

## Principles of International Auditing and Assurance



# Principles of International Auditing and Assurance

*4th Edition*

*Rick Hayes, Philip Wallage and Peter Eimers*

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## FOREWORD

'The world has grown into a global marketplace at an exceedingly fast pace in recent years...changes in one part of the world can have significant effects on other parts.' Had I not used quotation marks, one could easily read this statement as a reference to the global financial crisis that shocked the world in 2008, or the very recent COVID-19 virus crisis. Rather, this was the observation of the then IAASB Chairman Prof. Robert Roussey, with which he started his Foreword to the *first edition* of this book, *Principles of Auditing*, in 1999. Robert continued by describing how this global marketplace had triggered the emergence of International Accounting Standards (now IFRS) and International Standards on Auditing (ISAs), and stated: 'In the late 1990s, these international standards are on the brink of becoming the global standards of the future.'

Indeed, that is what they have become – and so have the 'Clarified' International Standards on Auditing. In his Foreword to the second edition of this book in 2005, my immediate predecessor, John Kellas, started with: 'In the last few years the auditing environment has changed dramatically. The failure of Enron was perhaps the biggest single catalyst for change.... The International Auditing and Assurance Standards Board (IAASB), the independent standards-setter that operates under the auspices of the International Federation of Accountants (IFAC), has sought to respond effectively to the new environment.' Under John's leadership, the IAASB has completely rewritten the ISAs to make them more understandable and better fit for use. All 36 ISAs and International Standard on Quality Control (ISQC) 1 have clearly distinguished the auditor's objectives, the requirements of the standards, and the standards' application and other explanatory material. Many contained considerations specific to audits of smaller entities and of public sector entities, and as part of this 'clarification' effort many ISAs were also thoroughly revised for their content. This impressive exercise was essentially completed when I succeeded John as Chairman in January 2009. The full suite of these Clarified ISAs and ISQC 1 became effective for audits of financial statements for periods beginning or after 15 December 2009.

But...adoption and commitment to the use of standards is one thing. Implementation, including a thorough understanding and proper application of the standards, is another. This requires education, training, monitoring and enforcement. That is why Professors Rick Hayes, Philip Wallage en Hans Gortemaker issued the third edition of *Principles of Auditing – An Introduction to International Standards on Auditing* in 2014. As a co-author on the previous editions, I know how much effort that takes. But it was urgently needed,

as I have learned time and again in my many outreach activities across the world. This indeed is a global marketplace, with dramatic and ongoing changes, and practitioners and students need to update themselves about such changes. The Clarified ISAs are one striking example, but the IAASB issues other standards as well. The third edition addressed those standards in a special chapter about other assurance and non-assurance engagements. This included revised standards on review engagements and compilation engagements, which are of particular relevance for services to smaller entities that are exempted from mandatory audits in many countries. The IAASB had also issued new assurance standards, such as International Standard on Assurance Engagements (ISAE) 3410 addressing greenhouse gas statements, a landmark standard in the area of sustainability-related assurance services engagements.

I then wrote in the Foreword: ‘Will the changes stop here? A rhetorical question, of course. It is very likely that we will see expanded audit reports in the future, to better inform users of financial statements about significant audit matters. We may see the further emergence of Integrated Reporting, and assurance standards thereon. The IAASB may decide to update the ISAs for key areas such as professional skepticism, risk assessment, group audits, quality control, and may enhance the ISAs further in relation to audits of financial institutions. But that will take time, and the authors rightly decided not to wait for that.’

That is indeed what has happened, and it has resulted in a number of key revised or new standards, or exposure drafts, as well as practical guidance. A key innovation has been the revised auditor’s report, including the introduction of Key Audit Matters in a new ISA 701. This has dramatically changed the contents of the auditor’s report; whereas in the past it expressed only a one line conclusion (accompanied by what many saw as ‘boilerplate’ text), it now often contains a number of pages explaining what the auditor felt were the most significant matters in that particular audit. This makes the audit much more relevant to users of these reports such as investors, analysts and many others.

But the IAASB has also thoroughly revised fundamental standards like ISA 315 on risk assessment and ISA 540 about the audit of estimates – including explicit attention for professional scepticism, separate treatment of inherent and control risk, fraud, automated tools and techniques, and other key concepts. Furthermore, the IAASB has published exposure drafts of revised standards on quality control (now: ‘quality management’) and group audits, and draft guidance on ‘extended external reporting’ (including integrated reporting), to be finalized in 2020/21. And the ethics board IESBA has substantially revised and enhanced the Code of Ethics for Professional Accountants.

The authors of this fourth edition, Professors Rick Hayes, Philip Wallage and Peter Eimers, have revised and updated this book as far as they could, given that some revised standards are not final yet. That makes the book again highly relevant for a large variety of users all over the globe.

Have the ISAs become the ‘global standards’ as Chairman Roussey had anticipated in 1999? Yes, they have. The authors show in Chapter 2 that as of June 2019, 130 jurisdictions are using the ISAs. An impressive list (just think of the many translations needed!). Further, the 27 larger international networks of accounting firms have committed to using the Clarified ISAs in their global audit methodologies. The Supreme Audit Institutions (SAIs) are also using the Clarified ISAs through a special public sector version called ISSAIs.

So, it is fair to say that there is one global language for auditing, both for the private and the public sector. And this is warmly supported by the International Organization of Securities Commissions (IOSCO), by banking and insurance regulators, and by global institutions like the World Bank, UNCTAD and IMF.

We hear, and will continue to hear, critical comments with regard to the relevance and effectiveness of audit and assurance, in light of crises and failures, as well as findings from audit inspections across the world. However, underlying these comments are the positive expectations that many have of the contributions that auditors can make to this global, dynamic marketplace, and, in turn, to financial stability and trust. That is the public interest that all of us want to serve.

I wish this book – again -a global uptake, and the readers much success with their professional endeavors.

*Professor Arnold Schilder*  
*Chairman, International Auditing and Assurance Standards Board,*  
*January 2009–June 2019*



## PREFACE TO THE FOURTH EDITION

Welcome to the world of auditors by opening this book!

The audit profession has been relevant to society for several centuries. Living in a complex and dynamic world, there is a growing interest in reliable corporate reporting. Many stakeholders presume that trust is a fundament for doing business. An auditor's work is your window into the heart of an enterprise. Investors, bankers, suppliers, employees, unions, business partners in the value chain, NGOs, governments, regulators. all make use of the work and reporting by auditors.

Auditing is not like financial or managerial accounting. Accounting is a system where an objective representation of reality is recorded and summarized. Auditing is a set of procedures and techniques by which that representation is 'agreed' to specific criteria. So, accounting endeavors to record economic values, categorize them, and then summarize them in a report. Using a set of proscribed procedures (audit standards), and given specific criteria (financial accounting standards), auditing analyses whether that representation is properly recorded, categorized and reported.

You are studying auditing to further your professional goals, if you are like most people reading this book. In addition to your university or college degree you would like to get a professional credential (such as CPA, CA, RA, CFE, WP, GR, CMA, etc.), or you have heard, correctly, that auditing is a 'high demand' profession. In other words, you would like some practical knowledge which will help you in your career. To fulfil your goals is our wish.

This textbook is written from the view of the professional auditor. Theory and academic concerns are covered. The emphasis is on the professional standards promulgated by the International Auditing and Assurance Standards Board (IAASB) and the practical day-to-day experience of international auditing firms. The authors of both the current and previous editions were all extremely successful professional auditors even before writing this book. The authors are also university professors who have taught hundreds of students from around the world, so this textbook is from the point of view of the international student.

Auditing is not just about accounting issues. Auditors don't just look at (financial) data, but also at systems and processes, behavior, and how an enterprise is governed. All sorts of enterprises are audited – profit oriented, not for profit, government, private and public. Auditors may be independent of the enterprise, a valuable internal analyst or working for the government. Audit-trained accountants are also hired to do forensic

analysis. Today, as fraudulent schemes become ever larger and more harmful, it is auditors who are an important line of defense. Auditors' detailed analytical skills have created jobs in areas as diverse as marketing and divorce consulting.

Even before we co-authors began to write the first edition of this book over 30 years ago, we all agreed that our only concern was to produce a high-quality audit text for the international student. This meant that it had to be fully up to date, use outstanding material, have a sound balance of audit theory and real practice, and be based on international auditing and assurance standards. We see the world from a truly global, cross-cultural perspective. This fourth edition is fully revised and includes the latest developments in the international Standards on Auditing, such as technology in the audit, the extended auditors report and auditing estimates.

We co-authors have a special place in our hearts for our students. We believe that it is our duty to convey our joy as auditors and audit teachers to you.