, if someone wants to cheat the **supervisor** cheats and hides* (Fernando Teixeira dos Santos, former Finance Minister)

✓ *When someone really wants to deceive someone, they deceive* (Machado Pereira, Statutory Auditor (ROC) of some companies of the Group)

1. Introduction

✖ Information risk



Quality of information?

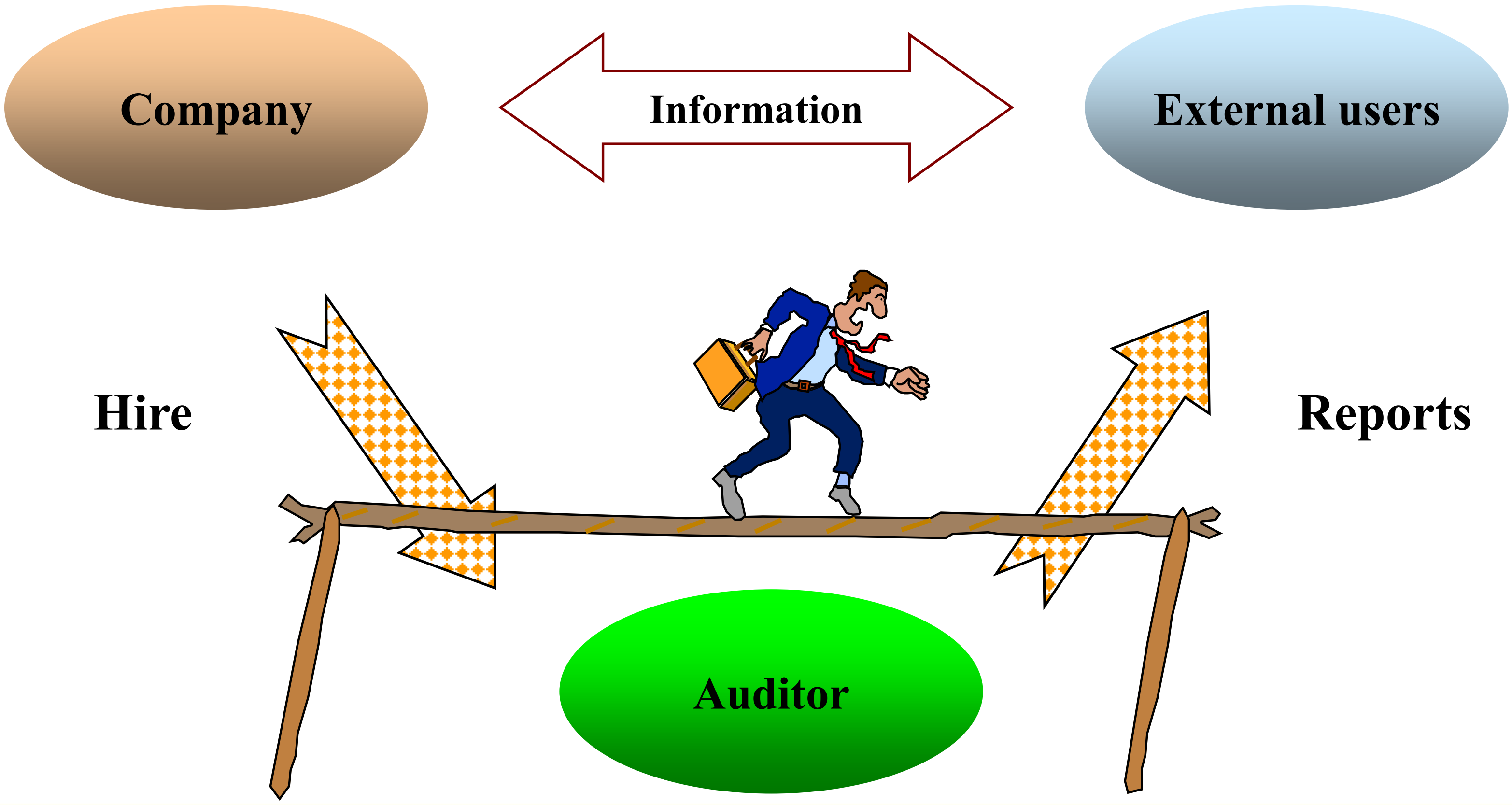
1. Introduction

Implications of information risk

In 1995, Robert Elliott (KPMG partner) indicates that the cost of capital of an American company is broken down into 3 tranches:

2. Financial Auditing

- Auditor's role: contributing to the Financial Statements credibility



2. Financial Auditing

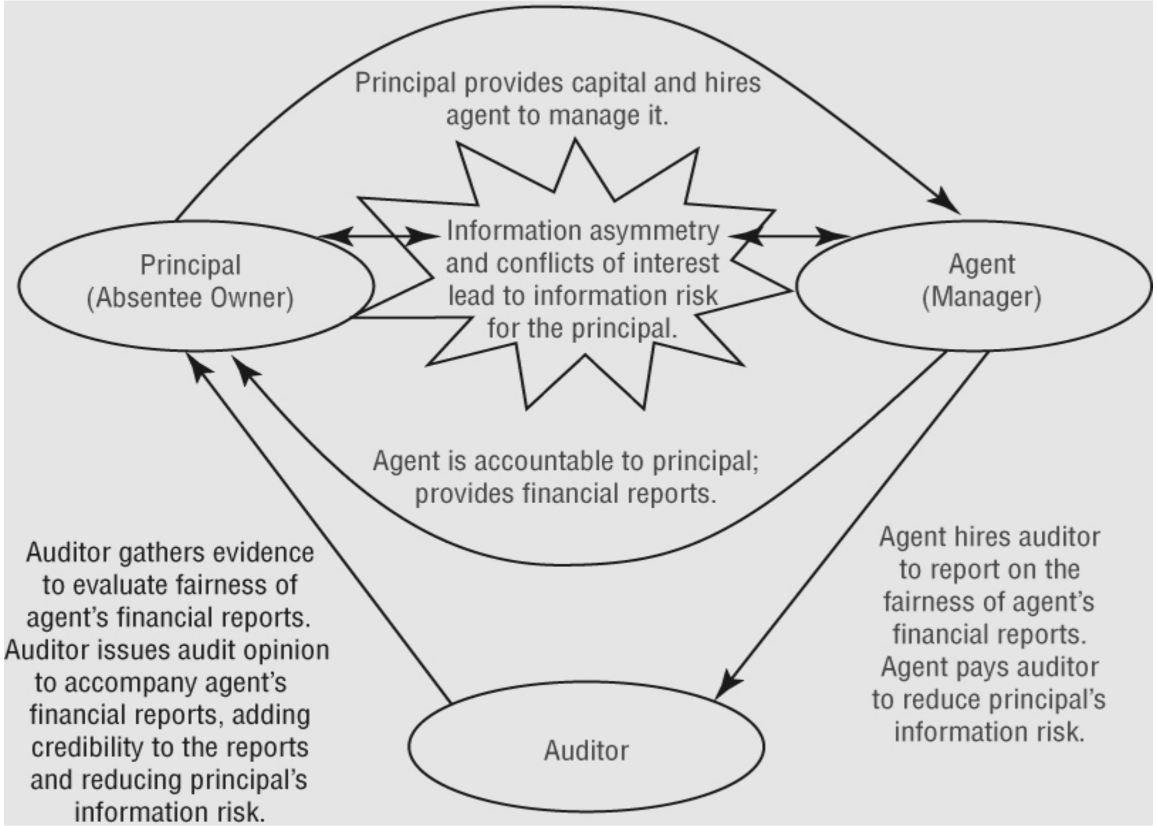
- **Auditor's role - special function in the company**

By certifying the public reports that collectively depict a corporation's financial status, the ***independent auditor*** *assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's* ***creditors*** *and* ***stockholders****, as well as to the* ***investing public****. This public watchdog function demands …. complete fidelity to the* ***public trust****.*

Chief Justice Warren Burger (US Supreme Court)

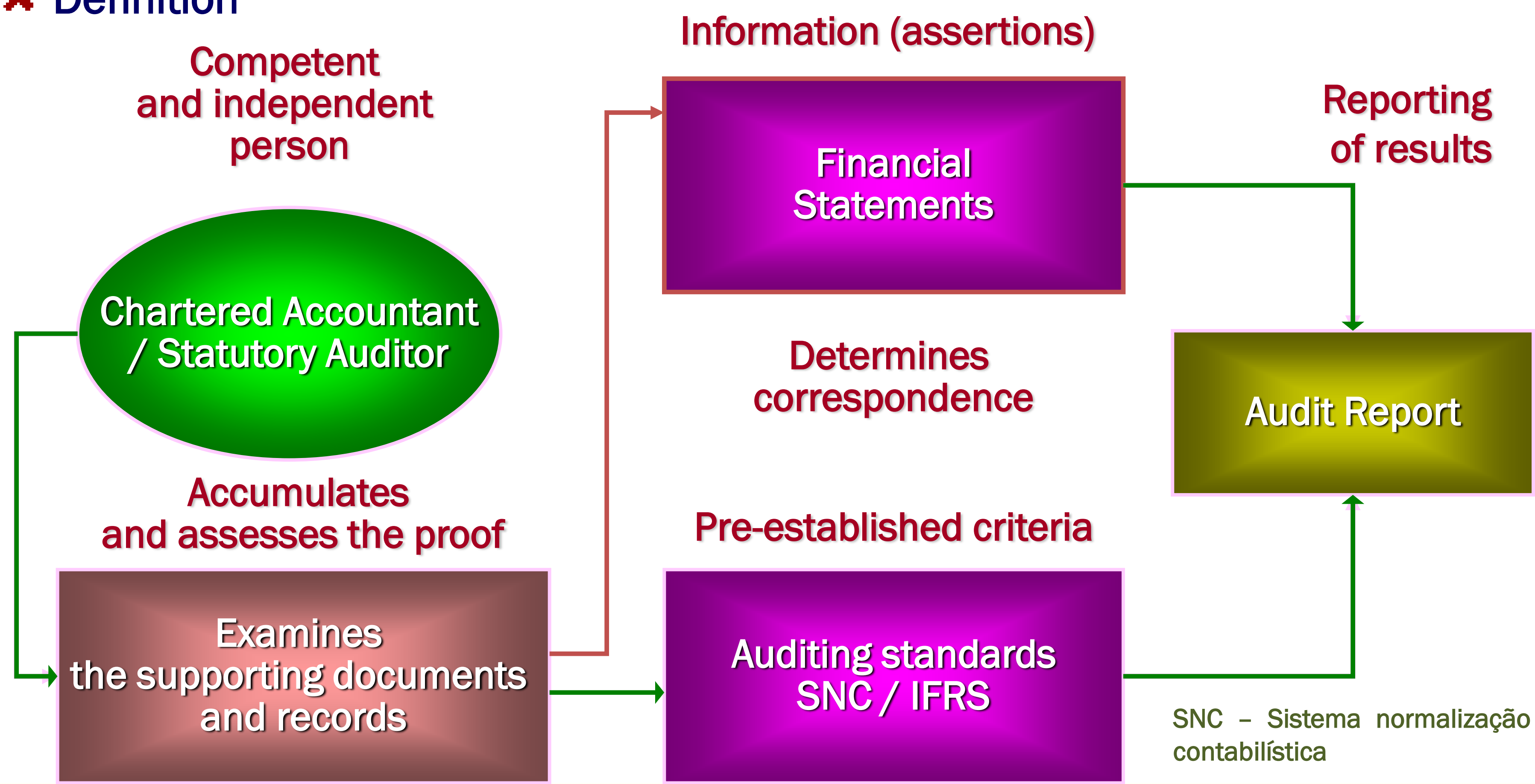
2. Financial Auditing

- What is the justification for the existence of an audit?



2. Financial Auditing

- Definition



SNC – Sistema normalização contabilística

2. Financial Auditing

- Overview

Fonte: https://www.youtube.com/watch?v=aztSsS6GYYw

2. Financial Auditing

Overview

The public interest function of statutory audit means that a wide range of people and institutions rely on the quality of the work of statutory auditors or audit firms.

Good audit quality contributes to the orderly functioning of markets by improving the integrity and efficiency of financial statements.

Statutory auditors thus play a particularly important social role.

Preamble of the Regulation (EU) N.º 537/2014 of the European Parliament and Council, from April 16th, 2014

2. Financial Auditing

Auditor's responsibility

Auditor

- Responsible for the audit report and the opinion issued
- Duties to report to the supervisory board / fiscal board and competent authorities - Art. 63, 79 and 81 EOROC

Administration

- Is responsible for adopting adequate accounting policies and an internal control system, as well as for presenting and preparing the financial statements.

Consequences:

- Chartered accountant / Statutory Auditor (ROC) is jointly and severally liable to the company and stakeholders for any damage caused to them by their wrongful conduct – n.º. 1 of art. 78 CSC
- Chartered accountant / Auditor (ROC) is liable to creditors for culpable failure to comply with legal or contractual provisions designed to protect them, and the assets become insufficient – n.º. 2 of article 78 CSC
- For deficiencies in the report or opinion, the Chartered accountant / Auditor (ROC) is jointly and severally liable for damages caused to issuers or third parties – n.º 1 of article 10 CVM

2. Financial Auditing

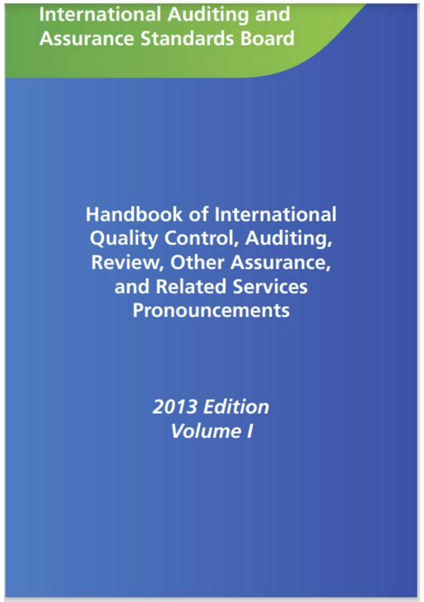
- **Auditor's general objectives – ISA 200 (§11 e 12)** International Standards on Auditing*
  - When conducting an audit of financial statements, the **general objectives of the auditor** are:
    - Obtain reasonable assurance as to whether the FS **as a whole** are free of material misstatement, either due to fraud or error, thus enabling to express an opinion on whether the financial statements are prepared, in all material respects, according to an applicable financial reporting framework; and
    - Reporting on the financial statements according to its conclusions.

In all cases where reasonable assurance of reliability cannot be obtained and a qualified opinion is insufficient in the circumstances for reporting to users, **International Standards on Auditing** (ISA) require the auditor to give an excuse of opinion or to resign from work, when such a resignation is possible under applicable law or regulation.

2. Financial Auditing

- **International Standards on Auditing** (**ISA**) are professional standards for the auditing of financial information. These standards are issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board **(IAASB).**
- ISA guides the auditor to add value to the assignment hence building confidence of investors.

International Federation of Accountants
529 Fifth Avenue,
New York, NY 10017 USA



2. Financial Auditing

✘ Requirements to perform an audit– ISA 200

Comply with relevant ethical requirements

Plan and execute an audit with professional skepticism

Exercise professional judgment when planning and executing an audit

Obtain sufficient and appropriate audit evidence to reduce audit risk to an acceptable low level

Conduct the audit in accordance with applicable auditing standards

2. Financial Auditing

- Requirements to perform an audit– ISA 200

  - ✓ **Professional Judgement**

    Auditors add value to users by making quality decisions associated with their assessment of the client's financial statements. Quality decisions are impartial, meet users' expectations, comply with professional auditing standards, and are based on sufficient factual information to support the decision that is made.

↓

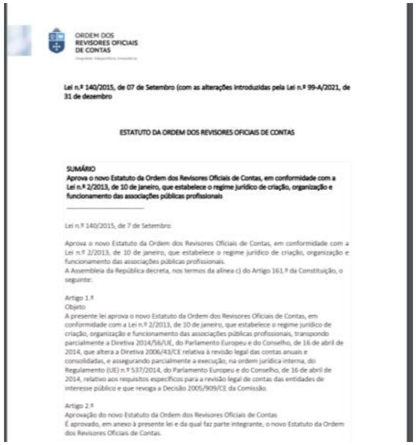
A well-structured decision process is fundamental

2. Financial Auditing

✘ Requirements to perform an audit– ISA 200

✓ Professional Skepticism (art. 70 EOROC)

- An attitude that includes an **interrogative mind**, characterized by **doubt** and a **critical spirit** that is alert to conditions that may indicate a possible misstatement due to error or fraud, and a critical appreciation of the evidence.



ORDEM DOS REVISORES OFICIAIS DE CONTAS

Lei n.º 140/2015, de 07 de Setembro (com as alterações introduzidas pela Lei n.º 99-A/2021, de 31 de dezembro

ESTATUTO DA ORDEM DOS REVISORES OFICIAIS DE CONTAS

SUMÁRIO
Aprova o novo Estatuto da Ordem dos Revisores Oficiais de Contas, em conformidade com a Lei n.º 2/2013, de 10 de janeiro, que estabelece o regime jurídico de criação, organização e funcionamento das associações públicas profissionais

Lei n.º 140/2015, de 7 de Setembro

Aprova o novo Estatuto da Ordem dos Revisores Oficiais de Contas, em conformidade com a Lei n.º 2/2013, de 10 de janeiro, que estabelece o regime jurídico de criação, organização e funcionamento das associações públicas profissionais.
A Assembleia da República decreta, nos termos da alínea c) do Artigo 161.º da Constituição, o seguinte:

Artigo 1.º
Objeto
A presente lei aprova o novo Estatuto da Ordem dos Revisores Oficiais de Contas, em conformidade com a Lei n.º 2/2013, de 10 de janeiro, que estabelece o regime jurídico de criação, organização e funcionamento das associações públicas profissionais, transpondo parcialmente a Diretiva 2014/56/UE, do Parlamento Europeu e do Conselho, de 16 de abril de 2014, que altera a Diretiva 2006/43/CE relativa à revisão legal das contas anuais e consolidadas, e assegurando parcialmente a execução, na ordem jurídica interna, do Regulamento (UE) n.º 537/2014, do Parlamento Europeu e do Conselho, de 16 de abril de 2014, relativo aos requisitos específicos para a revisão legal de contas das entidades de interesse público e que revoga a Decisão 2005/909/CE da Comissão.

Artigo 2.º
Aprovação do novo Estatuto da Ordem dos Revisores Oficiais de Contas
É aprovado, em anexo à presente lei e da qual faz parte integrante, o novo Estatuto da Ordem dos Revisores Oficiais de Contas.

➢ The auditor should plan and perform an audit with professional skepticism recognizing that there may be **circumstances/situations** that cause the **financial statements to be materially misstated**.

EXERCISE: Indicate some possible cases of some of these circumstances

2. Financial Auditing

EXERCISE

Please indicate some possible cases of some of these circumstances/situations, mentioned before, that may cause the financial statements to be materially misstated.

EXERCISE

Analyse the last accounts report published by Enron

2. Financial Auditing

- **Requirements to perform an audit– ISA 200**
  - ✓ Effect of the absence of skepticism and apropriate professional judgment

KPMG LLP served as the external auditor for some of the largest subprime mortgage lenders in the United States leading up to and during the housing market crisis of the mid-2000s. The audits of two of their largest lending clients, New Century Financial Corporation and Countrywide, ultimately led the firm to settle litigation charges in 2010 for $44.7 million and $24 million, respectively. The business model of these two subprime mortgage lenders consisted of providing loans to borrowers with weak credit histories. The business model had begun to fail during a short period of time in 2007, when the economy weakened, borrowers began defaulting, and home prices declined drastically. New Century filed for bankruptcy and Countrywide was purchased by Bank of America, which subsequently suffered massive losses related to business failures at Countrywide.

Just before the housing crash of 2007 put the companies in severe financial crises, KPMG had given both companies unqualified audit opinions. In both cases, KPMG was subsequently accused of violating professional standards, lacking independence, and being negligent. KPMG defended itself by arguing that its audits were not the cause of the financial woes at New Century and Countrywide. Rather, the firm contended that it was the failed business model of the two companies that led to investor losses. As you read through this chapter, consider the following questions:

- How does the business environment affect the litigation risk faced by audit firms? (LO 1)
- Should auditors be held liable when their client's business fails or its financial statements contain a fraud that the auditors did not detect? (LO 2)
- What defenses do auditors use in response to litigation? (LO 3)
- What actions can auditors take to minimize litigation exposure? (LO 3, 4, 5, 6)

Source: Johnstone, K. M., Gramling, A. e Rittenberg, L. E., (2014), Auditing: a business risk approach, 9th edition, Cengage.

2. Financial Auditing

- **Services provided by auditors**

Exclusive competence of the Chartered Accountant / Statutory Auditor (ROC) (Article 41 + 42 + 45) - Functions of Public Interest

- Audit of the accounts
  - Statutory audit - derives from the law or from the statutes (CLC*)
  - Voluntary review - derives from contract (Audit Report)
  - Services related to the previous two - when they have a specific or limited purpose or scope.
- Other functions where the law requires the intervention of the Chartered Accountant / Auditor (ROC)

Other functions that may be performed by the Chartered Accountant / Auditor (ROC) (Article 48)

- Lecturing
- Members of audit committees and supervisory or oversight bodies of companies or other entities
- Consultancy and other services in the scope of matters inherent to their professional training and qualification
- Insolvency Administrator

* CLC – Certificação Legal de Contas

2. Financial Auditing

✘ Services provided by auditors

Entities subject to audit/revision of accounts

- Resulting from legal, statutory or contractual provision
- Have organized accounts and meet the requirements set out in n.º 2 of Article 262 of the CSC (exceed 2 of the 3 limits in 2 consecutive years):
  - Balance sheet: 1.500.000€
  - Sales and other revenues: 3.000.000€
  - Number of employees: 50

Exercise: Conduct a search of the thresholds for other countries than Portugal

3. Audit Report

Audit Report (ISA 700, 701, 705, 706, 720)

Unchanged opinion (clean opinion)

Modified opinion

Limitation of scope:

- Client's imposition or other circumstances
- Absence of financial statements

Qualified opinion with reserve(s) – opinião qualificada com reserva(s)

Refuse of opinion (escusa opinião)

Disagreement SNC/IFRS:

- Recognition
- Measurement
- Disclosure

Qualified opinion with reserve(s)

Adverse opinion

Declaration of inability/impossibility to report

3. Audit Report

✘ *Selection of the modified opinion (ISA 705)*

Nature of the matter that gives rise to the modification	Auditor's judgment on the depth of the effects or possible effects on the Financial Statements **Material but not deep** misstatements - Distorções materiais, mas não profundas	**Material and deep** misstatements – distorções materiais e profundas
FS are materially misstated	Opinion with reservations (by disagreement)	Adverse opinion
Inability to obtain appropriate and sufficient evidence	Opinion with reservations (by limitation of scope)	**Refuse of opinion (escusa opinião)**

3. Audit Report

- *Unqualified opinion (ISA 700*) – opinião limpa*

LEGAL CERTIFICATION OF ACCOUNTS / AUDIT REPORT

Report on the audit of financial statements

- § Opinion

We have audited the accompanying financial statements of XPTO, S.A., which comprise the balance sheet as at 31/12/2022 (showing a total of .... euros and total equity of .... euros, including a net profit of .... euros), the income statement by nature, the statement of changes in equity and the cash flow statement for the period then ended, and the notes to the financial statements that include a summary of significant accounting policies.

*In our opinion, the attached financial statements present in a **true and fair way,** in all material aspects, the financial position of XPTO, S.A. as of 12/31/2022 and its financial performance and cash flows for the period ending on that date in accordance with the Accounting and Financial Reporting Standards adopted in Portugal through the Accounting Standards System - Sistema de Normalização Contabilística (PT).*

*** (ISA) 700 (REVISED), FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS**

3. Audit Report

✘ *Unqualified opinion (ISA 700)*

✘ § Basis for the opinion

Our audit was conducted in accordance with the International Auditing Standards (ISA) and other technical and ethical standards and guidelines of the Statutory Auditors Body (OROC). Our responsibilities under these standards are described in the section "Auditor's Responsibilities for Auditing Financial Statements" below. We are independent from the Entity under the terms of the law and comply with all other ethical requirements under the Code of Ethics of the Statutory Auditors Body (OROC).

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Audit Report

✘ *Unqualified opinion (ISA 700)*

✘ **§ Responsibilities of the management board and the supervisory board** *(conselho fiscal)* **by the financial statements (if applicable)**

The management board is responsible for:

- ✓ *the preparation of financial statements that present a true and fair view of the entity's financial position, financial performance and cash flows in accordance with the Accounting and Financial Reporting Standards adopted in Portugal through the Accounting Standards System;*
- ✓ *the preparation of the management report in accordance with applicable laws and regulations;*
- ✓ *the creation and maintenance of an appropriate internal control system to enable the preparation of financial statements free from material misstatement due to fraud or error;*
- ✓ *the adoption of appropriate accounting policies and criteria in the circumstances; and*
- ✓ *the assessment of the Entity's ability to maintain itself in going concern, disclosing, when applicable, the matters that may raise significant doubts about the continuity of activities.*

The supervisory board is responsible for supervising the preparation and disclosure process of the Entity's financial information. (if applicable)

3. Audit Report

Unqualified opinion (ISA 700)

§ Responsibilities of the auditor for auditing the financial statements

Our responsibility is to obtain reasonable assurance that the financial statements as a whole are free from material misstatement due to fraud or error, and to issue a report stating our opinion. ***Reasonable assurance*** *is a high level of security but is not a guarantee that an audit performed in accordance with ISA will always detect a material misstatement when it exists. Misstatements may arise from fraud or error and are considered material if, alone or jointly, they can reasonably be expected to influence economic decisions of users taken based on those financial.*

As part of an audit according to ISA, we make professional judgments and maintain professional skepticism during the audit and also:

- ✓ *We identify and assess the risks of material misstatement of financial statements due to fraud or error, design and execution of audit procedures that respond to these risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The* ***risk of not detecting material misstatement due to fraud is higher*** *than the risk of not detecting material misstatement due to error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or overlap with internal control;*

3. Audit Report

✘ *Unqualified opinion (ISA 700)*

✘ § Responsibilities of the auditor for auditing the financial statements

- ✓ *we gain an understanding of **internal control** relevant to the audit with the objective of designing audit procedures that are appropriate in the circumstances, but not to express an opinion on the effectiveness of the Entity's internal control;*

- ✓ *we assessed the adequacy of the accounting policies used and the reasonableness of the **accounting estimates** and related disclosures made by the management board;*

- ✓ *we concluded on the appropriation of the use, by the management board, of the assumption of going concern and, based on the audit evidence obtained, if there is any material uncertainty related to events or conditions that may raise significant doubts about the Entity's capacity to continue its activities. If we conclude that there is material uncertainty, we should draw attention in our report to the related disclosures included in the financial statements or, if these disclosures are not appropriate, modify our opinion. Our conclusions are based on the audit evidence obtained to date of our report. However, future events or conditions may lead the Entity to discontinue its activities;*

- ✓ *we assessed the overall presentation, structure and content of the financial statements, including the disclosures, and whether these financial statements represent the underlying transactions and events so as to achieve a fair presentation;*

3. Audit Report

Unqualified opinion (ISA 700)

In EPI

- § Responsibilities of the auditor for auditing the financial statements
  - ✓ *we communicate with those in charge of governance, including the supervisory board, among other matters, the scope and planned timing of the audit, and significant audit findings including any significant internal control weaknesses identified during the audit;*
  - ✓ *of the matters that we communicate to the governance officers, including the supervisory board, we determine those that were the most important in the audit of the current year's financial statements and that are the relevant audit matters. We describe these matters in our report, except when the law or regulation prohibits their public disclosure;*
  - ✓ *we declare to the supervisory board that we complied with the relevant ethical requirements regarding independence and communicate all relationships and other matters that may be perceived as threats to our independence and, where applicable, the respective safeguards.*

Our responsibility also includes verifying that the information in the management report is consistent with the financial statements.

3. Audit Report

✘ *Unqualified opinion (ISA 700)*

Reporting on other legal and regulatory requirements

✘ § About the management report

In compliance with article 451, no. 3, paragraph e) of the Commercial Companies Code (CSC), we are of the opinion that the management report was prepared in **accordance with the applicable legal and regulatory requirements** in force, the information contained therein is consistent with the audited financial statements and, taking into account knowledge and appreciation of the Entity, **we have not identified any material inaccuracies.**

§ On the additional elements provided for in Article 10 of Regulation (EU) No 537/2014

In compliance with Article 10 of Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014, and in addition to the relevant audit matters indicated above, we also report the following:

- ✓ *We were appointed/elected auditors of the Entity for the first time at the General Shareholders' Meeting held on ... for a term of office between 202X and 202X. We were appointed/elected at the shareholders' meeting held on ... for a second term of office between 202X and 202X.*
- ✓ ...

Date, signature (name of firm and partner responsible for the audit) and professional address

3. Audit Report

- *Unqualified opinion (ISA 700)*

EXERCISE – FIND EXAMPLES OF UNQUALIFIED OPINIONS FROM CHARTERED ACCOUNTANTS / AUDITORS

3. Audit Report

✘ *Modified / qualified opinion (ISA 705)*

ISA 705, Modifications to the Opinion in the Independent Auditor's Report

This ISA establishes three types of modified opinions, namely:

- a qualified opinion
- an adverse opinion
- a disclaimer of opinion

INTERNATIONAL STANDARD ON AUDITING 705 (REVISED)
MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for audits of financial statements for periods ending on or after December 15, 2016)

CONTENTS

International Standard on Auditing (ISA) 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, should be read in conjunction with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.*

3. Audit Report

- ***Modified / qualified opinion (ISA 705)***

ISA 705, Modifications to the Opinion in the Independent Auditor's Report

- § Opinion with reservations

  Limitation of scope: *In our opinion, except for the possible effects of the matter referred to in the section "Basis for the opinion with reservations", the attached financial statements present ... .*

  Disagreement: *In our opinion, except for the effects of the matter referred to in the section "Basis for Opinions with Reservations", the attached financial statements present ...*

- § Basis for qualified opinion

  (description of reservations)

  - Explain the reasons for reservations for limitation to the scope of work
  - Includes a description and quantification of the reasons for the reserve for disagreement

  Our audit was conducted in accordance with…"

  *We believe that the **audit evidence** we have obtained is sufficient and appropriate to provide a basis for our audit opinion with reservations.*

3. Audit Report

Modified / Qualified opinion (ISA 705)

- Example of reservations by disagreement - misstatement at disclosure level

*As stated in Note yy, the Company's financing agreements have expired, and the amounts payable are due on March 19, 2023. The Company has not been able to complete renegotiate the financing or obtain alternative financing. This situation indicates that there is a material uncertainty that could raise significant doubts about the Company's **ability to continue**. The financial statements do not adequately disclose this matter.*

- Example of reservations by disagreement - misstatement at measurement level

As mentioned in Note X to the financial statements, no depreciation has been reflected in the financial statements, which constitutes a derogation to the SNC. This is the result of a decision taken by management at the beginning of the previous financial year and which led us to issue a qualified opinion in the audit report on the financial statements for that year. Based on the straight-line depreciation method and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by xxx in 2022 and xxx in 2021, tangible fixed assets should be reduced by the accumulated depreciation of xxx in 2022 and xxx in 2021 and accumulated losses should be increased by xxx in 2022 and xxx in 2021.

3. Audit Report

Modified / Qualified opinion (ISA 705)

- Example of reservation by limitation of scope

Because we were appointed auditors of the Company during 2022, we were unable to observe the physical counting of inventories at the beginning of that period or to confirm through alternative procedures those quantities in inventory. Since opening inventories affect the determination of results of operations, we were unable to determine whether adjustments to the results of operations and the results carried forward from opening 2022 would be necessary. Our audit opinion on the financial statements for the period ended December 31, 2022, has been modified accordingly. Our opinion on the financial statements for the current period as of 12/31/2022 is also modified due to the possible effects of this matter on the comparability of the amounts of the current period with the amounts of the corresponding figures.

- Example of reservation by limitation of scope

At 31/12/2022, it was not possible to test the interest recognized in results for the year from the portfolio of credit granted to clients, due to an impossibility of extracting information from the operating system. For this reason, it was not possible for us to analyze the information of sufficient and appropriate support to validate the accounting balance of Interest Obtained in the amount of ____ euros.

3. Audit Report

Modified opinion with Disclaimer - disclaimer of opinion (ISA 705)

- **§ Disclaimer of opinion (title is changed)**

  We have been hired to audit the financial statements ....

  *We do not issue an opinion on the attached financial statements. Due to the relevance of the matters referred to in the section "Basis for the disclaimer of opinion", we have **not obtained sufficient and appropriate audit evidence** to provide us with a basis for issuing an opinion on the attached financial statements.*

- **Bases for the disclaimer of opinion**

  (description of reservations)

  Delete the 2 paragraphs that appear in the model of the unmodified opinion.

3. Audit Report

- *Modified opinion with Disclaimer - disclaimer of opinion (ISA 705)*

- **§ Responsibilities of the auditor for auditing the financial statements**

  *Our responsibility is to perform an audit on the financial statements in accordance with the International Auditing Standards (ISA) and other technical and ethical standards and guidelines of the Statutory Auditors Institute. However, due to the matter(s) described in the section Bases for the Disclaimer of Opinion, we **have not obtained sufficient and appropriate evidence** to provide a basis for an audit opinion on these financial statements.*

  *We are **independent** from the Entity under the terms of the law and comply with all other ethical requirements under the Code of Ethics of the Portuguese Institute of Chartered Accountants (OROC).*

3. Audit Report

Adverse opinion (ISA 705)

- § **Adverse opinion** (title is changed)

  In our opinion, due to the relevance of the matters referred to in the section "Basis for Adverse Opinion", the attached financial statements do not present …

- § Basis for adverse opinion

  (description of reservations).

  Our audit was conducted in accordance with…

  We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

3. Audit Report

- *Adverse opinion (ISA 705)*

EXERCISE – Find Examples of Adverse Opinions from CHARTERED ACCOUNTANTS / Statutory AUDITORS

3. Audit Report

If there is a qualification by incorrect application of the going concern assumption, then this section ceases to exist.

- ***Special sections (if applicable)***

- § **Material Uncertainty Regarding Going Concern (optional)**

*As mentioned in the notes to the financial statements, the Entity prepares the financial statements on a **going concern basis**. The going concern assumption implies that the Entity has adequate resources to maintain the activities and that the management board has no intention of ceasing the activities in the short term.*

=> there is material uncertainty, and it is duly disclosed in the FS (ISA 570)

*As set out in Note X to the financial statements, which indicates that Banco Menos, S.A. recorded a loss of xxxxx during the year ending 31/12/2022 and that date, the financial autonomy ratio is 7%. As referred to in Note 6, these events or conditions, as well as other matters referred to in that Note, indicate that there is a material uncertainty which may pose significant doubts as to the entity's ability to continue. **Our opinion is not modified with respect to this matter.***

3. Audit Report

Audit Report - Relevant Audit Matters (ISA 701)

INTERNATIONAL STANDARD ON AUDITING 701
COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for audits of financial statements for periods ending on or after December 15, 2016)

CONTENTS

International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report,* should be read in conjunction with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.*

3. Audit Report

Audit Report - Relevant Audit Matters (ISA 701)

§ Relevant Audit Matters

- Relevant matters are those that required special attention in the execution of the audit and that were previously communicated to the **management board**.
- Indicators of relevant subjects
  - ✓ Areas assessed for high risk of material misstatement or significant risks
  - ✓ Areas involving significant judgments produced by the management board including estimates involving high estimation uncertainty
  - ✓ Transactions with significant impact on accounts
- Relevant matters should be included in the audit report, if:
  - ✓ Audited entity has **listed securities**
  - ✓ Required by law or **regulation**
  - ✓ Auditor decides to report on the matter, and this is not against the law.

3. Audit Report

Audit Report - Relevant Audit Matters (ISA 701)

§ Relevant Audit Matters

=> Auditor decides to describe them in audit report

The relevant audit matters are the ones that, in our professional judgment, had the greatest importance in the auditing of the financial statements of the current period. These matters should be considered in the context of the audit of the financial statements as a whole, and in the formation of the opinion, and we do not issue a separate opinion in this respect.

In addition to the material(s) described in the section "Basis for Opinion with Reservations" and in the section "Material Uncertainty Regarding Going Concern", we have decided that the following are relevant audit material to be communicated in this report. => (if there are reservations and/or material uncertainty)

(Describe below the following subjects to support the audit opinion:

- *a description of the most significant risks of material misstatement identified, including the risks of material misstatement due to fraud, referring, where relevant, to the respective disclosures included in the financial statements;*
- *a summary of the auditor's response to the material misstatement risks assessed;*
- *if relevant, any key observations that may have arisen in relation to those risks.)*

3. Audit Report

Audit Report - Relevant Audit Matters (ISA 701)

§ Relevant Audit Matters

=> Auditor considers that there are no relevant matters other than reservations or material uncertainty

The relevant auditing matters are the ones that, in our professional judgment, had the greatest importance in the auditing of the financial statements of the current period. These matters should be considered in the context of the audit of the financial statements as a whole, and in the formation of the opinion, and we do not issue a separate opinion in this respect.

Except for the material described in the Bases for Opinions with Reservations (Adverse) or Material Uncertainty Regarding Going Concern, we inform you that there are no other relevant auditing matters to report in our report.

=> Auditor considers that there are no relevant matters

The relevant auditing matters are the ones that, in our professional judgment, had the greatest importance in the auditing of the financial statements of the current period. These matters should be considered in the context of the audit of the financial statements as a whole, and in the formation of the opinion, and we do not issue a separate opinion in this respect.

We inform you that there are no relevant audit matters to communicate in our report.

EXERCISE – FIND EXAMPLES OF modified opinions, namely:

- a disclaimer of opinion

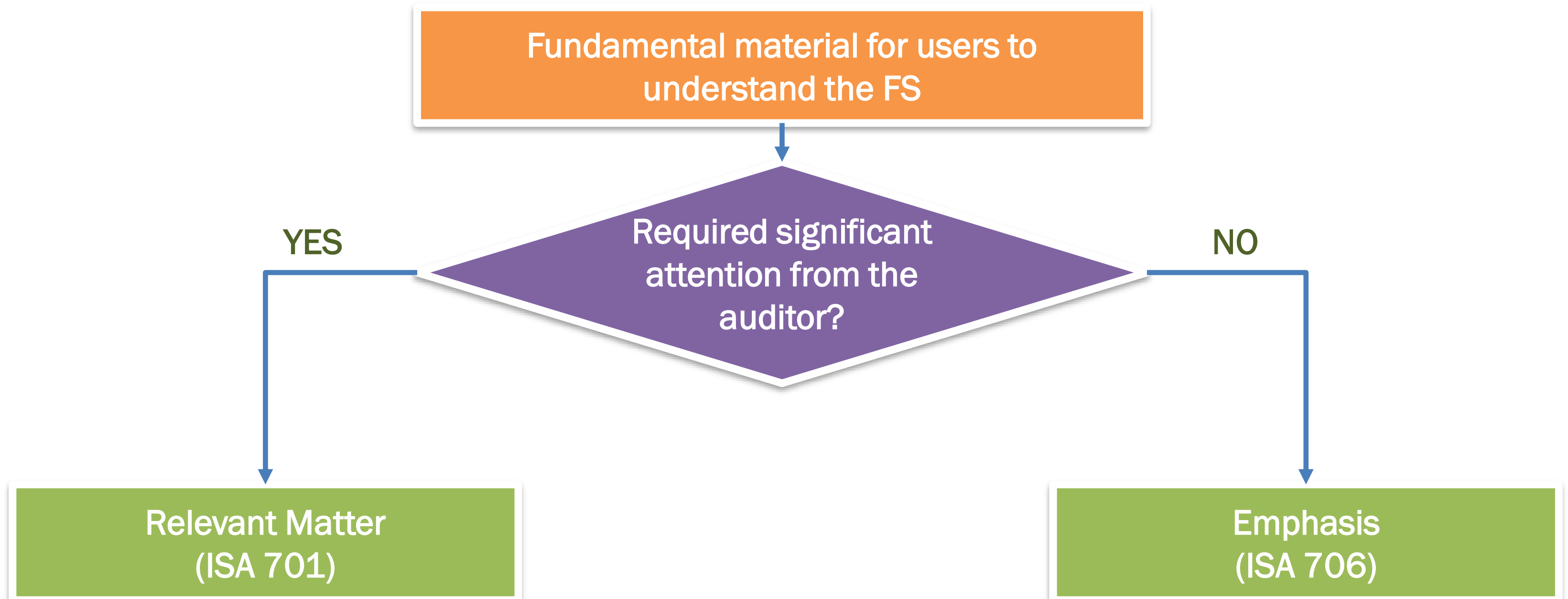
FROM CHARTERED ACCOUNTANTS / AUDITORS reports

3. Audit Report

Audit report - opinion with emphasis and/or other matters (ISA 706)

§ Emphasis

Matter appropriately presented or disclosed in the financial statements which, in the auditor's judgment, is of such importance that it is fundamental for the users' understanding of the financial statements. These matters <u>do not include</u> the reservations and/or relevant audit matters.



3. Audit Report

EXERCISE – Please find 2 or 3 examples of emphasis on Auditor´s Reports.

Indicate the Emphasis, the Audited company and the Auditing firm that performed the Audit

3. Audit Report

Audit report - opinion with emphasis and/or other matters (ISA 706)

§ Emphasis

Examples of subjects to be reported as emphasis:

- An uncertainty related to the **future outcome of litigation** or exceptional regulatory actions
- Significant **subsequent event** occurring between the date of the FS and the date of the auditor's report
- The early application of a new accounting standard that has a material effect on the FS
- Disaster with material impact on the financial position of the entity
- Changes in accounting policies
- Correction of a **qualified misstatement** in the previous year

INTERNATIONAL STANDARD ON AUDITING 706 (REVISED)
EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for audits of financial statements for periods ending on or after December 15, 2016)

CONTENTS

3. Audit Report

Audit report - opinion with emphasis and/or other matters (ISA 706)

§ Other matters

These are matters that are not related to the matters presented or disclosed in the FS, but which in the auditor's opinion are relevant to users' understanding of the audit, the auditor's responsibilities or his report. Disclosure of such matters is not prohibited by law and does not encompass relevant auditing matters.

Examples:

- Explain why Auditor did not resign if you issued a Disclaimer Opinion
- Indicate that you have issued an opinion on the FS prepared by the company based on another accounting standard (e.g., on the reporting of the subsidiary information)
- In the special purpose report indicate that it is intended exclusively for its intended users and should not be distributed or used by others
- Accounts audited by another auditor
- Disclosure of the substantive reasons for the current auditor's difference of opinion on the financial statements of the previous period compared to the opinion that the auditor previously expressed

3. Audit Report

Audit report - opinion with emphasis and/or other matters (ISA 706)

§ Emphasis Example

- Refer to the site where you can find the disclosures related to the subject matter
- Indicate that Opinion is not changed

We draw your attention to Note X to the financial statements, which describes the uncertainty regarding the outcome of the lawsuit filed against the Company by XYZ Company. Our opinion is not changed in this matter.

§ Example of Other matters

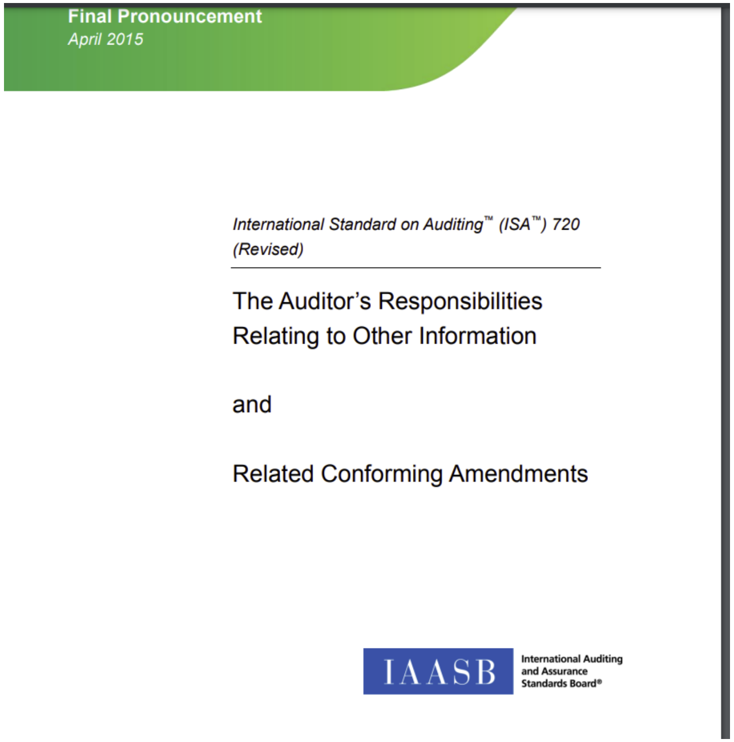
The financial statements of Banco Menos, S.A. for the year ended December 31, 2022, were audited by another auditor who expressed an unreserved opinion on these financial statements as of March 31, 2023.

3. Audit Report

Audit report - other information (ISA 720)

§ Other information - auditor's responsibility

- ✓ The annual report includes financial and non-financial information that is beyond the Financial Statements. Normally, the other information includes: **Management Report** (part of the obligations); message from the President.
- ✓ Auditor should request the **Management Report** and other documents before issuing the Audit Report.
- ✓ If the auditor finds any inconsistencies between the financial statements and the other information or considers that the other information is materially misstated, the auditor should **request its correction** and ultimately inform the shareholders (in this case, if the auditor had already issued the report)
- ✓ If the other information is not corrected, the auditor should **describe** in his report **the misstatement** in the "Other Information".


Final Pronouncement
April 2015

International Standard on Auditing™ (ISA™) 720 (Revised)

The Auditor's Responsibilities Relating to Other Information

and

Related Conforming Amendments

IAASB International Auditing and Assurance Standards Board®

3. Audit Report

- *Audit report - other information (ISA 720)*

INTERNATIONAL STANDARD ON AUDITING 720 (REVISED)

THE AUDITOR'S RESPONSIBILITIES RELATING TO OTHER INFORMATION

(Effective for audits of financial statements for periods ending on or after December 15, 2016)

CONTENTS

4

3. Audit Report

Audit report - other information (ISA 720)

- **§ Other information (in the scenario where the Other Information is obtained before the date of the Audit Report)**

The Board of Directors is responsible for the other information. The other information includes the Management Report and (including other maps that are part of the Annual Report)*. Our opinion on the financial statements does not cover the other information and therefore we do not express any opinion on the same.*

In connection with our audit of the financial statements, our responsibility is to read the other information and, in that context, to consider whether the other information is materially inconsistent with the financial statements or whether our knowledge acquired in the audit or otherwise indicates that the other information is materially misstated. If, based on the work performed, we conclude that the other information is materially misstated, we are required to report such fact.

The following text depends on whether or not the other information is materially misstated.

3. Audit Report

✘ *Audit report - other information (ISA 720)*

✘ § Other information

Other information contains material misstatements	Other information contains no material misstatements
As described below, we conclude that the ***other information*** *is materially misstated.* *(describe the inconsistencies/misstatements)*	✓ Report with **unmodified opinion** *We have nothing to report regarding the other information.* ✓ Report with **modified opinion** *Additionally, and as described in the above section of the Basis of Opinion with* ***Reservations****, we have not obtained adequate and sufficient evidence of the existence of certain equipment which totaled a net book value of __ EURO. Consequently,* ***we cannot conclude whether the other information is materially misstated*** *with respect to this matter.*

4. Professional regulation

- Introduction

Auditors are professionals
Professionals are people
People make mistakes
That's why auditors make mistakes

EXERCISE – Going concern

Understanding the going concern is a major issue for the Auditor´s work.

Assume that you are auditing the accounts of a bank in Portugal, and you want to better understand the market in which it operates, major opportunities and threats and what are the main trends that may impact the bank´s activity.

For this you want to understand what are the products/services that competitive banks are offering to clients and what are the conditions (price, timing, commissions, etc.) they propose.

You want also to understand the Fintech industry in Portugal as it is also competitor of traditional banks. Focus on trends of Fintechs.

This benchmark should allow you to understand the banking industry market in Portugal and in other countries in particular the offer to clients.

With this market understanding you should be able to build your opinion concerning the **going concern** of the Bank that you are auditing.

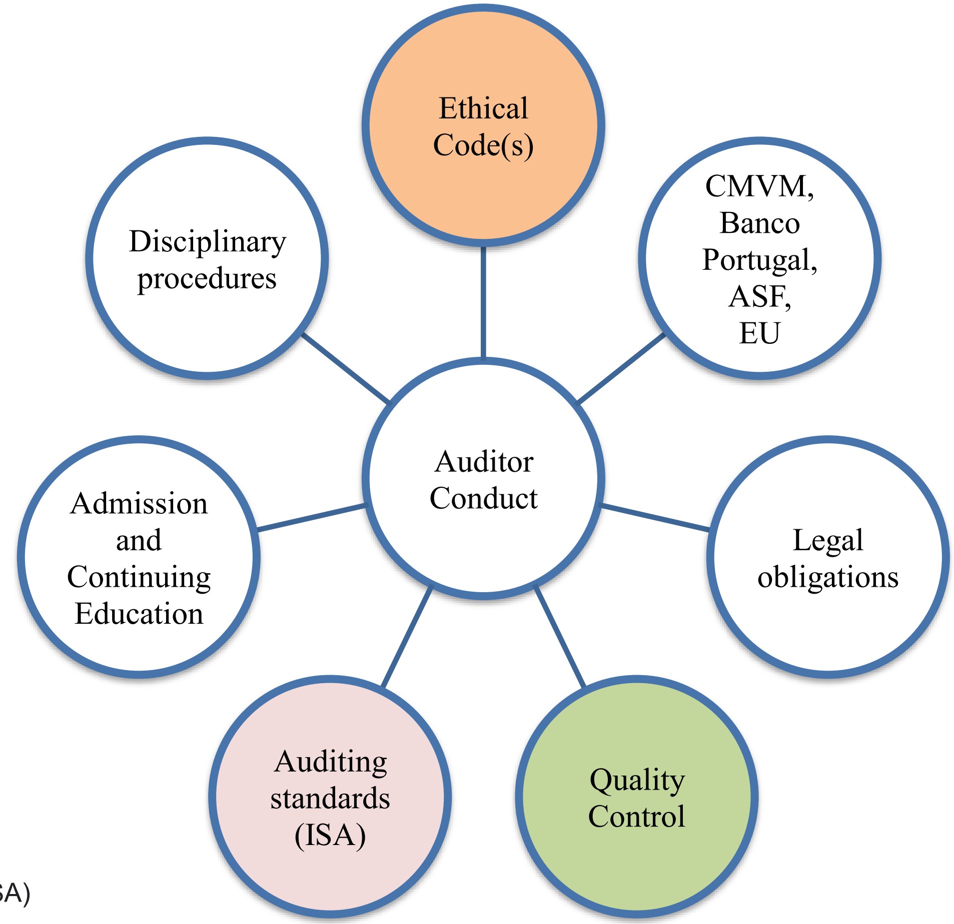
EXERCISE – Going concern

Perform a brief market analysis of Banking and Fintech industry focusing on the aspects before mentioned for you guidance in your audit work including risk assessment.

(2 pages in PowerPoint)

4. Professional regulation

- Facts that contribute to the proper conduct of the auditor



ASF – Autoridade de supervisão de seguros e Fundos de Pensões

International Standards on Auditing (ISA)

4. Professional regulation

✘ Auditing standards

✓No. 6 art. 45.º EOROC:

Audits are conducted in accordance with **international auditing standards** adopted by the European Commission except when:

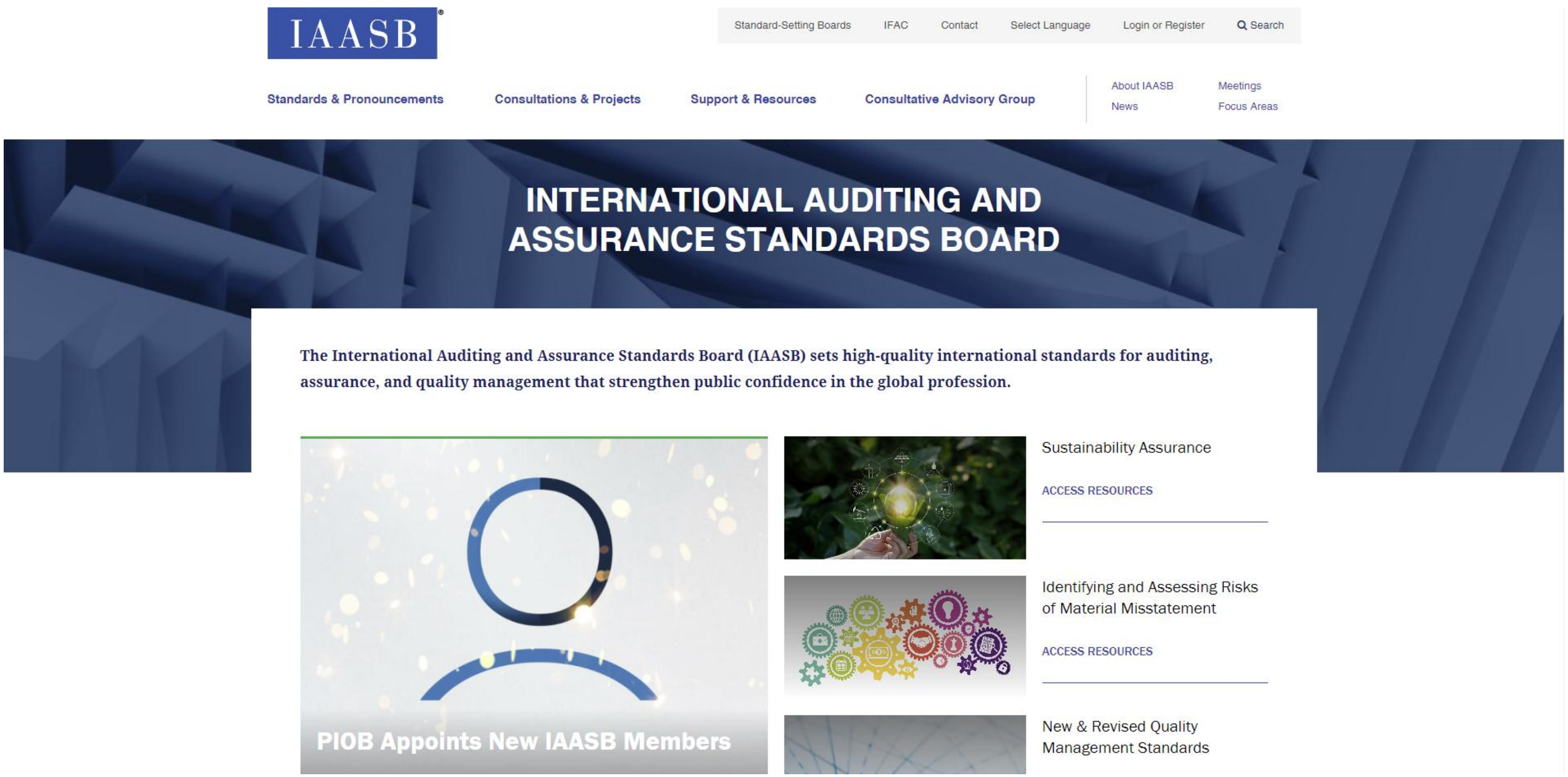
- *The review is for matters that are not regulated by international auditing standards;*
- *The imposition of additional audit procedures or requirements arises from specific legal requirements or to the extent necessary to enhance the credibility and quality of the accounts.*

✓No. 8 art. 45.º EOROC:

While not adopted by the European Commission, the international auditing standards are directly applicable.

4. Professional regulation

- Auditing standards IAASB – International Auditing and Assurance Standards Board



4. Professional regulation

- **Auditing standards IAASB – International Auditing and Assurance Standards Board**

It is an independent body that seeks to develop high quality standards of public interest for:

- Auditing -> International Auditing Standards (ISA's) and International Recommendations of Auditing Practices (IAPS)
- Simplified examinations or review work -> International Standards of Review Work (ISRE)
- Reliability assurance work -> international standards on assurance work (ISAE)
- Related Services -> International Standards for Related Services (ISRS)
- Quality control -> international quality control standards (ISCQ)

4. Professional regulation

- Auditing standards and audit services

The Importance of Adhering to Professional Auditing Standards as Illustrated in the Audits of Thornton Precision Components, Limited performed by Ernst & Young, LLP UK

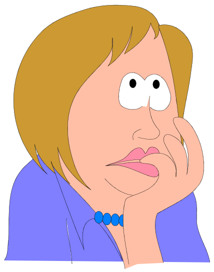
Auditors who adhere to the professional auditing standards are viewed as conducting a quality audit. A lack of adherence to the professional auditing standards heightens the risk that the auditor will provide an unqualified audit opinion on financial statements that are materially misstated. This lesson is highlighted in the 2004-2006 audits of Thornton Precision Components, Limited (TPC) performed by Ernst & Young, LLP UK (E&Y UK).

TPC became a wholly owned UK subsidiary of Symmetry Medical, Inc. in 2003. Symmetry became a public company in 2004 and was listed on a United States stock exchange. Its consolidated financial statements included TPC's financial data. Beginning in 2003, Ernst & Young, LLP (E&Y US) became Symmetry's audit firm. In connection with the 2004-2006 audits of Symmetry, E&Y US engaged E&Y UK to perform audits of TPC, using Public Company Accounting Oversight Board (PCAOB) auditing standards. During the 2004-2006 audits, E&Y US relied on E&Y UK's audits to issue unqualified audit opinions for Symmetry.

From 1999 through September 2007, TPC's management participated in multiple schemes to increase TPC's revenues, net income, and other performance indicators. These schemes included booking fictitious revenues, understating costs of goods sold, creating fictitious inventories, and improperly capitalizing certain expenses. The fraud at TPC was not discovered by the auditors, but only came to light in 2007 when a TPC employee alerted Symmetry's CEO to the fraud. In 2008, Symmetry restated its financial statements, which included among other items, significant reductions in Symmetry's net income.

In 2012, the Securities and Exchange Commission (SEC) concluded that E&Y UK (a firm registered with the PCAOB) had conducted its audits in such a way that the audits did not adhere to the relevant professional auditing standards. Deficiencies in E&Y UK's 2004-2006 audits of TPC included a failure to perform appropriate procedures to audit the accounts receivable balances, adequately review top-side journal entries, properly audit inventory, and a failure to plan, staff, and supervise the audits. During the audit, the audit partner and manager did not appropriately question management's representations, did not fully document the results of testing, did not appropriately consider the risks of misstatements due to fraud, and did not exercise due professional care and professional skepticism.

4. Professional regulation



✘ Ethics and professional deontology

✓Ethical dilemma

- It is a situation where the person has to decide on the appropriate behavior.
- Methodology of analysis:
  - Getting the relevant facts
  - Identify ethical issues from the facts
  - Determine who is affected by the outcome of the dilemma and how each individual/group is affected
  - Identify the available alternatives that the person has in hand to solve the dilemma
  - Identify the expected consequences in each alternative
  - Decide what action to take

4. Professional regulation

✘ Ethics and professional deontology

independence

AUDITING IN PRACTICE

Why Is Owning Stock in an Audit Client Unacceptable?

In 2005, Susan Birkert was an audit senior working for KPMG on the audit engagement of Comtech Corporation. One of Susan's friends asked her whether she thought that Comtech stock was a good investment. She responded that, indeed, it was a good investment. At that point, her friend asked if she would like him to purchase Comtech stock on her behalf. She agreed, and gave her friend $5,000 to make the purchase under his name rather than hers. She did so because she was aware that owning stock in one's audit client is not allowed because of independence concerns. If auditors own stock in their audit clients, they are not independent of their clients because they are part owners. Therefore, rather than acting in an unbiased manner during the conduct of the audit, they might make judgments that favor the client company rather than external users of the financial statements. Even if the auditor does not actually behave in a biased manner and is independent in fact, external users may *perceive* an independence conflict—the auditor would not be independent in appearance.

Susan continued working on the Comtech engagement well into 2006, and she lied when she responded to KPMG's yearly written requirements to comply with the firm's independence policies. Prompted by an anonymous tip later in 2006, KPMG launched an internal investigation into the matter and terminated her employment. The PCAOB barred her from serving as an external auditor for a period of at least one year. For further details on this case, see PCAOB Release No. 105-2007-003.

Source: Johnstone, K. M., Gramling, A. e Rittenberg, L. E., (2014), Auditing: a business risk approach, 9th edition, Cengage.

4. Professional regulation

Ethical principles

Conduct that honors the profession

- Integrity
- Objectivity
- Professional competence and zeal
- Confidentiality (article 84 EOROC)
- Professional behaviour

4. Professional regulation

✘ Auditor independence

✓**Article 71 EOROC – the duty of Independence**

- The chartered accountant (ROC) or any singular person in a position to directly or indirectly influence the outcome of the statutory or voluntary audit shall be independent of the audited entity and shall not participate in the decision-making of that entity.
- People involved in the work, as well as closely related persons, **may not hold** or have **any material and direct economic interest** in or participate in the transaction of any financial instruments issued, guaranteed or otherwise supported by any audited entity that falls within the scope of its statutory audit activities.
- People involved in the work **may not accept offers** or favors from the audited entity, except if they are insignificant.

4. Professional regulation

Auditor independence

✓Art. 77 EOROC: conditions for carrying out statutory audits to public interest entities

- **Non audit fees / total fees** < 30% - when **non audit services** are provided for a period of 3 or more consecutive years to the entity, its parent company or its subsidiaries.
- If total fees received in each of the last three consecutive years **exceed 15%** of the SROC's **turnover**:
  - Inform the supervisory board of the audited entity and the safeguard measures taken
  - The supervisory board must assess whether there are conditions to continue the provision of services for a period not exceeding 2 years
  - Communicate the situations before to CMVM
  - CMVM may determine that in the calculation enters the fees of companies in the SROC network (ex. Relevant for the Big 4 firms)
- If the **Statutory Audit** is performed, the SROC or another firm in its network is barred from rendering services to the EPI, parent company or other company controlled by it:
  - Tax advisory services (for example payroll taxes, customs taxes, etc)
  - Preparation and entry of accounting records and accounts
  - ...
- Any consulting service must be previously approved by the EPI's supervisory board.

EPI – entity of public interest

4. Professional regulation

EPI – entity of public interest

An Entity of Public Interest (EPI) is an entity, such as a publicly traded company, financial institution, or other organization that has a substantial impact on the public, financial markets, or the economy, and is therefore subject to enhanced audit and financial reporting requirements.

These entities are often large and complex, and their financial statements are of significant interest to a wide range of stakeholders, including shareholders, investors, regulators, and the general public.

4. Professional regulation

Auditor independence

✓Art. 77 EOROC: conditions for carrying out statutory audits to public interest entities

revisores oficiais de contas cesse a atividade ou em caso de transferência de responsabilidades ou de substituição de revisor oficial de contas ou de sociedade de revisores oficiais de contas pelo período remanescente dos cinco anos.

Artigo 77.º

Condições para a realização de revisão legal das contas de entidades de interesse público

1 — Quando o revisor oficial de contas ou a sociedade de revisores oficiais de contas de uma entidade de interesse público prestar a esta, à sua empresa-mãe ou às entidades sob o seu controlo, durante um período de três ou mais exercícios consecutivos, serviços distintos da auditoria, não proibidos nos termos do n.º 8, os honorários recebi-

7 — Para efeitos do disposto nos n.os 3 a 5, a CMVM pode exigir, quando tal se justifique para a aferição da independência do revisor oficial de contas, da sociedade de revisores oficiais de contas ou, se aplicável, do revisor oficial de contas do grupo, que no cálculo do rácio de 15 % sejam incluídos os honorários recebidos da entidade de interesse público por todos ou por parte dos membros da rede deste.

8 — Ao revisor oficial de contas ou à sociedade de revisores oficiais de contas que realize a revisão legal das contas de uma entidade de interesse público, ou a qualquer membro da rede a que esse revisor oficial de contas ou essa sociedade de revisores oficiais de contas pertença, é proibida a prestação direta ou indireta à entidade auditada, à sua empresa-mãe ou às entidades sob o seu controlo

4. Professional regulation

✘ Auditor independence

✓Art. 77 EOROC: conditions for carrying out statutory audits to public interest entities

Large list of forbiden services

Diário da República, 1.ª série—N.º 174—7 de setembro de 20

na União Europeia de quaisquer dos seguintes serviços distintos da auditoria:

a) Serviços de assessoria fiscal relativos:

i) À elaboração de declarações fiscais;
ii) A impostos sobre os salários;
iii) A direitos aduaneiros;
iv) À identificação de subsídios públicos e incentivos fiscais, exceto se o apoio do revisor oficial de contas ou da sociedade de revisores oficiais de contas relativamente a esses serviços for exigido por lei;
v) A apoio em matéria de inspeções das autoridades tributárias, exceto se o apoio do revisor oficial de contas ou da sociedade de revisores oficiais de contas em relação a tais inspeções for exigido por lei;
vi) Ao cálculo dos impostos diretos e indiretos e dos impostos diferidos;
vii) À prestação de aconselhamento fiscal;

b) Os serviços que envolvam qualquer participação na gestão ou na tomada de decisões da entidade auditada;
c) A elaboração e lançamento de registos contabilísticos e de contas;
d) Os serviços de processamento de salários;
e) A conceção e aplicação de procedimentos de controlo interno ou de gestão de riscos relacionados com a elaboração e ou o controlo da informação financeira ou a conceção e aplicação dos sistemas informáticos utilizados

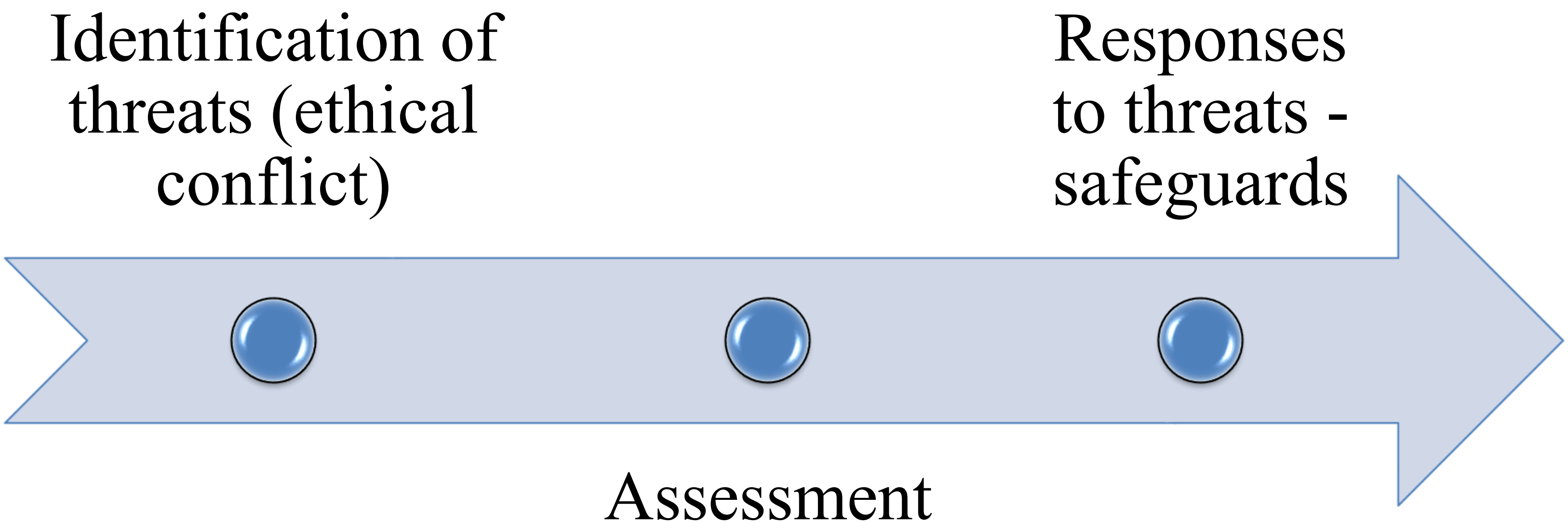
4. Professional regulation

- Auditor independence

Auditing as ethical judgment process

4. Professional regulation

Ethical principles - threat resolution process



Threat of personal interest, threat of self-review, threat of representation, threat of familiarity, threat of intimidation.

Threats to independence => Chartered accountant (ROC) must not carry out the work (no. 3 art. 71 EOROC)

4. Professional regulation

Quality control

Methods that seek to ensure that the chartered accountant / Statutory Auditor, (ROC/SROC), is meeting the normative requirements of the profession, contributing to its defense and professional reputation.

By SROC

- ISCQ 1 (International Standard on Quality Control 1 – IFAC)
- Art. 74 EOROC: duty to have an internal control system
- Art. 80 EOROC: Internal quality control of the work in EPI

By OROC (peer review) under CMVM supervision to auditors who do not audit public interest entities

- No. 1 do art. 69.º EOROC
- At least one check every 6 years (RCQOROC)

By the CMVM to the auditors of public interest entities (No.4 of Article 4 of the Legal Framework for Audit Supervision)

- At least one check every 3 years (art. 26.º – Quality Control of Regulation 537/2014)

4. Professional regulation

International Standard on Quality Control 1

See ISA 220

Auditors have an obligation to establish and maintain a quality control system that provides reasonable assurance of reliability:

- ✓ The firm and its staff comply with professional standards and applicable legal and regulatory requirements; and
- ✓ Reports issued by the firm or the partners responsible for the work are appropriate under the circumstances.

IAASB International Auditing and Assurance Standards Board

The IAASB's Quality Management Proposals

February 2019: Three exposure drafts released for public comment

- Proposed ISQM 1 (Previously ISQC 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*
- Proposed ISQM 2, *Engagement Quality Reviews*
- Proposed ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*
- Also released: a covering explanatory memorandum – addresses:
  - The relationships between the standards
  - Overall matters
  - Possible effective dates, including a question to seek views about the time needed to implement the standards

4. Professional regulation

- International Standard on Quality Control 1

See ISA 220

INTERNATIONAL STANDARD ON AUDITING 220

QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)+

CONTENTS

4. Professional regulation

International Standard on Quality Management (ISQM) 1

Element	Overview	Example
Quality related leadership responsibilities within the firm	The firm must promote a culture in which quality is essential to be observed in the execution of services and policies and procedures must be established to support this culture	The firm's training programs emphasize the importance of quality work, and this is reinforced in individual performance assessment and incentive system decisions.
Relevant ethical requirements	The firm shall define policies and procedures that provide reasonable assurance that the firm, employees and other individuals subject to the **requirement of independence** will effectively maintain independence when required by a relevant ethical standards	Each partner and employee must answer an **annual independence questionnaire**, namely in matters of financial threats, familiarity.
Acceptance and continuation of client relationships and specific jobs	Policies and procedures should be established to decide when the firm should accept or continue a relationship with a client. These policies and procedures should **minimize the risk of being associated with a client whose management body shows a lack of integrity**. The firm should only accept work that it can carry out with high levels of professional competence.	Client assessment form (KYC – **know your client**), dealing with matters such as previous auditor's comments, management body integrity assessment.

4. Professional regulation

Exercise

Please identify some KYC questionnaires and analyze what information they request regarding the client firm.

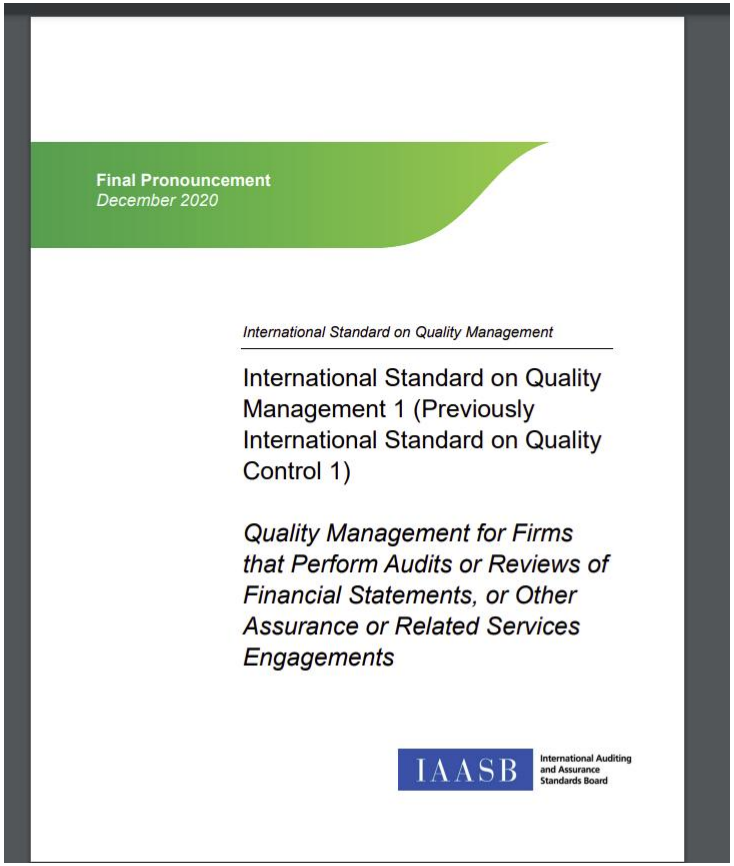
4. Professional regulation

International Standard on Quality Management (ISQM) 1

Element	Overview	Example
Human resources	Policies and procedures should be established to provide the firm with reasonable assurance that it has sufficient staff with the necessary competence, skills and commitment to ethical principles: ⇒ Carry out the work in accordance with professional standards and other legal requirements ⇒ Allow the firm to issue a report that is appropriate to the circumstances	Each employee must be evaluated in any job using the firm's Role Assess Matrix.
Work execution	The firm shall define policies and procedures that provide reasonable assurance that work is performed in accordance with professional standards and other applicable legal requirements, and that the firm issues the report appropriate to the circumstances	The firm has a partner responsible for providing **internal clarifications** in accounting and auditing matters
Monitoring	The firm should establish a monitoring process designed to provide reasonable assurance that policies and procedures related to the internal quality control system are relevant and adequate, and that they are working effectively.	The firm has a partner responsible for quality control who must test that the quality control procedures are being put in place.

4. Professional regulation

✘ International Standard on Quality Management (ISQM) 1



Final Pronouncement
December 2020

International Standard on Quality Management

International Standard on Quality Management 1 (Previously International Standard on Quality Control 1)

Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

IAASB International Auditing and Assurance Standards Board

4. Professional regulation

OROC Horizontal Control

- Assess the degree of **adequacy of the means** used in relation to the nature and size of the work and the entities subject to legal review or auditing.
- Determine whether the Review/Audit Standards issued by OROC, and the applicable regulations and legislation, are complied with in the exercise of professional activity.

Controlo Horizontal	Total				SROC				ROC			
	2018		2017		2018		2017		2018		2017	
	nº	%	nº	%	nº	%	nº	%	nº	%	nº	%
Sem observações dignas de registo	34	55%	34	52%	11	52%	12	50%	23	56%	22	52%
Com observações de menor relevância	12	19%	16	24%	2	10%	6	25%	10	24%	10	24%
Com observações de relevância	12	19%	16	24%	7	33%	6	25%	5	12%	10	24%
Com resultados insatisfatórios	4	6%	-	0%	1	5%	-	0%	3	7%	-	0%
Subtotal	62	100%	66	100%	21	100%	24	100%	41	100%	42	100%
Anulados	1		6		-		2		1		4	
Total	63		72		21		26		42		46	

Example of OROC statistics on quality control on ROC/SROC

4. Professional regulation

OROC Vertical Control

- Verify that the checks made, and the **conclusions** drawn from the working files are **consistent** with the content of the reports included in the reporting documents.
- Determine whether audit standards are met.

Controlo Vertical	Total				SROC				ROC			
	2018		2017		2018		2017		2018		2017	
	nº	%	nº	%	nº	%	nº	%	nº	%	nº	%
Sem observações dignas de registo	29	32%	36	34%	20	39%	28	44%	9	22%	8	19%
Com observações de menor relevância	25	27%	36	34%	13	25%	21	33%	12	29%	15	36%
Com observações de relevância	30	33%	25	24%	14	27%	10	16%	16	39%	15	36%
Com resultados insatisfatórios	8	9%	9	8%	4	8%	5	8%	4	10%	4	10%
Subtotal	92	100%	106	100%	51	100%	64	100%	41	100%	42	100%
Anulados	1		4		-		-		-		4	
Total	93		110		51		64		41		46	

Example of OROC statistics on quality control on ROC/SROC

4. Professional regulation

Causes of deficiencies detected in OROC control

- Horizontal control

Controlo horizontal	Relevância	Menor Relevância	Total	2018 %	Total	2017 %
Nº processos	16	12	28	44%	32	44%
Nº Observações						
SICQ	28	7	35	60%	29	50%
PBCFT	4	3	7	12%	6	10%
Independência	3	3	6	10%	6	10%
Recursos Humanos	4	-	4	7%	14	24%
Formação	4	1	5	9%	2	3%
Honorários	-	1	1	2%	1	2%
	43	**15**	**58**	**100%**	**58**	**100%**

Legenda:

SICQ – Sistema Interno de controlo de qualidade

PBCFT – Prevenção do branqueamento de capitais e financiamento do terrorismo

4. Professional regulation

Causes of deficiencies detected in OROC control

- Vertical control

	Relevância	Menor Relevância	Total	2018 %	Total	2017 %
Nº processos	23	16	39	62%	42	58%
Nº dossiês	30	25	55	60%	61	58%
Nº Observações						
Planeamento	24	4	28	16%	25	14%
Execução	42	8	50	28%	63	35%
Relato	29	16	45	25%		
Divulgações	17	12	29	16%	87	48%
DOG	8	11	19	11%		
Honorários	1	2	3	2%	3	2%
Outras	2	2	4	2%	4	2%
	123	**55**	**178**	**100%**	**182**	**100%**

4. Professional regulation

Other relevant subjects

✓**Mandates (art. 54.º EOROC)**

- Term of mandate is from 1 to 4 years
- Boundaries in EIP – Entidades Interesse Público (public interest entities):
  - Partner responsible for the audit: maximum of 7 years since the first appointment and can then be appointed after 3 years.
  - Minimum term of 2 years and maximum limit 8 years (4-years mandate) and 9 years (3-year mandate) -> may be extended up to 10 years as long as there is a substantiated proposal from the supervisory board.
  - After a forced replacement (10 years have passed) a new designation only after 4 years.
  - The above-mentioned periods are counted from the moment the entity is considered of public interest
  - Gradual rotation of senior management involved in statutory audit

http://www.cmvm.pt/pt/AreadoInvestidor/Faq/Pages/FAQs-Auditoria.aspx

4. Professional regulation

✘ Other relevant subjects

✓**Auditor's "labor" mobility (art. 72.º & 91.º)**

- Impediment to hire the ROC for management and audit positions in the audited entity: up to 1 year (general); up to 2 years (EPI)
- Impediment to hire personnel and other SROC partners involved in the work for management and inspection positions in the audited entity: up to 1 year
- Responsible for the work that has been done in Auditors Report (CLC) functions in the last 3 years cannot be designated board member (including in group companies)
- EPI: employment contracts for Chartered Accountants, ROC/SROC partners only after 3 years

4. Professional regulation

Definition of Audit Quality

According to the **IAASB framework** for **audit quality (2014),** the term audit quality has a number of **different definitions** across the world and none of them has achieved the status of a globally recognized definition.

International Auditing and Assurance Standards Board (IAASB) – ***A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality*** (February 2014)

"The term **"audit quality"** encompasses the key elements that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis."

Overview" section, **page 4** (of the official PDF)

4. Professional regulation

Definition of Audit Quality

According to the **IAASB framework** for **audit quality (2014),** the term audit quality has a number of **different definitions** across the world and none of them has achieved the status of a globally recognized definition.

However, the framework references that audit quality is understood and achieved through the encompass of **5 key elements** that together create the conditions for **quality audits**, namely:

- Inputs factors (ethics, attitudes, auditor's knowledge, skills and experience)
- Process Factors (audit methodologies and quality control procedures)
- Outputs Factors (reports and other deliverables)
- Key interactions (communication among participants in the financial reporting supply chain)
- Contextual factors (regulatory conditions or other external factors)

4. Professional regulation

Definition of Audit Quality

According to **Fedyk., Anastassia, Hodson, J., Khimich,., & Fedyk, T. (2022),** audit quality is defined as the degree of assurance that financial statements are free from material misstatement, empirically measured by the likelihood of a **subsequent financial restatement**.

4. Professional regulation

Audit Quality

In **Rosati, Gogolin, and Lynn (2020)**, the authors don't give a long formal definition of "audit quality.

In the study, "audit quality" is measured using **four main proxies**, each representing a different way to detect potential earnings management or auditor performance issues:

- Abnormal Accruals
- Small Profits or Small Earnings Increases
- Going-Concern Opinions
- Financial Restatements

4. Professional regulation

Audit Quality

Abnormal Accruals:

Magnitude of discretionary accounting adjustments made by management;

Larger abnormal accruals = lower **audit quality**, because they indicate more earnings management;

Smaller abnormal accruals = higher **audit quality**.

4. Professional regulation

Audit Quality

Small Profits or Small Earnings Increases:

Whether firms report earnings that are just above zero or show tiny positive changes;

A high frequency of such **small profits** suggests earnings management, implying **lower audit quality**;

Fewer small profits = auditors are constraining earnings manipulation → **higher audit quality**

4. Professional regulation

Audit Quality

Going-Concern Opinions:

Whether the auditor issues a “going-concern” warning (a signal that the firm might not continue operating);

Issuing a going-concern opinion when appropriate reflects auditor independence and professional skepticism — thus **higher audit quality**.

Financial Restatements:

Restatements occur when a firm must revise its previous financial statements due to errors or misstatements;

Fewer restatements indicate that the audit initially caught potential issues, showing **stronger audit quality**;

More restatements suggest that the auditor missed something — **lower audit quality**.

4. Professional regulation

Audit Quality

Competence

Audit should be performed in accordance with applicable auditing standards

- Provide acceptable assurance that the financial statements are prepared in all material aspects in accordance with the accounting principles
- Provide acceptable assurance that the financial statements are not materially misstated, whether due to errors or fraud.

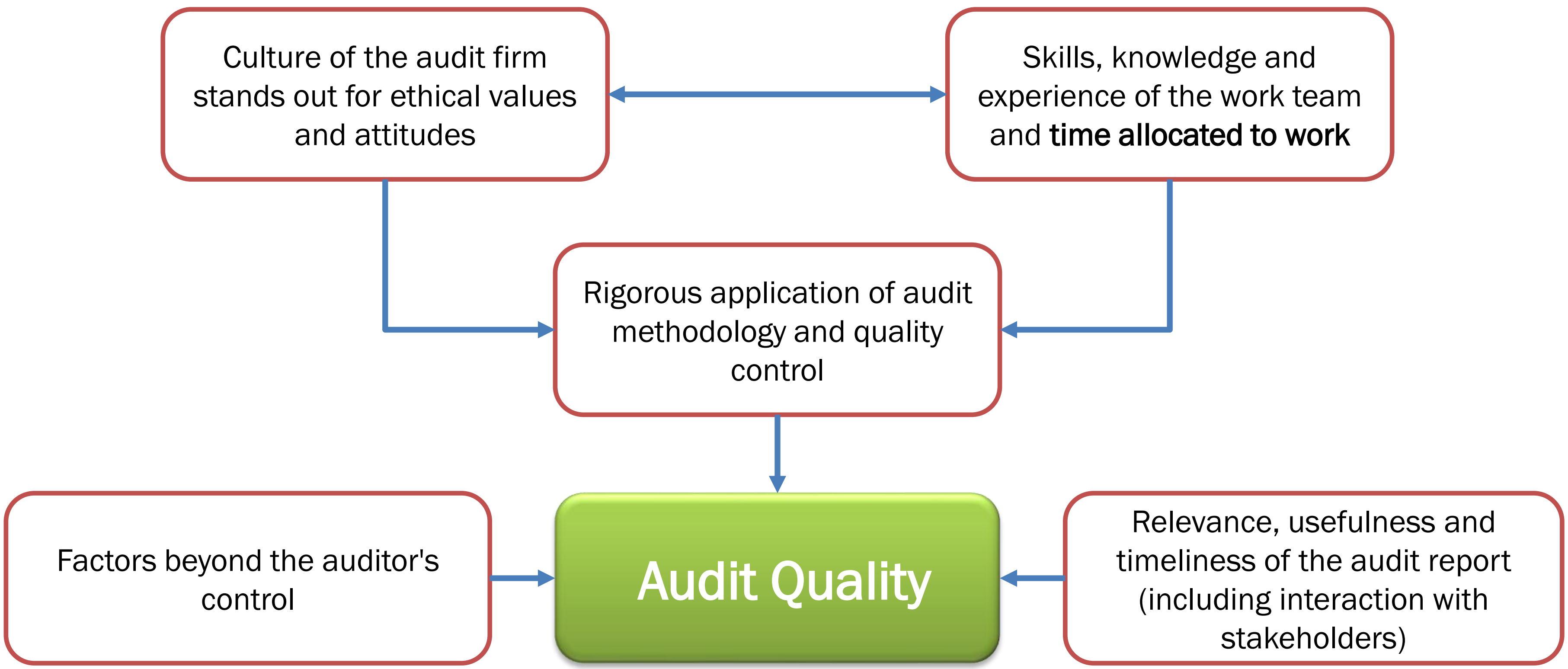
Independence

Auditor must report material misstatements detected and not corrected.

4. Professional regulation

✘ Audit Quality

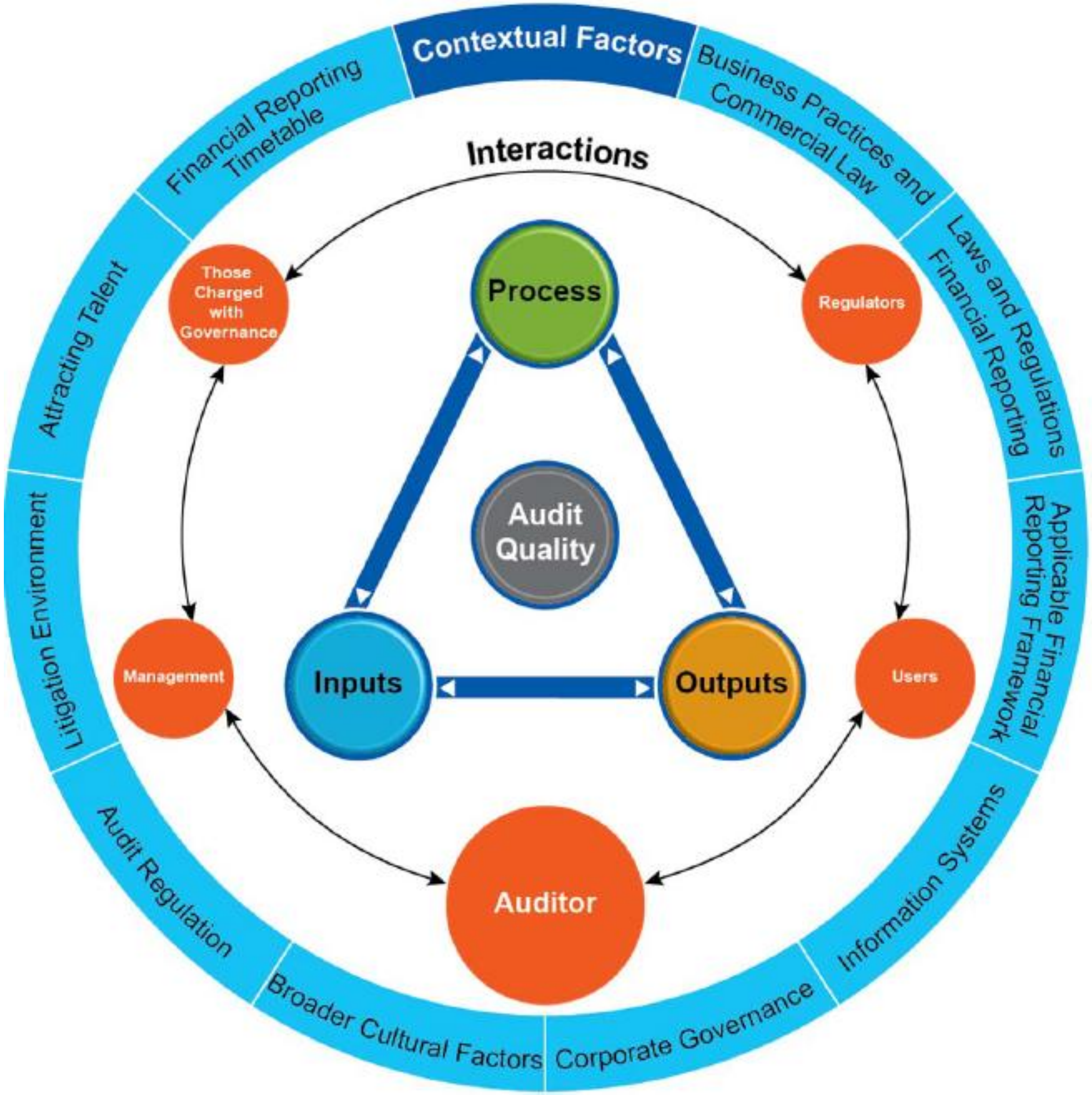
✓ **Audit quality drivers** (Financial Reporting Council, UK, 2008)



4. Professional regulation

✘ Audit Quality

Key elements of audit quality (IAASB Framework, 2016)



4. Professional regulation

Importance of conducting a quality audit

On December 20, 2011, the Public Company Accounting Oversight Board (PCAOB) revoked the ability of Bentleys Brisbane Partnership (an external audit firm) to audit public company audits, and the Board imposed a monetary penalty of $10,000 on Robert Forbes, the audit partner in charge of the audit of Alloy Steel International. These penalties were imposed because the PCAOB concluded that Bentleys and Forbes failed to exercise **due professional care** (a standard of care expected to be demonstrated by a competent auditing professional), failed to exercise **professional skepticism** (an attitude that includes a questioning mind and critical assessment of audit evidence), and failed to obtain sufficient evidence necessary to issue an audit opinion on the financial statements of Alloy Steel's 2006 fiscal year end financial statements. The PCAOB also concluded that Bentleys violated PCAOB quality control standards because the firm did not develop policies to ensure that the work performed by its personnel met PCAOB auditing standards and the Board said that the firm did not undertake audits that the firm could reasonably expect to be completed with professional competence.

Alloy Steel International is an American company headquartered in Malaga, Australia. Alloy's stock was traded on the Over the Counter (OTC) Bulletin Board and as such was subject to Securities and Exchange Commission (SEC) rules and requirements. Its auditors were subject to PCAOB rules and requirements. On the audit of Alloy, Bentleys and Forbes made a number of critical quality control mistakes. Bentleys and Forbes used an unregistered audit firm in Australia to actually perform the audit work, rather than performing the audit work themselves. Bentleys' and Forbes' involvement on the engagement was limited to reviewing the unregistered audit firm's workpapers. The unregistered audit firm's personnel had no training or experience in conducting audits that complied with PCAOB standards. Despite these factors, Bentleys and Forbes issued and signed an unqualified audit report on Alloy's 2006 financial statements. For further information about this scenario, see PCAOB disciplinary proceedings in Release No. 105-2011-007.

As you read through this chapter, consider the following questions:

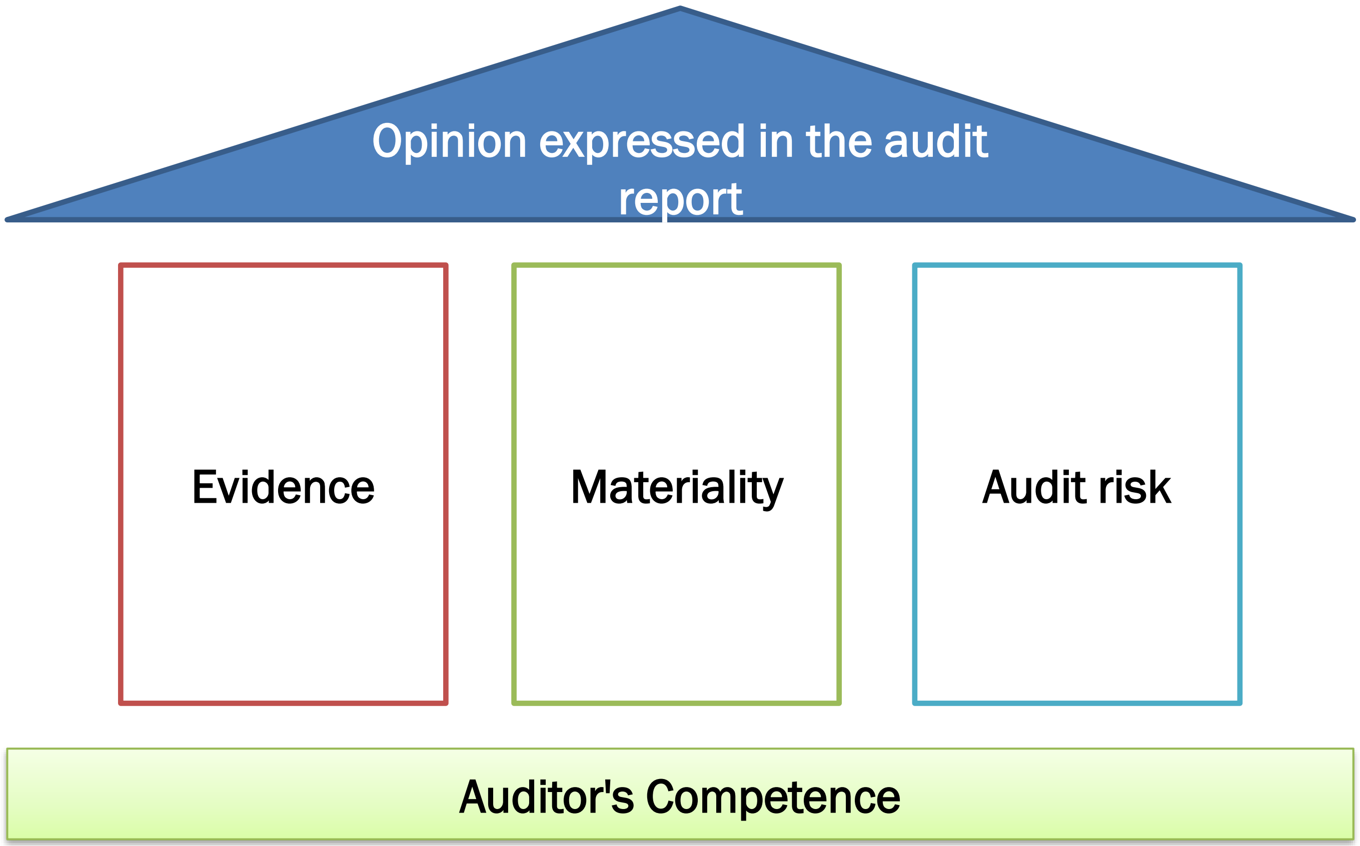
- What is the objective of auditing, and what process should auditors follow to accomplish this objective? (LO 1)
- Why do companies obtain audited financial statements? (LO 1)
- Who are the users of audited financial statements? (LO 1)
- What skills and knowledge are needed to be a competent audit professional? (LO 3)
- Why is it vital to perform an audit in a quality manner? (LO 5)
- Why are low quality audits, like those performed in this case, harmful? (LO 5)

The Public Company Accounting Oversight Board (PCAOB) revoked the ability to an audit firm to audit public company

Source: Johnstone, K. M., Gramling, A. e Rittenberg, L. E., (2014), Auditing: a business risk approach, 9th edition, Cengage.

5. Audit Pillars

- Essential elements in an audit



5. Audit Pillars

✘ Audit Evidence

"The Auditor shall design and implement audit procedures in such a way as to obtain **sufficient and appropriate audit evidence** to enable him/her to draw reasonable conclusions on the basis of which he/she **forms his/her opinion**". – **ISA 500**

✓ The auditor's opinion results from the proof/evidence obtained in the different procedures developed by the auditor on each of the **management assertions** contained in the Financial Statements. Therefore, the audit evidence is fundamental for:

- ☑ Express whether FS are truly and appropriately presented;
- ☑ Decide on the type of report to issue: modified or not modified report.

✓ The more appropriate and sufficient **audit evidence** obtained the **lower the audit risk**.

5. Audit Pillars

Audit Evidence

Concept (ISA 200.13)

- Any information used by the auditor to determine whether the <u>information being audited</u> - **assertions** - is in accordance with previously defined criteria. Therefore, **audit evidence** translates the information used by the auditor to arrive at the conclusions on which he/she bases his opinion.

- **Assertions:** statements made by management, explicitly or otherwise, which are included in the financial statements through the way the **classes of transactions** and **events**, **account balances** and **disclosures** are <u>recognized</u>, <u>measured</u> and <u>presented</u>.

The assertions are used by the auditor to consider the different types of material misstatements that can occur.

5. Audit Pillars

✘ Evidence concerning the assertions

Class of transactions and events, and related disclosures for the audited period	Account balances and related disclosures, at the end of the audited period
Occurrence	Rights and obligations
Completeness	Existence
Cutoff	Completeness
Classification	Accuracy, valuation and imputation
Accuracy	Classification
Presentation	Presentation

Assertions concerning other disclosures not directly related to the classes of transactions, events or account balances recorded (examples: Note on financial risk management - credit, liquidity, interest rate, exchange rate): should be used the above assertions.

5. Audit Pillars

Assertions about **classes of transactions and events**, and related disclosures, for the period covered by the audit:

Occurrence - the transactions and events that have been recorded or disclosed have occurred and pertain to the entity.

Completeness - all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

Accuracy - amounts and other elements relating to recorded transactions and events were properly recorded, and related disclosures were properly measured and described.

Cutoff - Transactions and events were recorded in the correct accounting period.

Classification - transactions and events were recorded in the appropriate accounts.

Presentation - Transactions and events have been properly aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

5. Audit Pillars

Assertions about **account balances**, and related disclosures, at period end:

Existence - the assets, liabilities and equity interests exist.

Rights and obligations - the entity owns or controls the rights to the assets and the liabilities are the obligations of the entity.

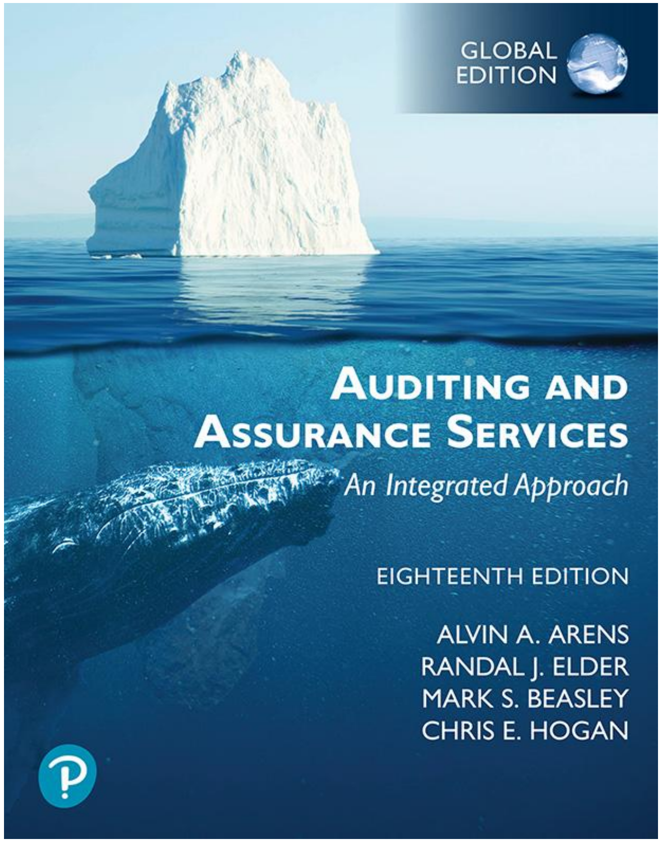
Completeness - all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

Accuracy, valuation and allocation - assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any valuation adjustments or allocations have been properly recorded, and related disclosures have been properly measured and described.

Classification - Assets, liabilities and equity interests have been recorded in the appropriate accounts.

Presentation - Assets, liabilities and equity interests have been properly aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

5. Audit Pillars

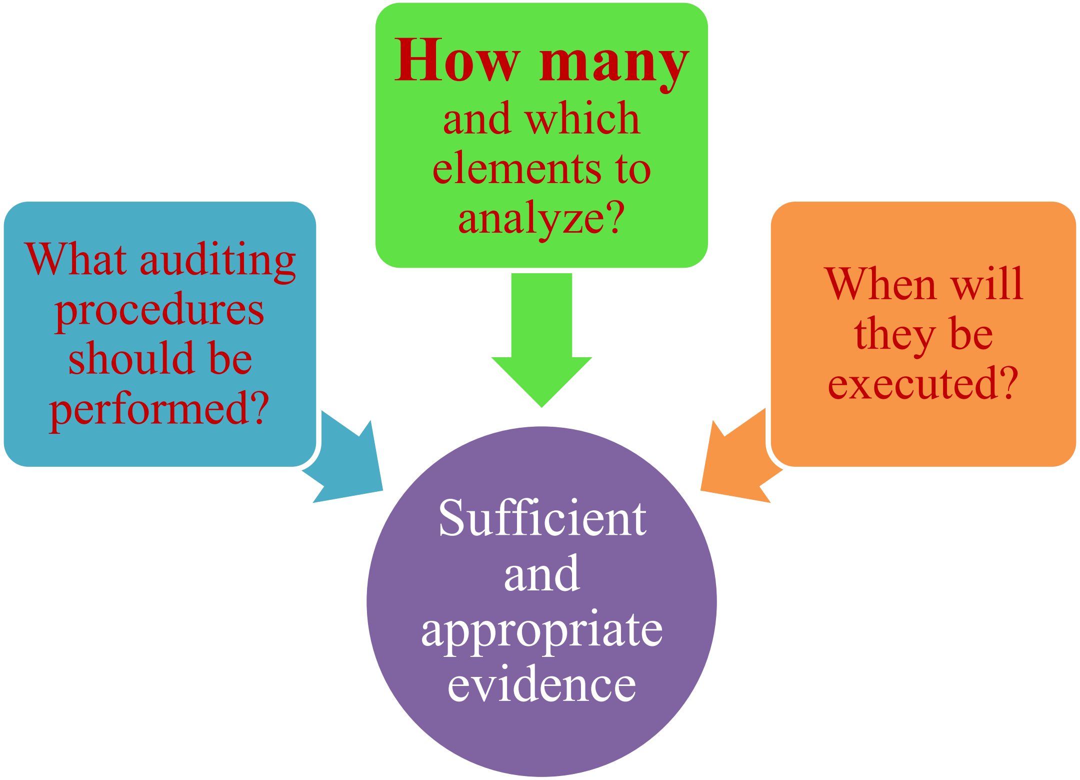


Chapter 7

Audit Evidence

5. Audit Pillars

- **Key questions about the evidence**



- The Auditor must be thorough (**precise**) and impartial in assessing the evidence.

5. Audit Pillars

Characteristics of Evidence for a Scientific Experiment, Legal Case, and Audit of Financial Statements

Basis of Comparison	Scientific Experiment Involving Testing a Medicine	Legal Case Involving an Accused Thief	Audit of Financial Statements
Use of the evidence	Determine effects of using the medicine	Decide guilt or innocence of accused	To arrive at a conclusion on which the auditor's opinion is based
Nature of evidence used	Results of repeated experiments	Direct evidence and testimony by witnesses and parties involved	Various types of audit evidence generated by the auditor, third parties, and the client
Party or parties evaluating evidence	Scientist	Jury and judge	Auditor

Characteristics of Evidence for a Scientific Experiment, Legal Case, and Audit of Financial Statements (continued)

Basis of Comparison	Scientific Experiment Involving Testing a Medicine	Legal Case Involving an Accused Thief	Audit of Financial Statements
Certainty of conclusions from evidence	Vary from uncertain to near certainty	Requires guilt beyond a reasonable doubt	High level of assurance
Nature of conclusions	Recommend or not recommend use of medicine	Innocence or guilt of party	Issue one of several alternative types of audit reports
Typical consequences of incorrect conclusions from evidence	Society uses ineffective or harmful medicine	Guilty party is not penalized or innocent party is found guilty	Statement users make incorrect decisions and auditor may be sued

Identify the three audit evidence decisions that are needed to create an audit program

Audit Evidence Decisions

There are three decisions about what evidence to gather and how much of it to accumulate:

The nature of audit procedures
The timing of audit procedures
The extent of audit procedures

Audit Program

- The list of audit procedures for an audit area or an entire audit is called an **audit program**

- The audit program always includes a list of the audit procedures, and it usually includes the timing and extent of the tests

Persuasiveness of Evidence

Audit standards require the auditor to accumulate sufficient appropriate evidence to support the opinion issued

The two determinants of the persuasiveness of evidence are:

- Appropriateness
- Sufficiency

Persuasiveness of Evidence

Appropriateness of evidence is a measure of the quality of evidence, which includes:

Relevance—evidence must *pertain to or be relevant to the audit objective* that the auditor is testing

Reliability—the degree to which evidence can be believable or worthy of trust

Persuasiveness of Evidence

The quantity of evidence obtained determines its sufficiency. It is measured:

- Primarily by the sample size the auditor selects, which is determined by
  - Auditor’s expectation of misstatements
  - The effectiveness of the client’s internal controls

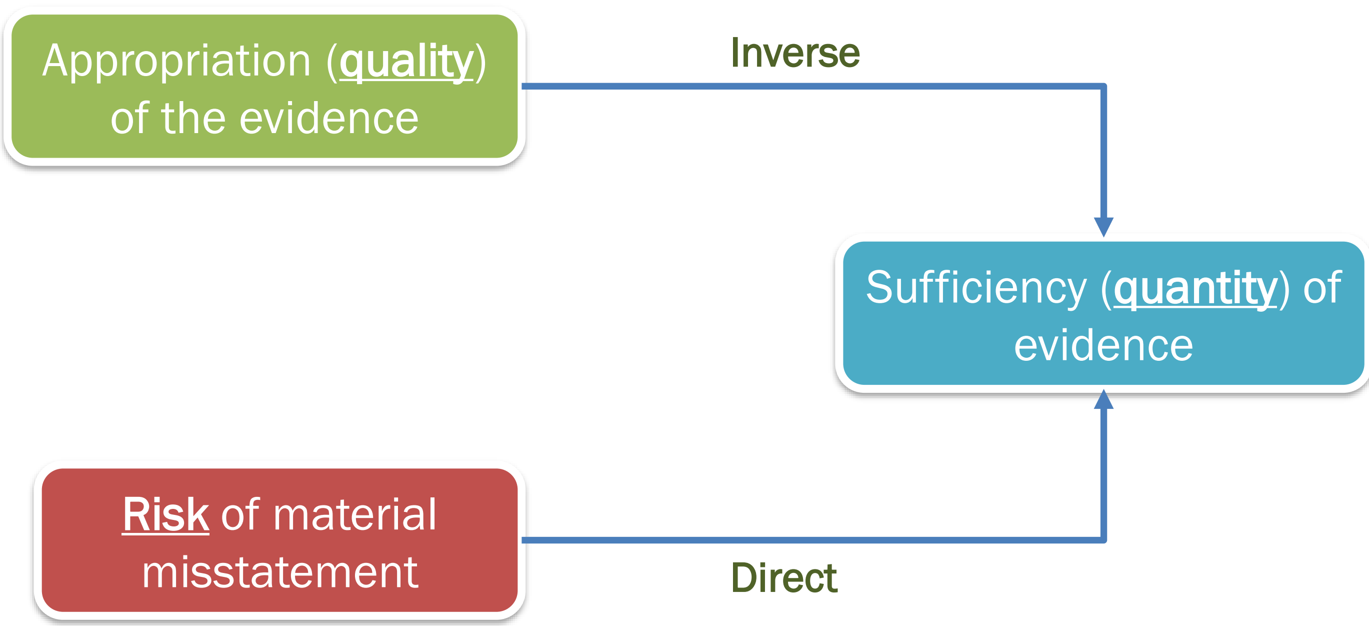
5. Audit Pillars

Persuasive audit evidence

Decisions about the evidence	Characteristics that affect persuasion
Nature of audit procedures and timeliness	Appropriate • Relevant • Trust ✓ Supplier independence ✓ Effectiveness of internal control ✓ Direct knowledge of the auditor ✓ Supplier Qualifications ✓ Objectivity of the evidence ✓ Opportunity: when they are executed, and the period covered by the analysis
Sample size and elements to select	Sufficient • Sample size must be adequate • Select the correct elements

5. Audit Pillars

✖ Audit Evidence (Chap. 7 – Arens, 18th ed, pag. 216)



Getting more evidence may, however, not compensate its lack of quality

5. Audit Pillars

Persuasive audit evidence

AUDITING IN PRACTICE

The Parmalat Confirmation Fraud

The Parmalat fraud involved a large family-held Italian company that produced dairy products around the world. The company's management perpetrated a fraud that involved taking cash from the business for family purposes, but not recording the transactions in the books, thereby resulting in an overstatement of cash on the company's books. It also shifted monetary assets in and out of banks located in the Bahamas Islands. The audit firm decided it should independently confirm the existence of Parmalat's $3.2 billion account with the Bank of America in New York. Unfortunately, the audit senior was careless, and after preparing the confirmation, he put it in the client's mail room where it was intercepted by management. Management was able to scan the signature of a Bank of America employee from another document and put it on a copy of the confirmation form. A Parmalat employee then flew to New York from Italy just to mail that confirmation to the auditors with the appropriate postmark. The auditors received the fraudulent confirmation and concluded that the cash balance existed. There is an important point here: There are no trivial tasks in an audit. Each procedure must be completed in a professional manner and with due care.

Source: Johnstone, K. M., Gramling, A. e Rittenberg, L. E., (2014), Auditing: a business risk approach, 9th edition, Cengage.

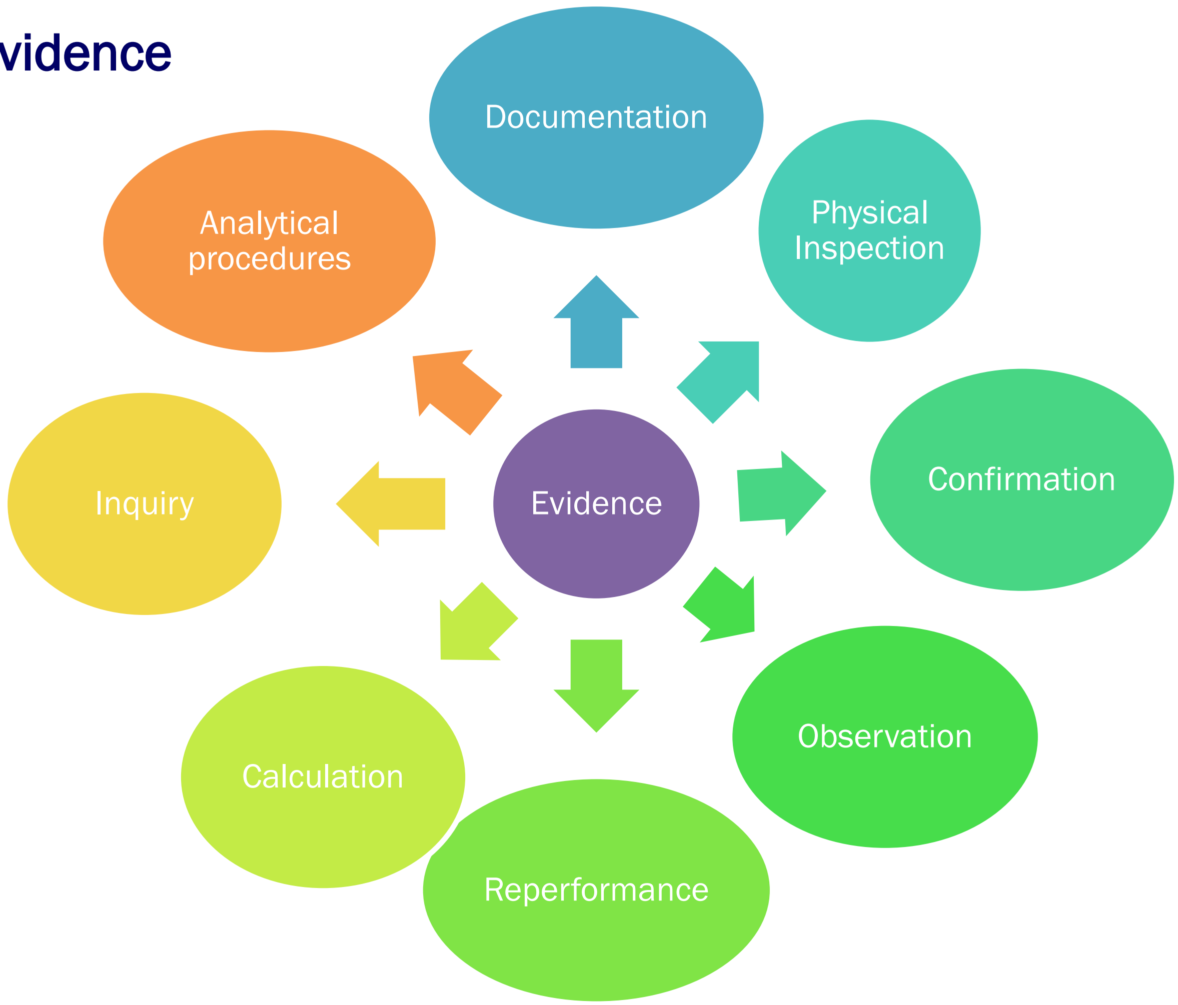
5. Audit Pillars

Exercise:

To prevent a situation as the one described before what could the auditor have done?

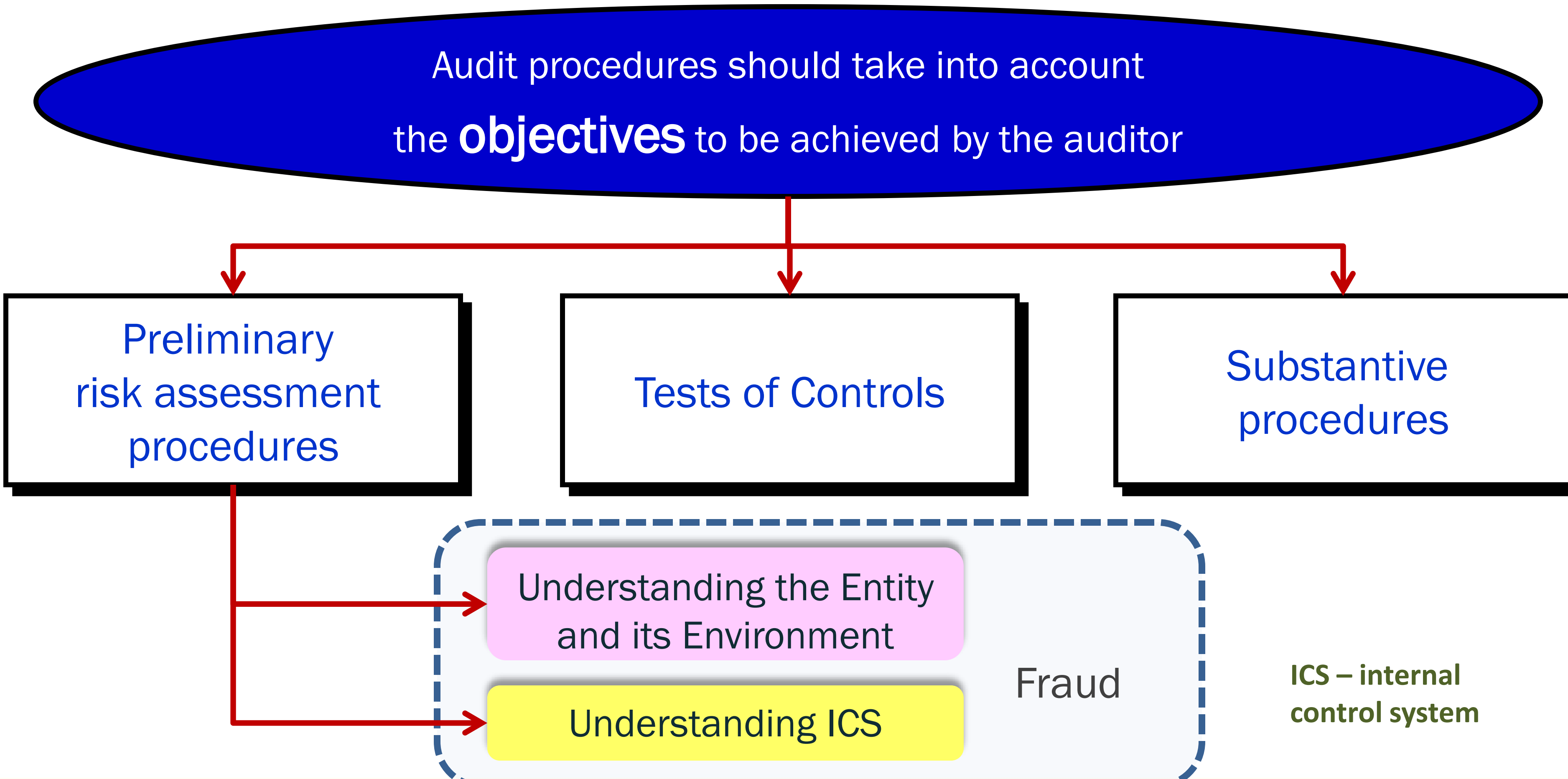
5. Audit Pillars

- Types of evidence



5. Audit Pillars

Audit procedures



5. Audit Pillars

- Implications of the **absence of evidence** => ISA 705

Depending on the circumstances, if the auditor is unable to obtain appropriate and sufficient audit evidence, this will have the following consequences:

✓**OPINION WITH RESERVATION** (BY LIMITATION OF SCOPE)

In our opinion, except for the possible effects of the matter referred to in the section "Basis for Opinions with Reservations", the attached financial statements present ...

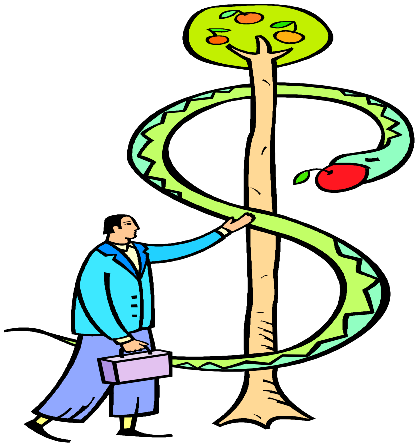
✓**EXCUSE OF OPINION**

We do not issue an opinion on the attached financial statements. Due to the relevance of the matter(s) referred to in the section "Basis for the avoidance of doubt", we have not obtained sufficient and appropriate audit evidence to provide a basis for our opinion on the accompanying financial statements.

5. Audit Pillars

- **Starting point: the auditor's responsibility is to issue an opinion**

In our opinion, the attached financial statements present in a true and fair way, in all material aspects, the financial position of XPTO, S.A. as of 12/31/2023 and its financial performance and cash flows for the period ending on that date in accordance with the Accounting and Financial Reporting Standards adopted in Portugal through the Accounting Standards System.



5. Audit Pillars

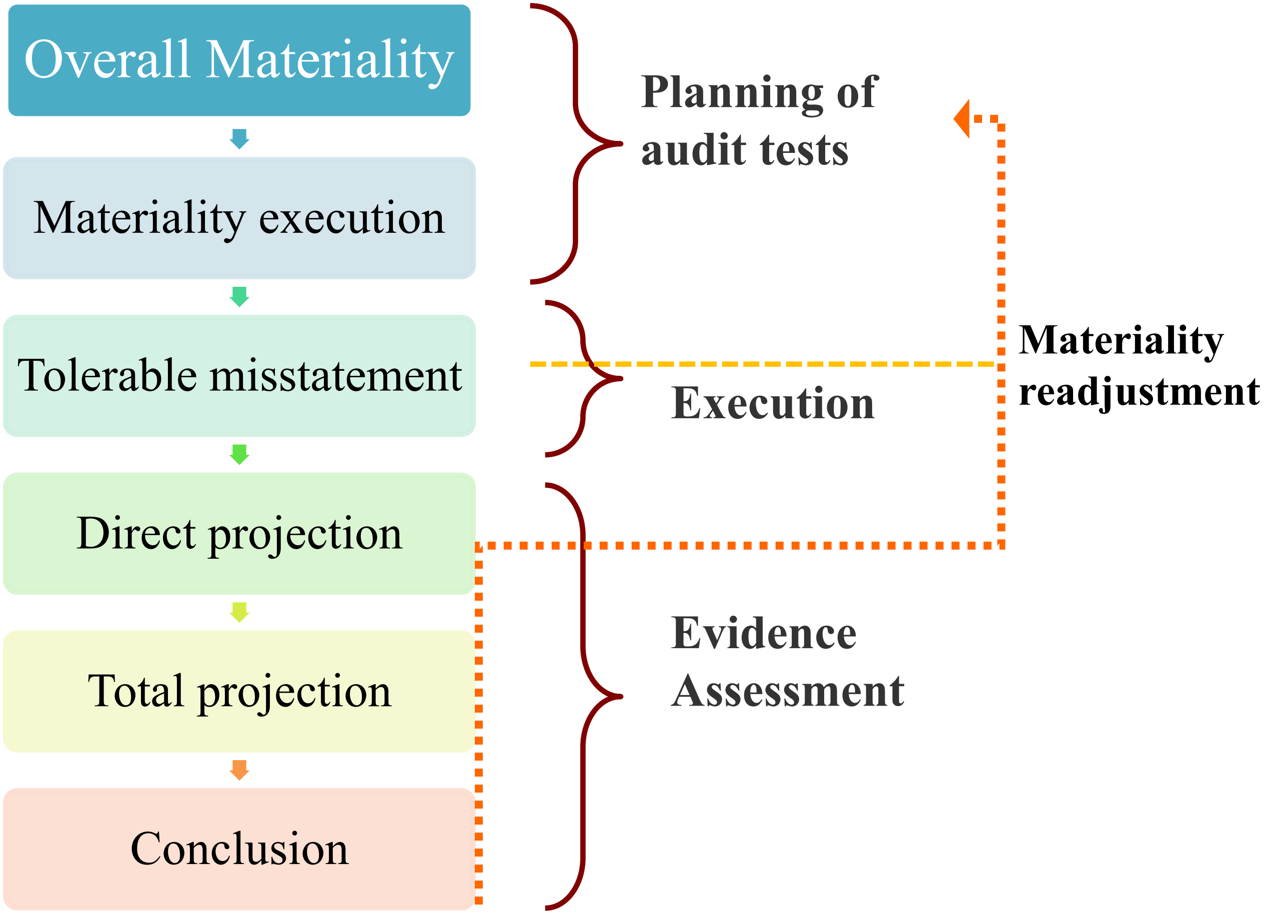
✘ Materiality concept – ISA 320

- Overall materiality: misstatements, including omissions, are considered material if they are expected, individually or jointly, to influence the economic decisions made by users on the basis of the financial statements. Judgements about overall materiality are determined by:
  - Circumstances at hand (e.g. studying the possibility of merging)
  - Perception of common financial information needs by users of the FS
  - Size or nature of a misstatement or by the combination of both.

- Execution Materiality: amount or amounts lower than the overall materiality that aims to reduce to an appropriately low level the probability that uncorrected and undetected aggregate misstatements exceed the overall materiality. Execution materiality is used in assessing the risk of material misstatement and determining additional auditing procedures.

5. Audit Pillars

- Materiality (ISA 320 + ISA 450 + ISA 530)



5. Audit Pillars

Global Materiality: quantitative aspect

GM formula = indicator x %

Choosing the appropriate reference indicator depends:

- ✓ Elements of the FS: assets, liabilities, equity, income or expenses
- ✓ Items that attract users' attention: profit, revenue, net assets, ...
- ✓ Nature of the entity, life cycle, sector of activity and economic environment it operates
- ✓ Structure of ownership of the entity and the way it is financed
- ✓ Volatility of the reference indicator

Thresholds suggested by IFAC – International Federation of Accountants

- ✓ 3% to 7% of pre-tax profits
- ✓ 1% to 3% of revenues
- ✓ 1% to 3% of assets
- ✓ 3% to 5% of equity

5. Audit Pillars

Assignment

For a company that in terms of Life cycle is considered a **Startup** what would be the impact of this in terms of the definition of the Thresholds suggested by IFAC concerning Global Materiality?

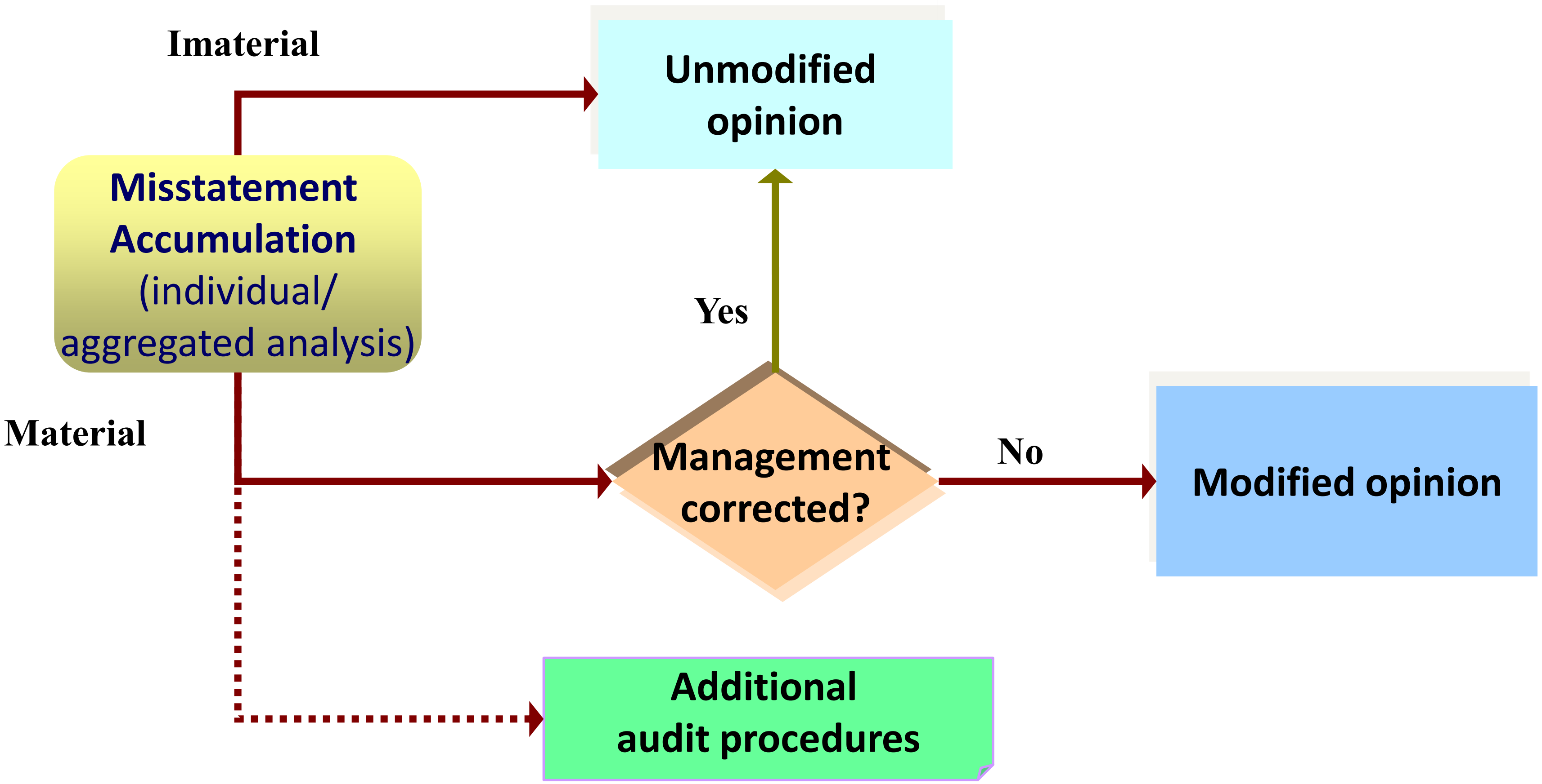
5. Audit Pillars

✘ Global Materiality: qualitative aspect

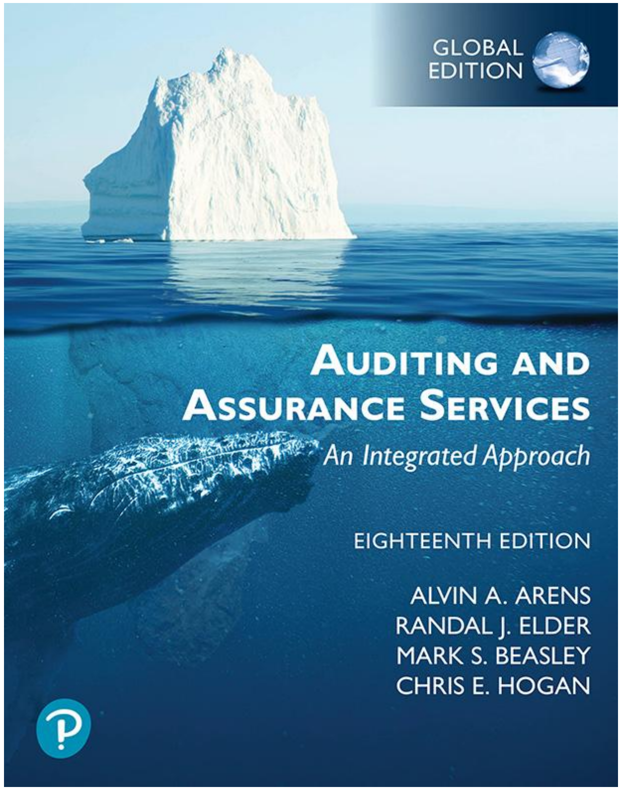
- Financing Clauses (convenants)
- Trends for changes
- Managers' incentives system
- Users of financial statements
- Propensity to hide illegal acts

5. Audit Pillars

- Relationship between materiality and type of auditor opinion



5. Audit Pillars



- Chapter 9
- Assessing the Risk of Material Misstatement

5. Audit Pillars

✘ Audit risk

- Auditors accept some level of **risk** or uncertainty in performing the audit function
- The assessment of risks is a matter of professional judgment rather than a precise measurement
  - Responding to these risks properly is critical to achieving a high-quality audit

5. Audit Pillars

✘ Audit risk

- The risk of material misstatement is the risk that the financial statements contain a material misstatement due to fraud or error prior to the audit
- **The risk of material misstatement exists at two levels:**
  - Overall financial statement level
  - Assertion level

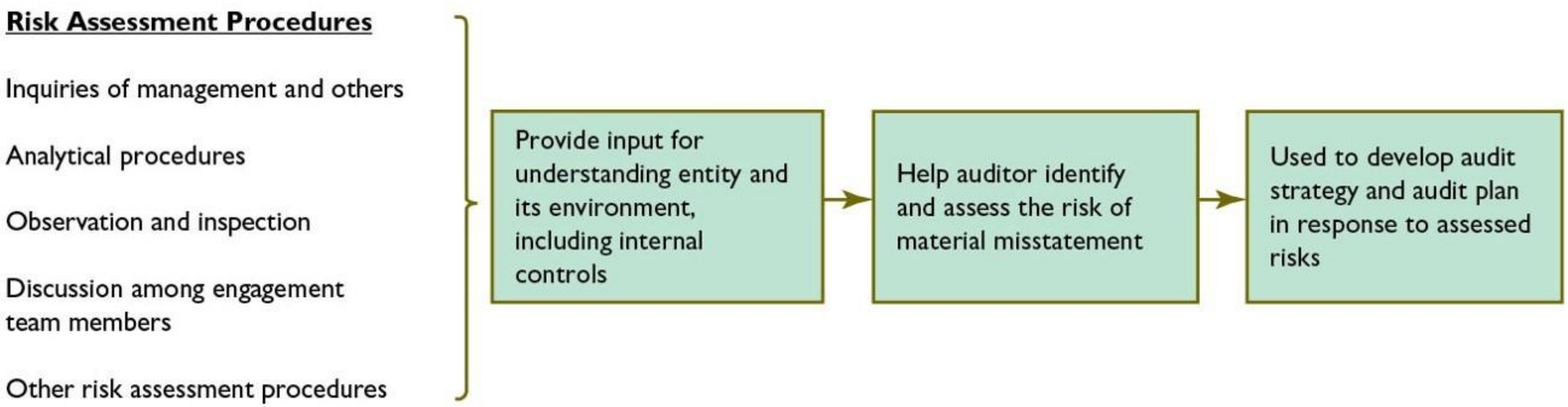
5. Audit Pillars

✘ Audit risk

- **Risk assessment procedures include the following:**
  - Inquiries of management and others within the entity
  - Analytical procedures
  - Observation and inspection
  - Discussion among engagement team members
  - Other risk assessment procedures

5. Audit Pillars

Audit risk



5. Audit Pillars

✘ Audit risk

Assignment

For a company as **VODAFONE** concerning the **audit strategy** and the **audit plan** what areas can be more significant for auditors?

5. Audit Pillars

✖ Audit risk

VODAFONE Assignment

vodafone

See the detailed answer in appendix

For a company such as **Vodafone**, a large multinational telecommunications and digital services provider, the **audit strategy** and **audit plan** must focus on areas of **high materiality, complexity, and inherent risk** — particularly those affected by **technological change, regulation,** and **cybersecurity**.

✘ Audit risk

VODAFONE Assignment

vodafone

See the detailed answer in appendix

1. **Revenue Recognition and Contract Accounting**

- Allocation of revenue between performance obligations (e.g., voice, data, and equipment).

- Revenue cut-off and completeness testing.

4. Cybersecurity and IT General Controls (ITGCs)

- Evaluation of **IT general controls** (access management, change management, backup and recovery).

- Review of **cyber risk management** and incident response procedures.

6. Taxation and Transfer Pricing

- Verification of **deferred tax assets/liabilities** and uncertain tax positions.

5. Audit Pillars

✖ Audit risk

VODAFONE Assignment

See the detailed answer in appendix

7. Provisions, Litigation, and Contingent Liabilities

- Adequacy of provisions for **legal disputes** and **regulatory investigations**.

9. Consolidation and Group Reporting

- Testing of **group consolidation controls** and intercompany eliminations.

10. ESG and Sustainability Disclosures (Emerging Area)

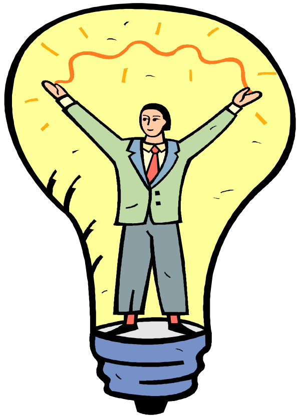
- Validation of **non-financial metrics** (e.g., energy use, emissions, digital inclusion).
- Assessment of **data governance** and traceability of ESG information.
- Consistency between **financial and sustainability reporting** narratives.

5. Audit Pillars

Audit risk

Concept: **it is the auditor's susceptibility to express an inappropriate opinion when the financial statements are materially misstated** (ISA200.13)

- In the report, the auditor expresses an opinion with an acceptable level of assurance that the financial statements are free from material misstatement.
- Acceptable security does not mean absolute security, so the financial statements may be misstated, and the auditor has not detected such misstatements - it is intended to minimize the occurrence of such a situation.



Audit Risk is determined by the auditor and managed by the auditor.

5. Audit Pillars

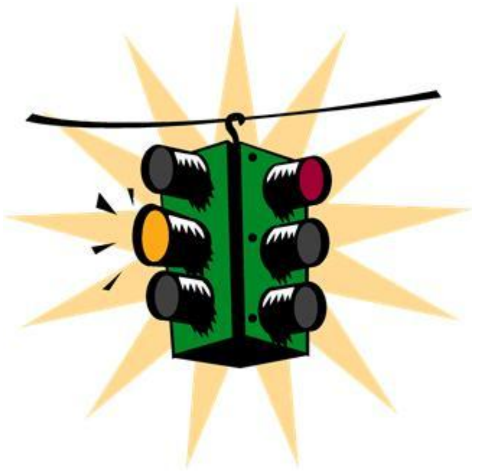
✘ Acceptable Audit Risk

Concept:

It is the measure of how much the auditor is available to accept that the financial statements may be materially misstated after having performed the audit and having issued an unqualified opinion.

Factors to consider in its definition:

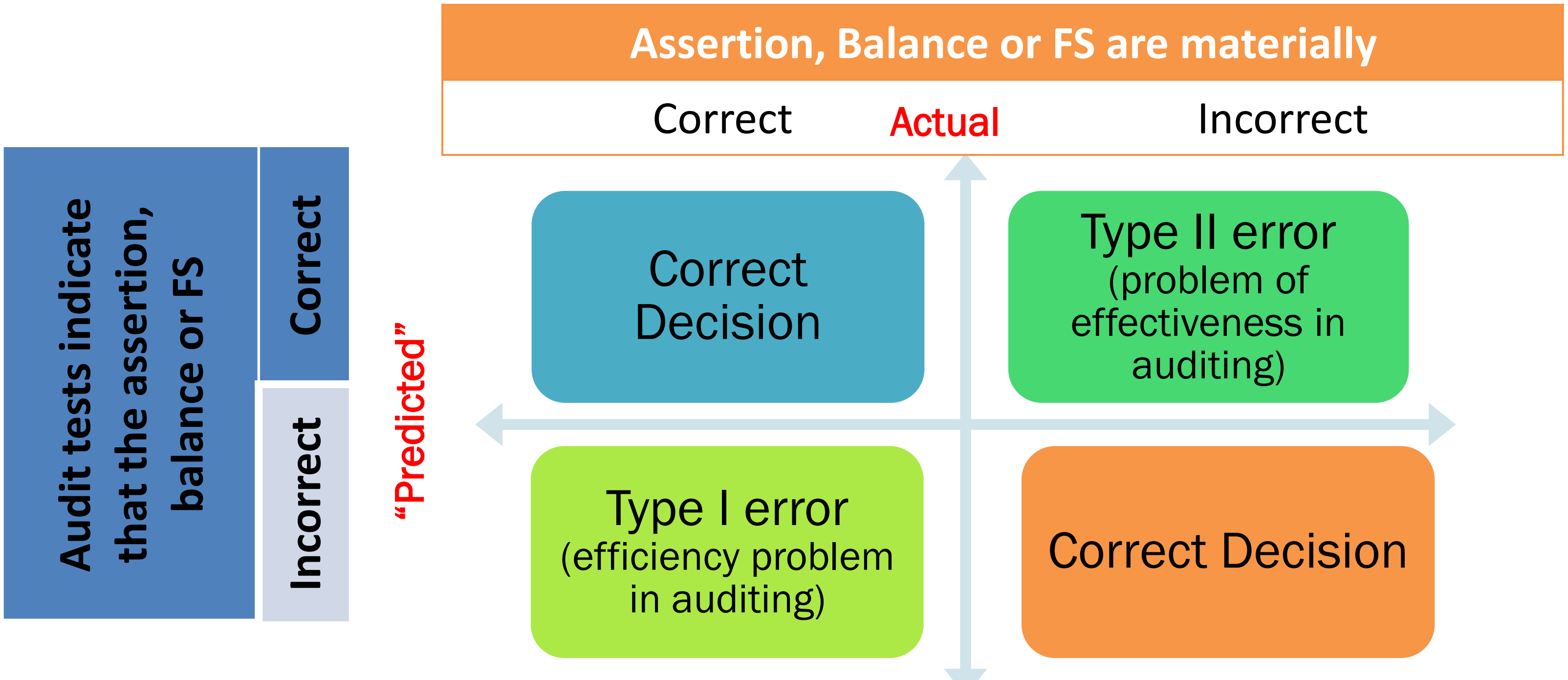
- User confidence in FS
- Probability of financial difficulties
- Management Integrity



5. Audit Pillars

✘ Audit Risk

The greater the auditor's need to have security in the opinion he is expressing, the lower the audit risk will have to be. For a 99% security level the auditor is willing to incur an audit risk of 1%.



5. Audit Pillars

✘ Audit risk Model / Components

- **The four risks in the audit risk model:**
  - Planned detection risk
  - Inherent risk
  - Control risk
  - Acceptable audit risk

5. Audit Pillars

✘ Audit risk components

Misstatement Risk or Information Risk:
risk of material misstatements

Inherent risk

Control risk

$$\text{Audit Risk} = \underbrace{IR \times CR} \times DR$$

Detection Risk:
risk of the auditor not detecting misstatements

- Inappropriate auditing procedures
- Unable to detect even using the proper procedures
- Misinterpretation of obtained results

Non-sampling risk

Sampling risk

5. Audit Pillars

✘ Audit risk components

$$\text{Audit Risk} = IR \times CR \times DR$$

Inherent risk: Measures the auditor´s assessment of the susceptibility of an assertion to be material misstatement.

Control risk: measures the auditor´s assessment of the risk that a material misstatement could occur in an assertion and not be prevented or detected on a timely basis by the client´s **internal control**.

Detection Risk: Risk of the auditor not detecting misstatements

5. Audit Pillars

✘ Audit risk components

Inherent Risk

Is the risk of a **material misstatement** in the financial statements **arising due to error or omission** as a result of factors other than the failure of controls (factors that may cause a misstatement due to absence or lapse of controls are considered separately in the assessment of control risk).

- **Inherent risk** measures the auditor's assessment of the susceptibility of an assertion about a class of transactions, account balance, or disclosure to material misstatement, before considering the effectiveness of related internal controls

5. Audit Pillars

✘ Audit risk components

Inherent Risk

Inherent risk is generally considered to be **higher** where a **high degree of judgment and estimation is involved** or where **transactions** of the entity are **highly complex**.

For example, the **inherent risk** in the audit of a newly formed financial institution (ex. a Fintech) which has a significant trade and exposure in **complex derivative instruments** may be considered to be significantly **higher** as compared to the audit of a well-established manufacturing concern operating in a relatively stable competitive environment.

5. Audit Pillars

✘ Audit risk components

Control Risk

Is the risk of a material misstatement in the financial statements arising due to **absence or failure** in the operation of **relevant controls** of the entity.

- **Control risk** measures the auditor's assessment of the risk that a material misstatement could occur in an assertion and not be prevented or detected and corrected on a timely basis by the client's internal controls

5. Audit Pillars

✘ Audit risk components

Control Risk

Organizations must have adequate internal controls in place to prevent and detect instances of fraud and error. **Control risk** is considered to be **high** where **the audited entity does not have adequate internal controls** to prevent and detect instances of fraud and error in the financial statements.

Assessment of control risk may be higher for example in case of a **small sized entity** in which **segregation of duties is not well defined** and the financial statements are prepared by individuals who do not have the necessary technical knowledge of accounting and finance.

Audit risk components

VODAFONE Assignment

Concerning financial audit for a company like VODAFONE what aspects should be included and present in the **Internal Control System** of VODAFONE to keep the Control Risk at a lower level?

5. Audit Pillars

✘ Audit risk components

VODAFONE Assignment

For a company such as **Vodafone**, a **robust Internal Control System (ICS)** is essential to keep **Control Risk** at a **low level**, ensuring reliability of financial reporting, safeguarding of assets, compliance with laws, and operational efficiency.

In appendix is a structured synthesis of what **should be included and present** in Vodafone's internal control framework — aligned with **COSO** and **ISA 315 (Revised)** principles, and tailored to the **telecommunications sector**.

5. Audit Pillars

- Audit risk components

See the detailed answer in appendix

5. Audit Pillars

✘ Audit risk components

Detection Risk

Is the risk that the auditors **fail to detect a material misstatement** in the financial statements.

An auditor must apply audit procedures to detect material misstatements in the financial statements whether due to fraud or error. Misapplication or omission of critical audit procedures may result in a material misstatement remaining undetected by the auditor.

Some **detection risk is always present** due to the inherent limitations of the audit such as the use of sampling for the selection of transactions.

Detection risk can be reduced by auditors by **increasing the number of sampled transactions** for detailed testing.

5. Audit Pillars

✘ Audit risk components

Audit risk model is used by the auditors to manage the overall risk of an audit engagement.

Auditors proceed by examining the **inherent** and **control risks** pertaining to an audit engagement while gaining an understanding of the entity and its environment.

Detection risk forms the **residual risk** after taking into consideration the **inherent and control risks** pertaining to the audit engagement and the overall **audit risk** that the **auditor is willing to accept**.

Where the auditor's assessment of **inherent and control risk is high**, the **detection risk** is set at a **lower level** to keep the **audit risk** at an acceptable level.

Lower detection risk may be achieved by increasing the **sample size** for audit testing. Conversely, where the auditor believes the **inherent and control risks** of an engagement to be **low**, **detection risk** is allowed to be set at a **relatively higher level**.

5. Audit Pillars

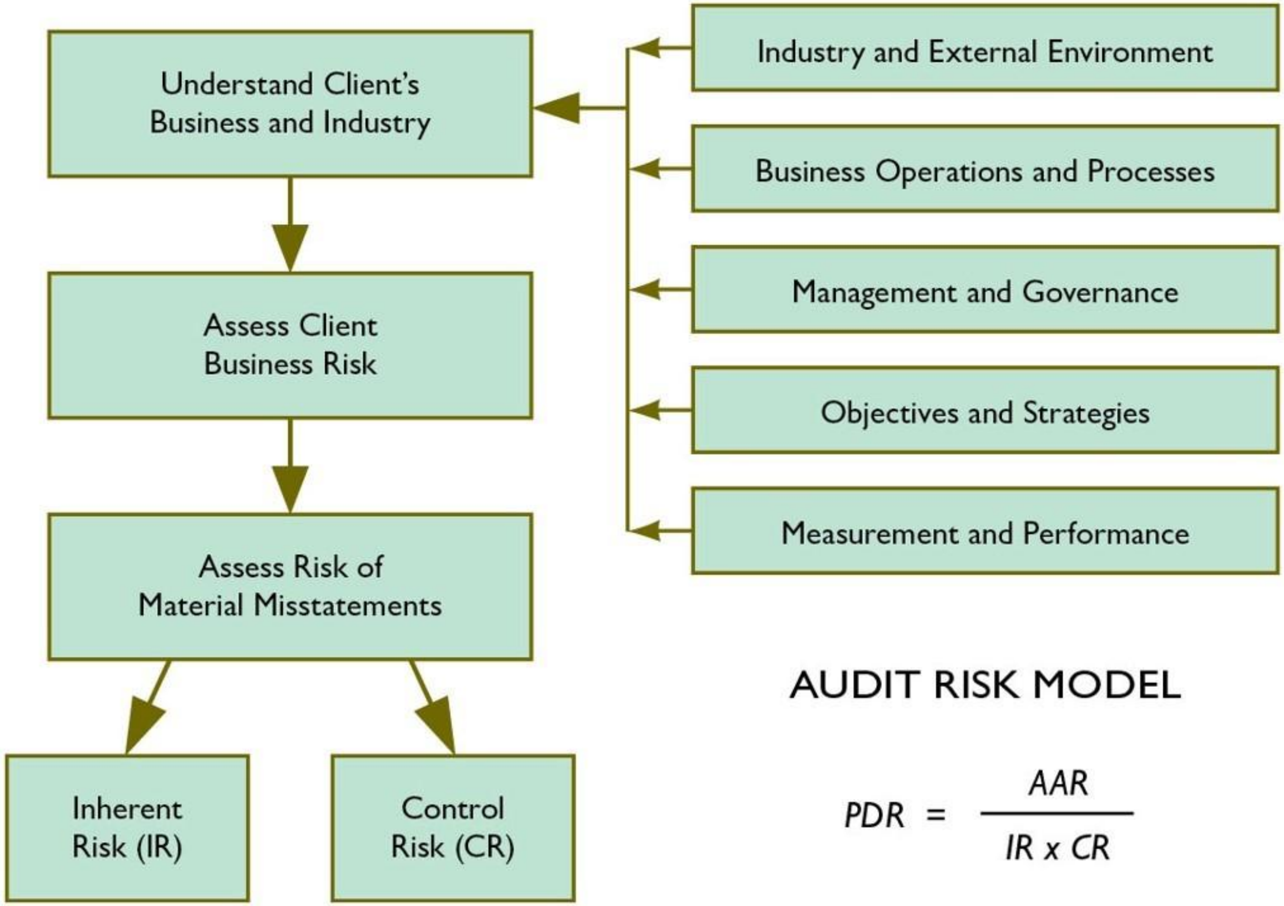
✘ Audit risk components

- **Acceptable audit risk** is a measure of how willing the auditor is to accept that the financial statements may be materially misstated after the audit is completed and an unmodified opinion has been issued

Assessing Acceptable Audit Risk (1 of 2)

- Auditors must decide the appropriate acceptable audit risk for an audit
  - Auditors first decide on engagement risk and then use engagement risk to modify acceptable audit risk
  - **Engagement risk** is
    - The risk that the auditor or audit firm will suffer harm after the audit is finished, even though the audit report was correct

Audit Risk Model and Understanding the Client's Business and Industry

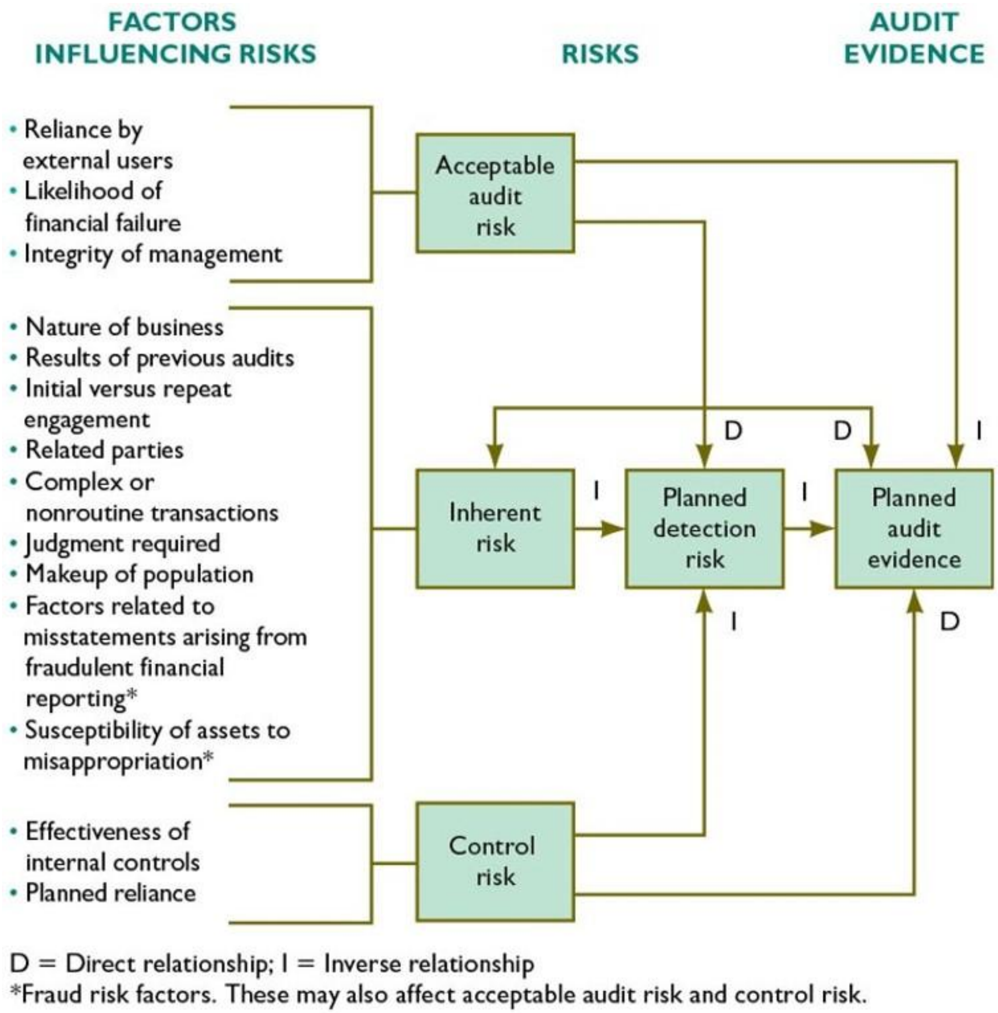


AUDIT RISK MODEL

$$PDR = \frac{AAR}{IR \times CR}$$

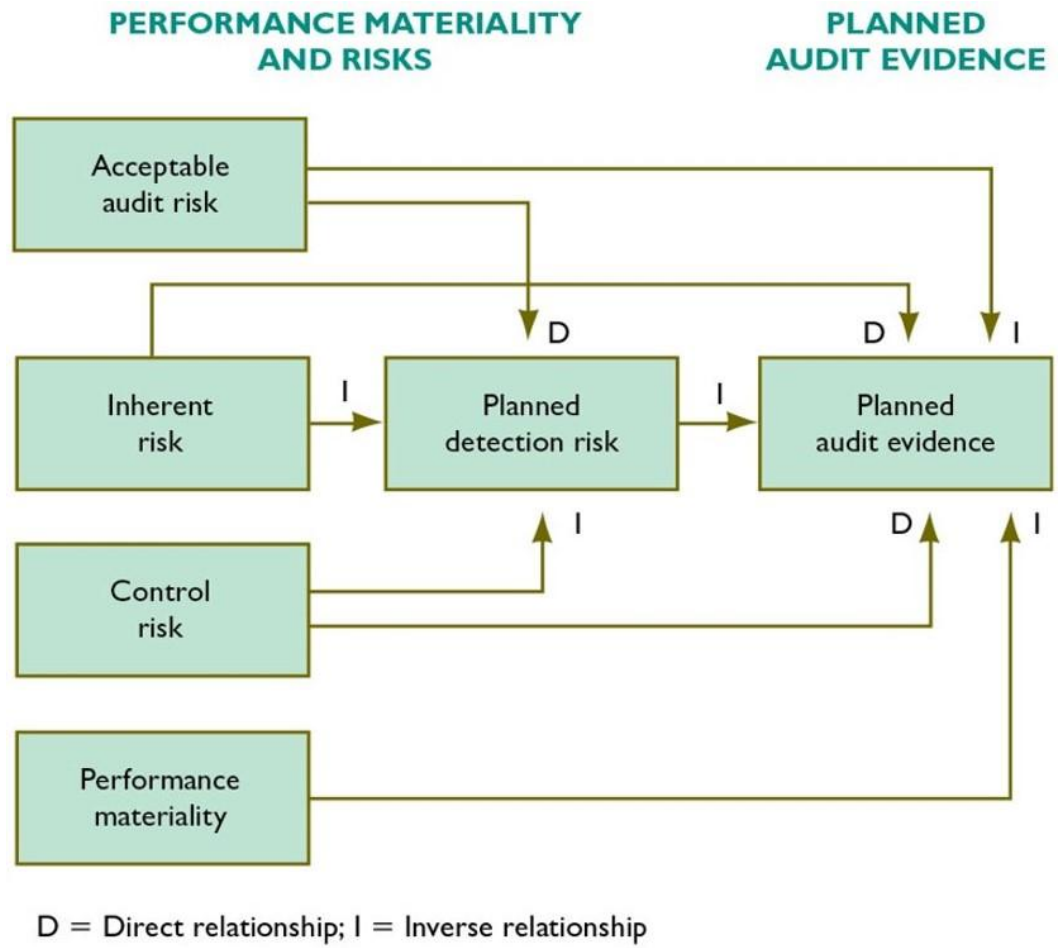
5. Audit Pillars

Factors Influencing Risks and Relationship of Risks to Planned Evidence



5. Audit Pillars

Relationship of Performance Materiality and Risks to Planned Evidence



5. Audit Pillars

Example

ABC is an audit and assurance firm which has recently accepted the audit of XYZ. During the planning of the audit, engagement manager has noted the following information regarding XYZ for consideration in the risk assessment of the assignment:

XYZ is a listed company operating in the financial services sector

- XYZ has a large network of subsidiaries, associates and foreign branches
- The company does not have an internal audit department and its audit committee does not include any members with a background in finance as suggested in the corporate governance guidelines
- It is the firm's policy to keep the overall audit risk below 10%

Inherent risk in the audit of XYZ's financial statements is particularly high because the entity is operating in a highly regulated sector and has a complex network of related entities which could be misrepresented in the financial statements in the absence of relevant financial controls. The first audit assignment is also inherently risky as the firm has relatively less understanding of the entity and its environment at this stage. The inherent risk for the audit may therefore be considered as high.

Control risk involved in the audit also appears to be high since the company does not have proper oversight by a competent audit committee of financial aspects of the organization. The company also lacks an internal audit department which is a key control especially in a highly regulated environment. The control risk for the audit may therefore be considered as high.

Source: https://accounting-simplified.com/audit/risk-assessment/audit-risk/

5. Audit Pillars

Example

If inherent risk and control risk are assumed to be 60% each, detection risk has to be set at 27.8% in order to prevent the overall audit risk from exceeding 10%.

Working

Audit Risk = Inherent Risk x Control Risk x Detection Risk

0.10 = 0.60 x 0.60 x Detection Risk

0.10 = 0.36 x Detection Risk

Detection Risk = 0.278 = 27.8%

5. Audit Pillars

How does audit risk affect audit strategy?

The extent and nature of audit procedures is determined by the level of detection risk required to bring audit risk to an acceptable level.

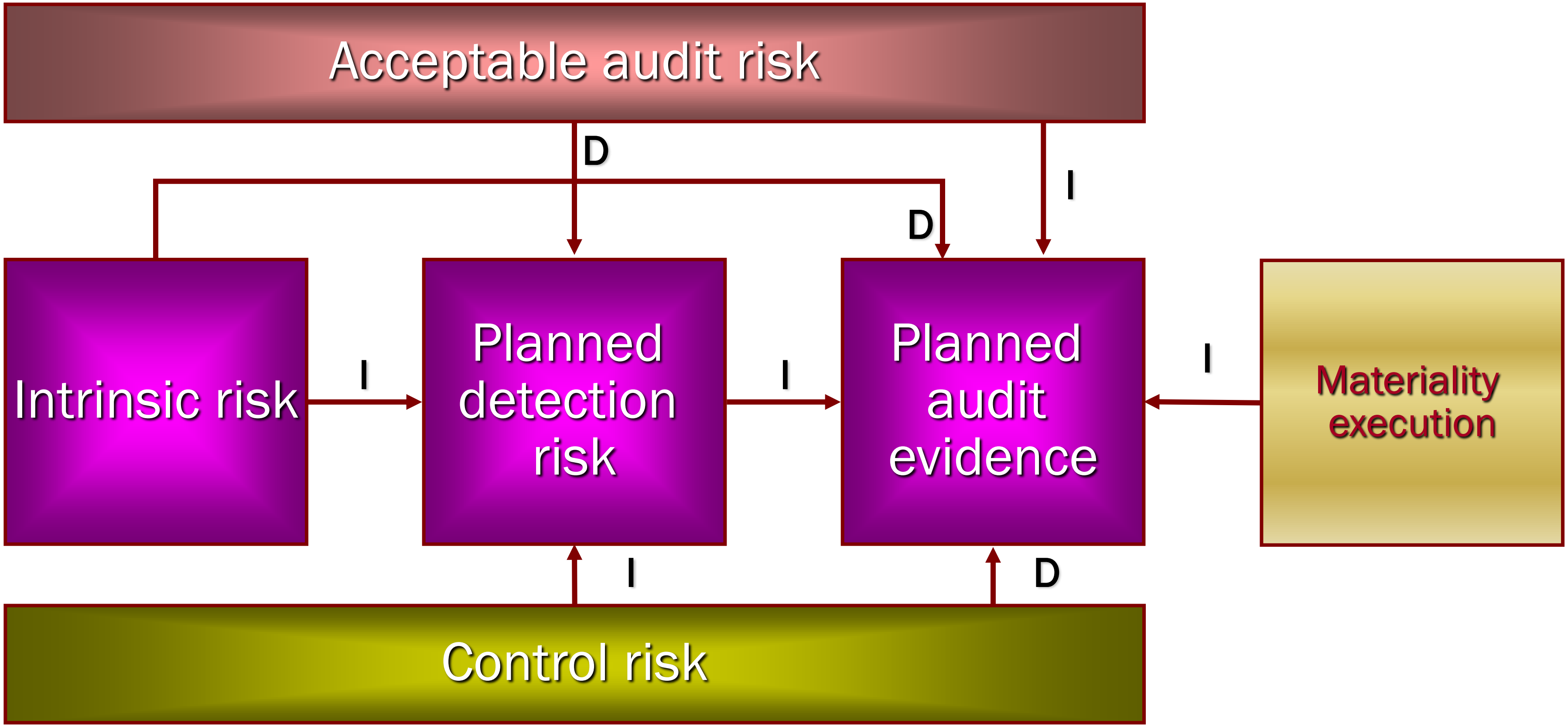
Auditors cannot control the inherent risk or control risk. They can however balance these risks by determining a suitable detection risk to keep the overall audit risk in check.

Detection risk directly influences audit strategy.

For example, if an audit requires a low detection risk to counter a high control risk, auditors may rely less on **control testing** and conduct extensive **substantive procedures** to form a valid audit opinion.

5. Audit Pillars

- Relationship between the 3 pillars



D = direct relation; I = inverse relation

5. Audit Pillars

- Auditing is highly influenced by the professional judgment of the Chartered Accountant (§23 of ISA 200)
  - ✓ The materiality and audit risk.
  - ✓ The nature, timeliness and extent of audit procedures used to satisfy ISA requirements and collect audit evidence.
  - ✓ The verification that sufficient and appropriate audit evidence has been obtained and the need to do more to achieve the objectives of the ISAs and thus the general objectives of the auditor.
  - ✓ The assessment of the judgements made by management in the application by the entity of the applicable financial reporting framework.
  - ✓ The elaboration of conclusions based on the audit evidence obtained, such as, for example, the assessment of the reasonableness of the estimates made by the management in the preparation of the financial statements.

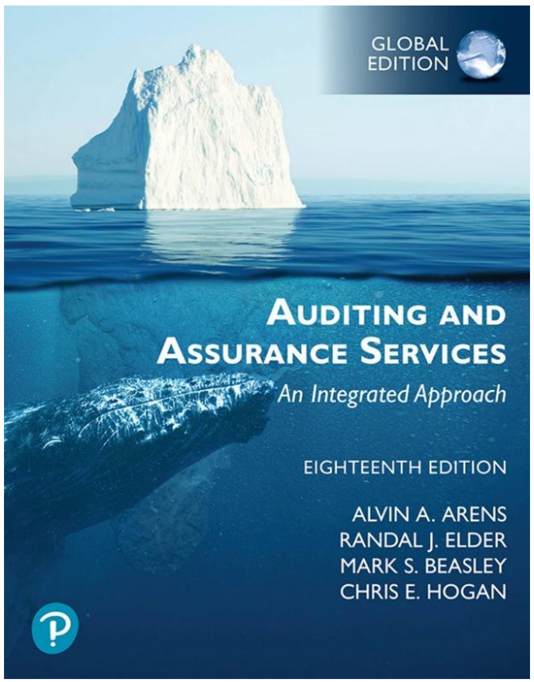
Questions

1. Explain why auditor´s reports are important to users of financial statements and why it is desirable to have standard wording?

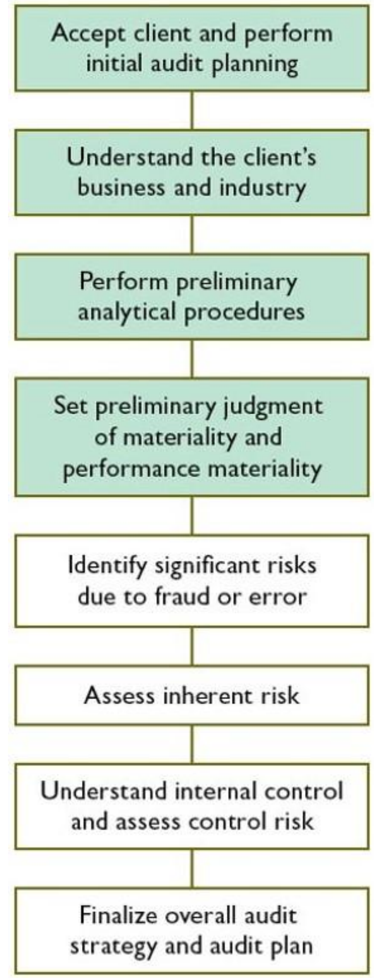
2. Provide a definition of professional judgement when referring to the Auditor

3. Define independence of the auditor and why this is a critical aspect?

- Audit Planning and Materiality



- Chapter 8



6. Audit path

Accounting process and auditing

Accounting

(guided by SNC - Sistema Normalização Contabilística and management responsibility)

- Analyzes events and transactions
- Recognition and measurement of the transactions occurred
- Classifies and aggregates the transactions in the various accounts
- Preparation of FS according to the applicable reporting structure
- **Account reporting to shareholders**

Audit

(guided by auditing standards and auditor responsibility)

- Obtain and assess the evidence on the FS
- Tests the assertions considering the applicable reporting structure
- Verifies that globally the financial information gives a true and appropriate image of the company
- Issues the audit report

6. Audit path

Stages of the audit

Acceptance of commitment

Audit planning

What events may occur that will cause material misstatements in FS?

Additional audit procedures and evidence of misstatements

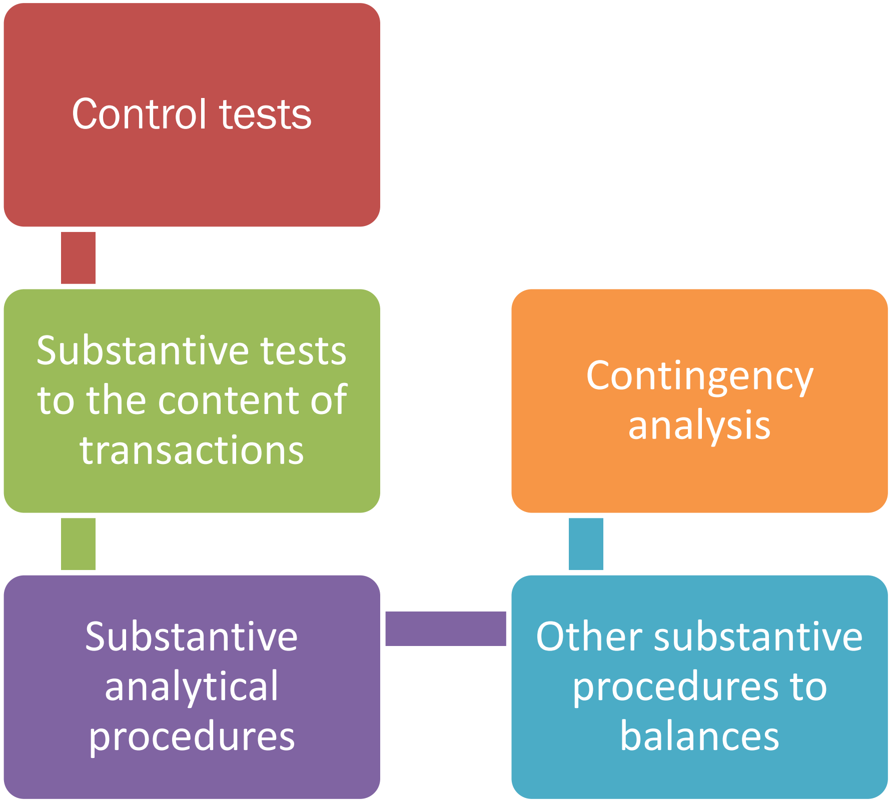
Did the identified events occurred and resulted in material misstatements in the FS?

Assessment and audit report

What is the appropriate audit opinion in view of the evidence obtained on FS?

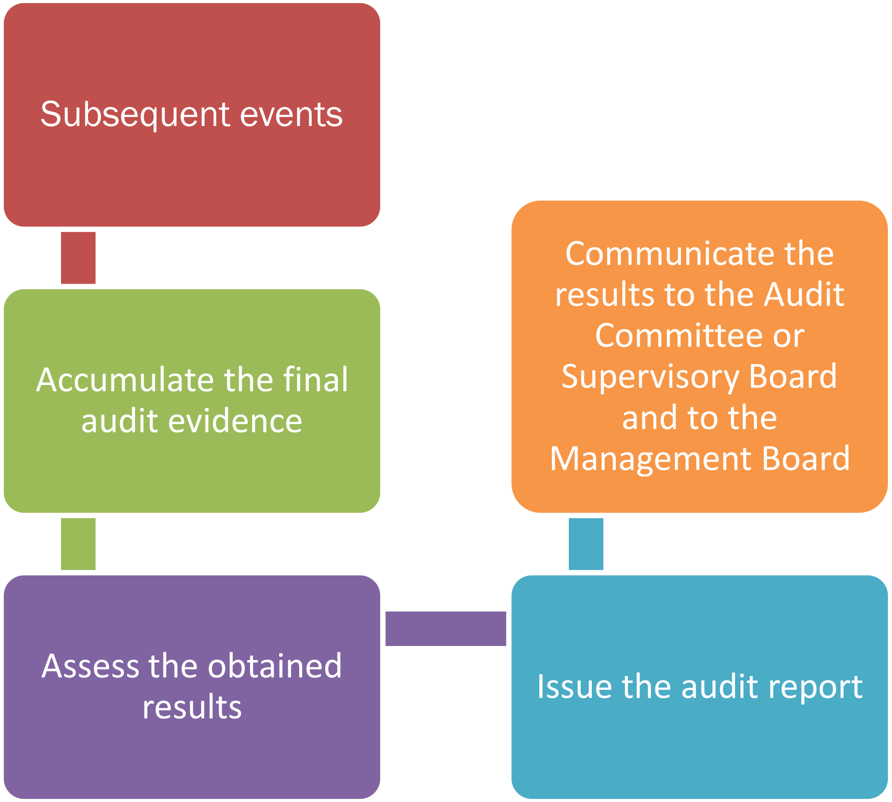
6. Audit path

- Response plan to misstatement risks



6. Audit path

- Conclusion, assessment and audit report

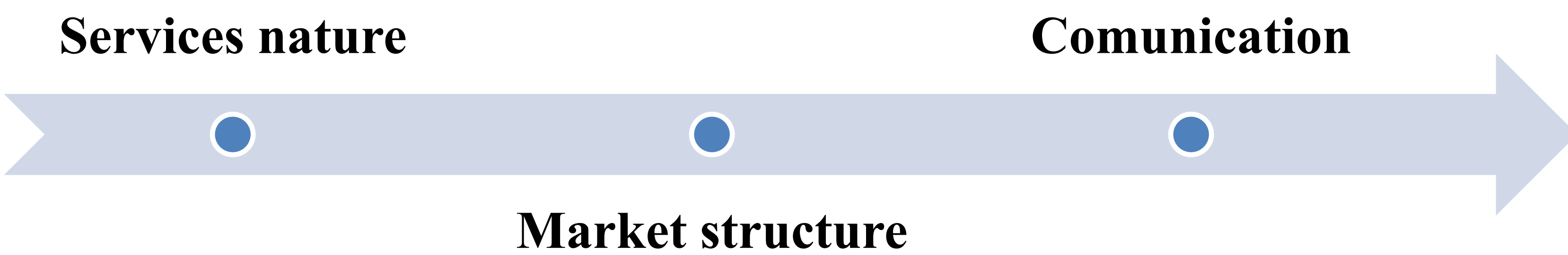


7. Acceptance of the commitment

✘ *Overview*

✓**Objective:** to determine if the conditions for the commitment are met and later convince the client to hire the auditor

✓Is it easy to get clients?



MANAGING ENGAGEMENT RISK

AIG was a large insurance company that posted a $3.9 billion restatement of earnings in May 2005. AIG purposely hid many of the transactions related to the restatement from its audit firm, PwC. Following the restatement, PwC was sued for damages, and ultimately paid a settlement of $97.5 million. In short, management's lack of integrity ultimately cost the CPA firm many millions of dollars.

7. Acceptance of the commitment

✘ Example BES | PWC

✓BES – Banco Espírito Santos was a client that had a significant level of risk

✓PwC wanted to stop being an auditor of BES because Mr. Ricardo Salgado had too much strength

http://www.jornaldenegocios.pt/empresas/detalhe/pwc_quis_deixar_de_ser_auditora_do_bes_porque_salgado_tinha_demasiada_forca.html

"O facto do Dr. Ricardo Salgado desempenhar em conjunto três papéis relevantes, a saber, CEO, responsável financeiro e responsável pela contabilidade, deixava-nos crescentemente desconfortáveis, pelo que entendemos que existiam riscos adicionais relacionados com esta realidade", disse José Alves, presidente da PwC, na comissão parlamentar de inquérito à gestão do BES e do GES."

✓PwC says there were "difficulties in obtaining information" at BES

http://economico.sapo.pt/noticias/pwc-diz-que-havia-dificuldades-de-obtencao-de-informacao-no-bes_210272.html

7. Acceptance of the commitment

Exercise - Client Risk Assessment (KYC & AML) in an Audit Firm

Indicate how you would conduct a Client Risk Assessment (KYC – Know Your Client), including AML – Anti-Money Laundering requirements, when assessing whether to accept a new client at your audit firm.
Describe the procedures, information to obtain, risk indicators, and the conclusion process.

Your answer should be structured according to good audit practice and relevant auditing standards (ISA 210, ISA 220, ISA 315) and the ISQM 1 requirements on client acceptance and continuance.

7. Acceptance of the commitment

Exercise Suggested Structure - Client Risk Assessment (KYC & AML) in an Audit Firm

1. Obtain Basic Information & Identify the Entity
Legal name, registration number, jurisdiction
Ownership structure, beneficial owners (UBOs)
Business model, industry, geographic exposure
Regulatory frameworks applicable (banking, insurance, crypto, etc.)

Documents to request:
Commercial registry extract
Bylaws ("estatutos")
Organizational chart
Identification documents of shareholders/directors

7. Acceptance of the commitment

Exercise Suggested Structure - Client Risk Assessment (KYC & AML) in an Audit Firm

2. Assess the Integrity of Management and Governance (ISA 220; EOROC Art. 78)

Background checks on directors
Search for litigation, sanctions, insolvency, fraud, or regulatory actions
Evaluate reputation, ethical history, and tone at the top
Understand corporate governance quality (supervisory board, audit committee)

Sources:

Previous auditor (mandatory communication)
Media and public databases
Court databases
Industry regulators

7. Acceptance of the commitment

Exercise Suggested Structure - Client Risk Assessment (KYC & AML) in an Audit Firm

4. AML/KYC Risk Assessment
Follow EU AML Directives + Portuguese Law 83/2017 (if relevant).
Should be identified AML steps:

4.1. Client Due Diligence (CDD)

- Verify identity of legal entity
- Verify identity and nationality of UBOs (>25%)
- Understand the purpose and nature of the business relationship

4.2. Risk Factors to Evaluate

High-risk indicators:

- Complex or opaque structures
- Offshore jurisdictions
- Cash-intensive businesses
- Cryptoassets activity
- Politically exposed persons (PEPs)
- High-risk countries (FATF list)
- Prior legal issues or sanctions

7. Acceptance of the commitment

Exercise Suggested Structure - Client Risk Assessment (KYC & AML) in an Audit Firm

4.3. AML Red Flags

Unusual ownership chains
Sudden changes in shareholders
Significant transactions without clear economic rationale
Adverse media
Unexplained wealth

4.4. Determine AML Risk Level

Low / Medium / High
Implications:
- High-risk → enhanced due diligence (EDD)
- Firm may decline engagement

7. Acceptance of the commitment

Exercise Suggested Structure - Client Risk Assessment (KYC & AML) in an Audit Firm

5. Evaluate Engagement Risk (Acceptable Audit Risk – ISA 315 & 200)

Factors:

Public interest entity?

High complexity?

Significant estimation uncertainty?

Prior misstatements or qualified opinions?

Litigious industry?

High fraud risk indicators?

Engagement risk affects:

Level of supervision

Need for specialists

Expected audit effort

Whether to accept or decline the client

7. Acceptance of the commitment

Exercise Suggested Structure - Client Risk Assessment (KYC & AML) in an Audit Firm

8. Competence & Resource Assessment (ISQM 1 & ISA 220)

Ensure the firm has:

Experience in the sector

Adequate human resources

Technical knowledge (complex industries: financial, crypto, insurance)

IT/cybersecurity expertise if applicable

Time to perform the audit properly

If not → hire specialists or decline.

9. Decision & Documentation

Summarize all risks identified

Document risk rating (Low/Medium/High)

Conclude whether risks can be managed

Decide: **Accept** or **Decline** the client

Prepare the **Engagement Letter** (ISA 210)

7. Acceptance of the commitment

- Stages (art. 73 and 78 EOROC, Section 2 of Chapter 3 CEDP, ISA 210, ISA 220)

1

- **Assess Management integrity, competence and independence of the Supervisory Board, quality of the internal risk management process**

- Integrity of the Management Board and Supervisory Board – art. 78 EOROC
- Changes in management, organizational structure
- Communicate with the previous auditor
- Inquire other entities
- Analysis of publications about the company
- Hindsight* analysis of the relationship with the client (§14 – 18 ISA 220)
  - Conflicts about the audit scope, opinion type, fees, etc.
  - Unilateral termination of contract
  - Rules of compulsory rotation in EPI – art. 54 e 78 EOROC

* Retrospectiva

7. Acceptance of the commitment

Stages

2
- Determine whether the auditor is capable of fulfilling ethical duties, including independence

3
- Determine whether incompatibilities (art. 88 and 89 EOROC) and impediments (art. 90 EOROC) do not apply

4
- Identify the reasons for the Entity wanting the accounts audited

- Legal or voluntary
- Media exposure of the entity
- Who are the main users of FS (attention to regulators!!)
- Stakeholder participation (e.g. banking loans with covenants)

7. Acceptance of the commitment

- Stages

5

- Identify special circumstances or unusual risks

- Changes in company activities
- Legislation affecting the sector where the entity is inserted
- Developments in the environment affecting the business (PEST analysis - political, economic, social, and technological)
- Susceptibility of FS being misstated - is there a past of reserves?
- New investments and/or restructuring programs
- Existence of related parties
- Prospective assessment of financial stability and client compliance with legal aspects
- Identify possible limitations of scope
- Assess the financial reporting system and its impact on the feasibility of an audit
- Management recognizes its responsibility in the preparation of the FS and Internal Control Systems

7. Acceptance of the commitment

Stages

6

- Assess the competence required for the execution of the audit and determine the composition of the team and the eventual use of experts (ISA 620) and work of component Auditors (ISA 600)

7

- Determination of Fees (art. 59 EOROC)

8

- Assessment of the commitment risk

9

- Make the decision to submit a proposal

10

- Service contract

7. Acceptance of the commitment

Stages

✓Commitment Letter

- The auditor should agree on the terms of audit work with the management or the governance representatives
- The agreed terms of audit work must be recorded in an **engagement letter**
- Audit objective and scope
  - Audit objective and scope
  - Responsibilities of the auditor and management
  - Applicable financial reporting referencial
  - Timetables for planning and executing the audit
  - Composition of the audit team
  - The expectation that management will provide written statements
  - Fees and basis of invoicing
  - Form and content of reports to be issued

Guias de Aplicação Técnica da OROC

GAT 4

https://www.oroc.pt/normativo-tecnico/normativo-tecnico/auditorianormativo-complementar-da-oroc/guias-de-aplicacao-tecnica-gat/

GAT - Guia aplicação técnica

8. Audit Planning

- Ubiquitous (mandatory procedure) requirement at the planning stage

✓Objective: to identify and assess the risks of material misstatement, either due to fraud or error - §25 & 26 of ISA 315

1) Identify misstatement risks

- Level of the FS
- Level of assertions for classes of transactions, account balances and disclosures (**inherent risk** and **control risk**)

2) Assess (magnitude and probability) the risks of misstatement

- Level of the FS
- Level of assertions

8. Audit Planning

Final Pronouncement
December 2019

International Standard on Auditing 315 (Revised 2019)

ISA 315 (Revised 2019)

and

Conforming and Consequential Amendments to Other International Standards Arising from ISA 315 (Revised 2019)

IAASB International Auditing and Assurance Standards Board

INTERNATIONAL STANDARD ON AUDITING 315 (REVISED 2019)

IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT

(Effective for audits of financial statements for periods beginning on or after December 15, 2021)

CONTENTS

8. Audit Planning

Final Pronouncement
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and

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IAASB International Auditing and Assurance Standards Board

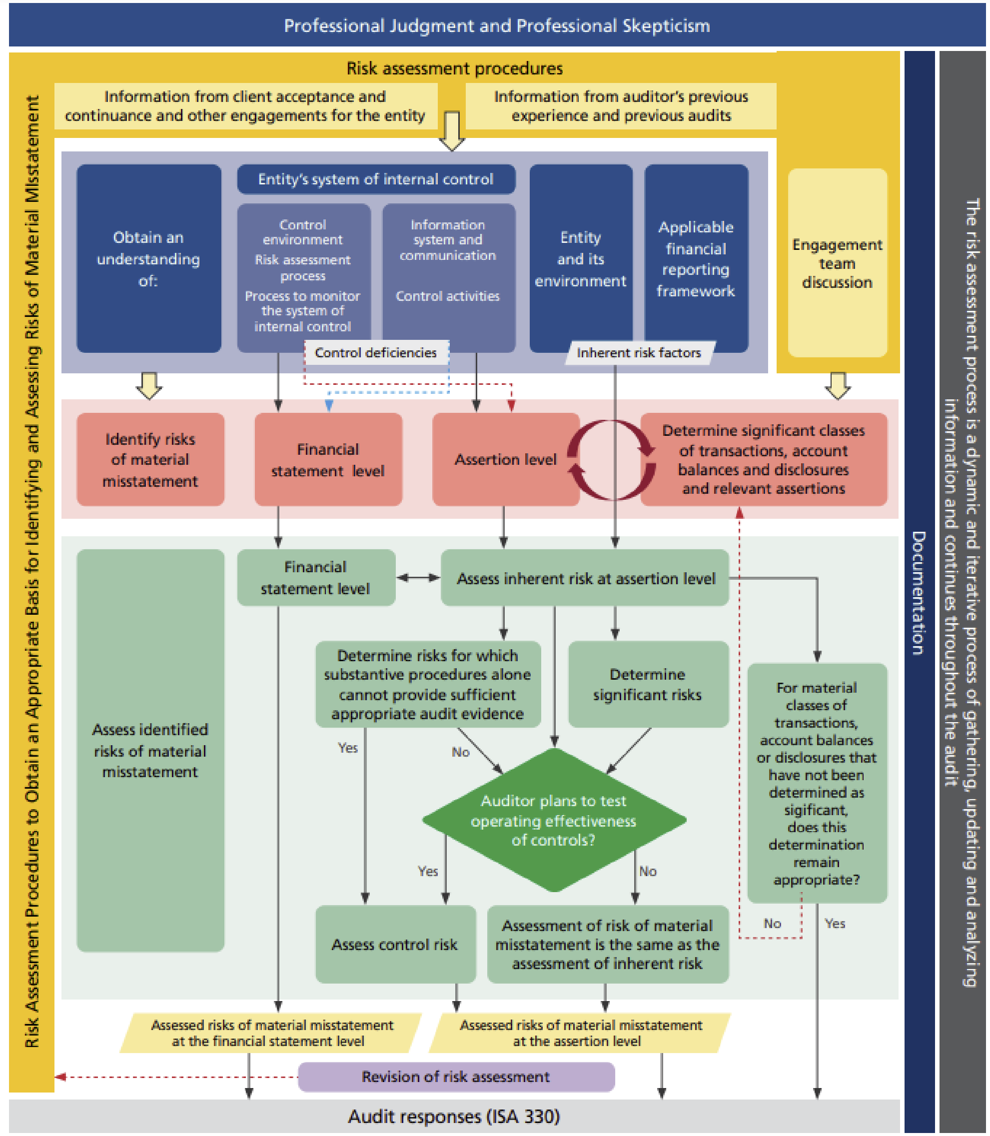
ISA 315 (REVISED 2019)

International Standard on Auditing (ISA) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, should be read in conjunction with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

ISA 315 (Revised 2019) has received the approval of the Public Interest Oversight Board (PIOB), which concluded that due process was followed in the development of the standard and that proper regard was paid to the public interest.

8. Audit Planning

The **standard is iterative** in nature, and the auditor is required to exercise **professional judgment** in determining the **nature and extent** of the procedures to be undertaken.



Source:

IAASB-Introduction-to-ISA-315.pdf

8. Audit Planning

Planning

- Objective: planning an audit aims at its effective execution - §4 ISA 300 reducing the audit risk to an acceptably low level

- It consists of two main activities:

Overall audit strategy	Detailed audit plan

8. Audit Planning

✘ Planning

Overall strategy

- Characteristics of the assignment
- Reporting objectives and reports to produce
- Critical factors to consider when performing the work
- Nature, timeliness and extent of required resources

See appendix ISA 300

Audit plan

- Nature, timeliness and depth of risk assessment
- Nature, timeliness and depth of additional audit procedures at assertion level
- Other auditing procedures required by some standard

8. Audit Planning

✘ Business knowledge

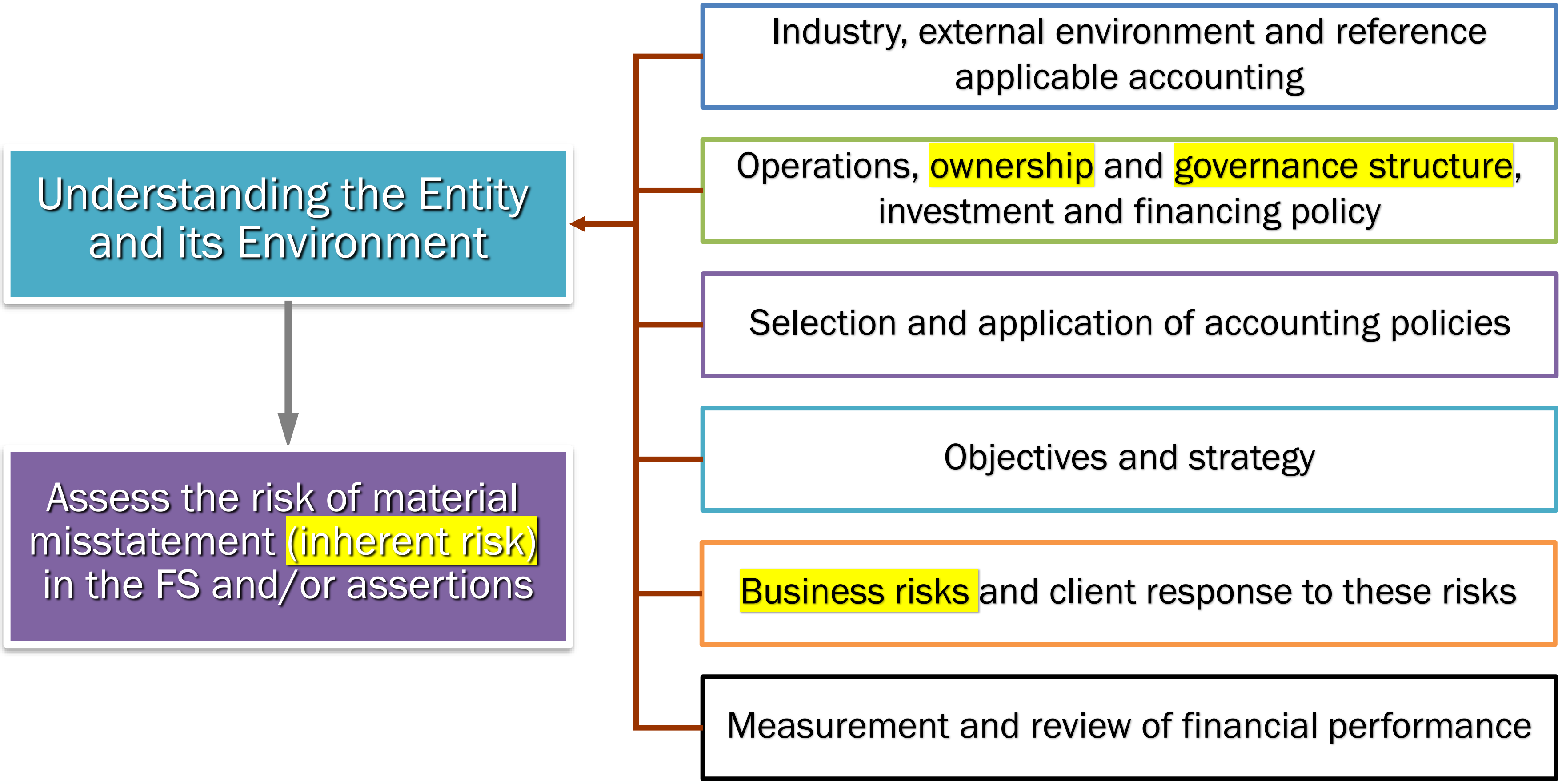
✓ ISA 315. 3

The objective of the auditor is to identify and assess the risks of material misstatement, due to fraud or error, at the level of the financial statements and the level of assertion, through the knowledge of the entity and its environment, including its internal control, thus providing a basis for designing and implementing responses to the assessed material misstatement risks.

MMR is the risk of the FS being materially misstated before the audit

8. Audit Planning

✘ Business knowledge - elements foreseen in ISA 315



8. Audit Planning

Business knowledge - business risk vs MMR

- Business Risk: risk resulting from significant conditions, events, circumstances, actions or inactions that may adversely affect the entity's ability to achieve its objectives and execute its strategies, or to set inappropriate objectives and strategies - §4 ISA 315.

The business risk is more comprehensive than the MMR(*) of financial statements but includes the latter. Most of the business risks have consequences on the FS.

(*) MMR - Material misstatement risk

8. Audit Planning

Business knowledge - business risk vs MMR

- Appendix 2 of ISA 315: business risks that indicate MMR – Material Misstatement Risk

- Volatile markets
- Strong regulation
- Capital Requirements
- New Products
- Business Expansion
- Mergers, acquisitions and restructuring
- Strategic alliances
- Accounting requirements
- Etc.

8. Audit Planning

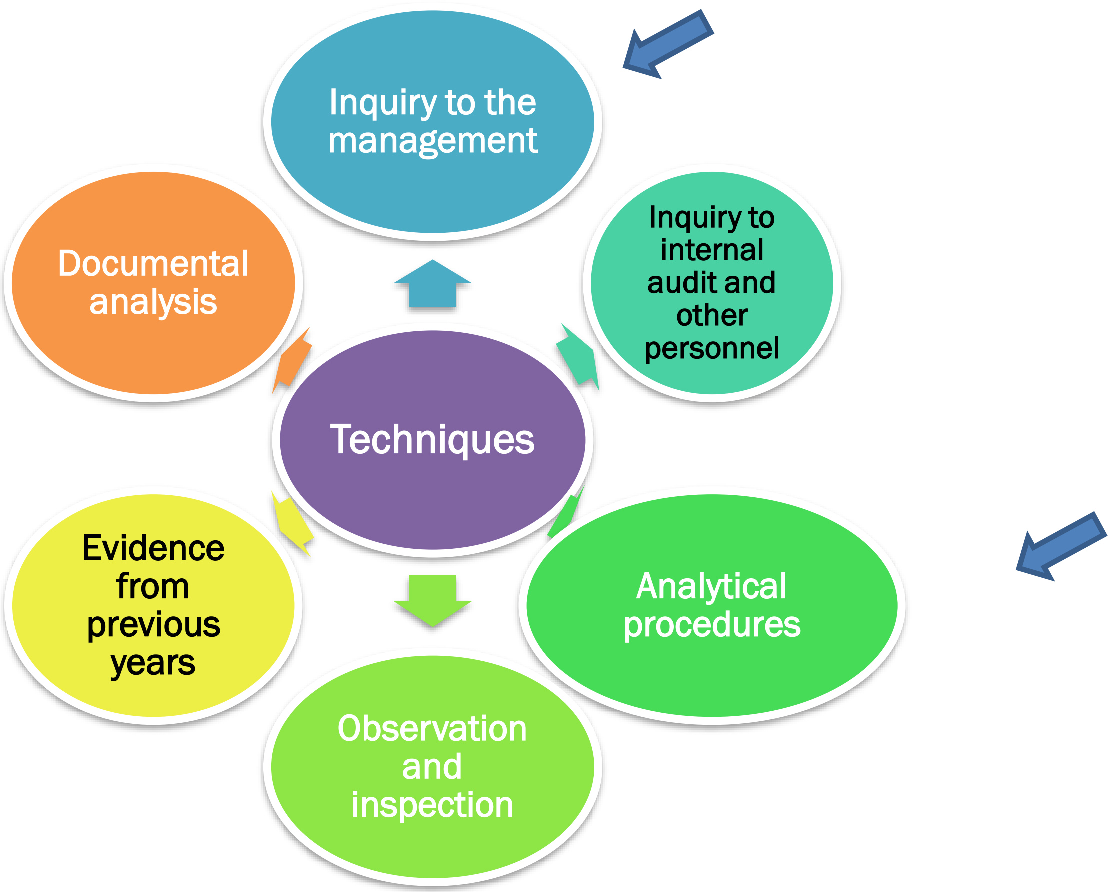
Business knowledge - business risk vs MMR

- Factors to consider when assessing the intrinsic risk

Business nature	Results from previous years audit	1st audit or recurring	Related parties
Complex or non-routine transactions	Requested judgment	Population composition	Fraud risk

8. Audit Planning

- Business knowledge - procedures used



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