AUDITOR-GENERAL
SOUTH AFRICA

AUDIT COMMUNICATION AND REPORTING

Report of the Auditor-General

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

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Report on the financial statements

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Our reputation promise

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

Modification of the audit opinion

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

Matters that do not affect the auditor's opinion

- **Emphasis of matters**
  - Highlight of a matter included in a note to the financial statements
  - Going concern
  - Significant uncertainty
  - Basis of accounting (Departures and deviations)
  - Material inconsistency of other information included in the annual report with financial statements
- **Other matters**
  - Additional reporting responsibilities in respect of the audit of the financial statements

Matters that do affect the auditor's opinion

- **Limitation on scope**
  1. Imposed by the entity
  2. Imposed by the circumstances, e.g:
     - accounting records are inadequate
     - insufficient and/or inappropriate audit evidence
     - auditor unable to carry out audit procedures believed to be necessary
  - Effect is so material and pervasive that the auditor is unable to express an opinion → Disclaimer of opinion
  - Effect is not so material and pervasive as to require disclaimer of opinion → Qualified opinion
- **Disagreement with management**
  Departures from financial reporting framework, e.g.:
  - unacceptability of the accounting policies selected
  - incorrect method of application of accounting policies
  - inadequacy of disclosures
  - Effect is so material and pervasive that the auditor concludes that a qualified opinion is inadequate → Adverse opinion
  - Effect is not so material and pervasive as to require an adverse opinion → Qualified opinion

Glossary of auditing terms

A

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

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

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

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

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

Assertions can be grouped as follows:

Classes of transactions/events	Account balances	AFS presentation and disclosure
occurrence	existence	occurrence, rights and obligations
completeness	completeness	completeness
accuracy	rights and obligations	classification and understandability
cut-off	valuation and allocation	valuation and accuracy
classification	value-for-money	compliance
value-for-money		

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

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

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

C

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

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

(a) Corresponding figures where amounts and other disclosures for the preceding period are included as part of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures.

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

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

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

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

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

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

D

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

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

Documentation – The material (working papers) prepared by and for, or obtained and retained by the auditor in connection with the performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.

E

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

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

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

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

F

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

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

G

Going concern assumption – Under this assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

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

L

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

M

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

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

Material inconsistency – Exists when other information contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

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

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

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

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

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

N

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

O

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

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

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

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

P

Planning – Involves establishing the overall audit strategy for the engagement and developing an audit plan, in order to reduce audit risk to an acceptably low level.

Q

Qualified opinion – A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management regarding departures from financial reporting framework, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion.

R

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

S

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

Significant risk – A risk that requires special audit consideration.

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

(a) Those that provide further evidence of conditions that existed at period-end; and

(b) Those that are indicative of conditions that arose subsequent to period-end.

These conditions can be either favourable or unfavourable.

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

(a) Tests of details of classes of transactions, account balances and disclosures; and

(b) Substantive analytical procedures.

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

T

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

U

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

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

(a) Industry, regulatory, and other external factors, including the applicable financial reporting framework.

(b) Nature of the entity, including the entity's selection and application of accounting policies.

(c) Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements.

(d) Measurement and review of the entity's financial performance.

(e) Internal control.

V

Valuation and allocation (Va) assertion – Assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

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

The internal control system is the whole system of financial and other controls, including the organisational structure, methods, procedures and internal audit, established by those charged with governance, management and other personnel to:

- assist in conducting the business of the audited entity in a regular economic, efficient and effective manner
- ensure adherence to management policies
- ensure compliance with applicable laws and regulations
- safeguard assets and resources
- secure the accuracy and completeness of accounting records
- produce timely and reliable financial and management information Internal control consists of the following five components:
- the control environment
- the risk assessment process
- the information system, including the related processes, relevant to financial reporting, and communication
- control activities
- monitoring of controls

It provides a framework for considering how different aspects of an entity's internal control may affect the audit. The auditor's primary consideration is whether, and how, a specific control prevents or detects and corrects material misstatements in classes of transactions, account balances, or disclosures, and their related assertions.

The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organisation, influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.

Elements of the control environment are:

- Communication and enforcement of integrity and ethical values through policy statements, codes of conduct and by example
- Commitment to competence
- The "tone at the top", i.e. management's philosophy and operating style
- Organisational structure
- Human resource policies and practices
- Assignment of authority and responsibility
- Participation by those charged with governance.

Risk assessment is the process of identifying and analysing relevant risks from internal and external sources to the achievement of the entity's objectives, as identified in the strategic plan, and determining how the risks should be managed.

Risk assessment implies:

- risk identification
- risk evaluation
- assessment of the risk appetite of the organization
- development of responses to the risk profile.

Control activities are the policies, procedures, techniques and mechanisms established to address/mitigate risks and to achieve the entity's objectives. They are an integral part of the entity's planning, implementing, reviewing and accountability for stewardship of government resources and achieving effective results. They include a range of detective and preventive control activities as diverse as, for example:

- authorisation and approval procedures
- segregation of duties
- access restrictions to and accountability for resources and records
- verifications
- reconciliations
- reviews by management of performance
- controls over information processing (application controls)
- general IT controls
- proper execution of transactions and events
- accurate and timely recording of transactions and events
- appropriate documentation of transactions and internal control
- reviews of operations and processes
- establishment and review of performance measures and indicators
- supervision
- human capital management

Information system and communication

Relevant and reliable information, both financial and non-financial, and the communication of this information are essential to the achievement of all internal control objectives.

In order to help ensure the quality of information and reporting, the carrying out the internal control activities and responsibilities, and to make monitoring thereof more effective and efficient, the internal control system should be fully and clearly documented and should also be available for examination.

Monitoring

Internal control systems should be monitored to assess the quality of the systems' performance over time. Monitoring is accomplished through routine activities, separate evaluations, or a combination of both. It involves assessment by appropriate personnel of the design and operation of controls on a suitable timely basis and the taking of necessary actions. It includes regular management and supervisory comparisons, reconciliations and actions.

Ongoing monitoring

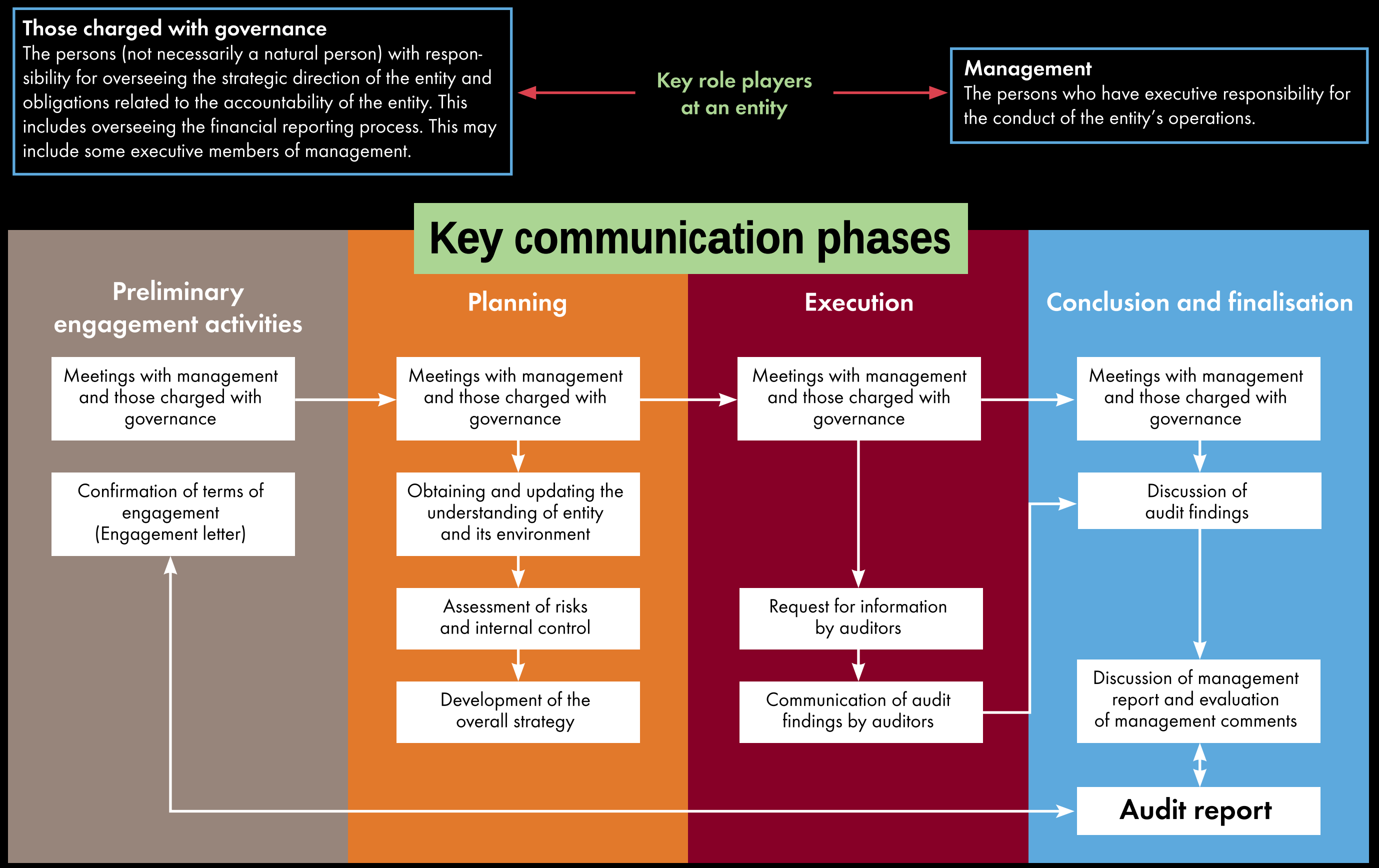
- Ongoing monitoring of internal control should be built into the normal, recurring operating activities of an entity. It includes regular management and supervisory activities, and other actions personnel take in performing their duties.
- Ongoing monitoring activities cover each of the internal control components and involve action against irregular, unethical, uneconomical, inefficient and ineffective internal control systems.

Separate evaluations.

The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures.

Separate evaluations may take the form of self -assessments as well as reviews by internal and external auditors of control design and the direct testing of internal control.

Communication in the audit process



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