

KINGDOM OF SAUDI ARABIA
Minister of Commerce

AUDITING STANDARDS

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Translator's comments

This is a working translation prepared for the benefit of none Arabic speaking professionals, to provide them with general understanding of the document and enable them to provide their views and comments. The formal document is the one issued in Arabic by the Ministerial Resolution No. 692, dated 28.2.1406H (11.11.1985 A.D)

This document issued after receiving the concerned parties views and comments on the products of stage one and stage two of the profession development project issued in (1404H) (1984AD)(in Arabic).

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PREFACE

The Ministry of Commerce in Saudi Arabia has been concerned with the development of the accounting and audit profession in the Kingdom in order for this profession to cope with the undergoing changes in the financial, commercial, and economic sectors and to meet the requirements of this profession which is deemed as one of the crucial activities of the community.

After an extensive study, the Ministry has laid down auditing standards which incorporate all the characteristics of auditors of accounts and determine the methodology employed in the performance of audit work as well as the form and content of the audit report. These standards are considered to be the means that would verify that financial statements are up to the level which would give a fair view of the financial position of the enterprise, the results of its operations, and the changes in the sources and applications of funds.

Ministerial Resolution No. 692, dated 28.2.1406H (11.11.1985 A.D.) considered Auditing Standards to be an official reference and guidelines for all Certified Public Accountants licensed to operate in the Kingdom of Saudi Arabia. The Ministry of Commerce has also conducted an analytical survey to clarify the circumstances in which the referenced standards were drafted, together with a classified comparison with similar standards in one or more of the following countries:

- o U.S.A.,
- o Great Britain,
- o West Germany, and
- o Tunis

This comparison was made with consideration of the nature of the subject,

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the circumstances of research and the feasibility of such comparison. Results of this study were attached to text of auditing standards in order to apply these standards, clarify them and justify the reasons for their application.

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AUDITING STANDARDS

1. INTRODUCTION
2. SCOPE OF AUDITING STANDARDS
3. AUDITING STANDARDS

1. INTRODUCTION

Audit is the professional examination and verification of a company's accounting documents and supporting data for the purpose of rendering an opinion as to their fairness, consistency and conformity with generally accepted accounting practices. It aims at enhancing the confidence of the competent reader that the audited financial statements give a fair view of the financial position of the company. This requires the availability of auditing standards that are objective, specific and acceptable to all auditors. These standards are also the criteria by which the proficiency of an auditor and the quality of his work will be evaluated.

2. SCOPE OF AUDITING STANDARDS

132 An audit report comprises the expression of an opinion on the financial statements of an enterprise by a duly qualified and properly appointed independent auditor following his examination of the enterprise's financial statements. Company Law requires certain corporate entities to submit audited financial statements to an annual general meeting of shareholders or partners; the rules of certain other associations may require the financial statements to be audited. The Auditing Standards apply whenever an auditor is engaged to express an opinion on the financial statements of an enterprise.

3. AUDITING STANDARDS

- 3.1 Education and Experience
- 3.2 Objectivity, Neutrality and Independence
- 3.3 Due Professional Care
- 3.4 Planning
- 3.5 Controlling and Recording
- 3.6 Evidence

3.1 Education and Experience

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- 3.1.1 The auditor in charge and his supporting audit staff should have sufficient education and experience needed to perform the audit functions entrusted to him.
(para 503)*
- 3.1.2 The auditor shall evaluate his level of education and experience as well as the education and experience of his staff in order to determine if he is capable of performing the audit work prior to concluding the relevant contract for the performance of such work.
- 3.1.3 The auditor should record the evaluation as stipulated by the foregoing standard.
- 3.1.4 The auditor may conclude a contract to audit the financial statements of a given enterprise, if, according to his professional experience, he finds it possible to acquire a sufficient degree of professional qualification through study or attendance of suitable training courses before the audit work is commenced.

Next paragraph (1004)

* Paragraph numbers remained as stated in the analytical study for easy reference.

3.2 Objectivity, Neutrality and Independence

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3.2.1 The auditor should be totally independent as relates to the audit work. He should also be objective and neutral in the *evaluation* evaluating of audit evidence or expression of opinion with regard to the financial statements being audited.
(para 1004)*

3.2.2 The auditor should avoid whatever subjects him to suspect by others as relates to his independence, neutrality and objectivity.

3.2.3 The auditor must ensure the independence, neutrality and objectivity of his audit team entrusted with the audit of a given enterprise.

3.2.4 The auditor shall abstain from expressing opinion in the financial statements of a given enterprise, if after appointment, he finds out that he or his staff still lack the required degree of independence.

3.2.5 The auditor shall record and ensure his independence as well as the independence of his staff from the enterprise the financial statements of which are being audited.

(paragraph 1503 follows)

* Paragraph numbers remained as stated in the analytical study for easy reference.

3.3 Due Professional Care

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- 3.3.1 The auditor must give due professional care at all stages of the audit and shall apply auditing standards with the same level of diligence expected of another auditor with sufficient professional qualification.

(Para 1503)*

- 3.3.2 The auditor must be acquainted with the affairs, circumstances and plans of the enterprise and the application of its funds and financial statements and to report that accordingly.
- 3.3.3 The auditor must seek facts and arrive at objective results free from bias.
- 3.3.4 The auditor must obtain the assistance of experienced and skilled parties if it is deemed appropriate to seek such help.

(paragraph 2009 follows)

* Paragraph numbers remained as stated in the analytical study for easy reference.

3.4 Audit Planning

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3.4.1 The auditor must sufficiently plan his examination to:

- i) Establish appropriate audit procedures to obtain reasonable assurance to support his audit opinion; (para 2009)*
- ii) Ensure that, if the auditor uses staff other than himself, all audit procedures are to be performed under adequate supervision by suitably skilled and experienced staff;
- iii) Be satisfied that the audit work will be performed in accordance with the Auditing Standards and any legal requirements relevant to the conduct of the audit.

3.4.2 When establishing audit procedures, the auditor should consider:
(para 2010)

- i) the scope of the audit engagement;
- ii) The business and organization of the particular enterprise especially in order to determine those transactions and events most likely to have a significant effect on the financial statements;
- iii) The effect of any significant changes either in legislation and accounting practice relevant to the enterprise or in the enterprise's trading activities and accounting procedures;
- iv) His experience of the reliability of the enterprise's management staff and accounting records together with an assessment of any management bias resulting from the financial position of the enterprise or other causes;

* Paragraph numbers remained as stated in the analytical study for easy reference.

- v) The audit strategy to be adopted for the particular enterprise including decisions as to materiality, the likely significance of past or anticipated errors and irregularities, the nature of each item in the financial statements, the source of audit evidence on which the auditor proposes to rely and the timing of the audit procedures.

3.4.3 If the auditor proposes to use staff other than himself, he must;
(para 2011)

- i) Consider the number and calibre of staff likely to be required and the timing of their involvement taking into account the time required for the preparation of the financial statements by the management of the enterprise;
- ii) Brief the audit staff as to the nature of the business and organization of the enterprise, the objectives of the audit work and the methods to be adopted;
- iii) Consider the extent of supervision that will be required after taking into account the complexity of the particular assignments allocated to individual members of staff.

3.4.4 If other auditors are involved, each auditor must: (para 2012)

- i) Be fully aware of the scope and responsibilities of his own engagement;
- ii) Consult with the other auditors to determine how the responsibility for completion of the detailed audit procedures is to be allocated.
(para 2518 follows)

3.5 Controlling and Recording

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CONTROLLING

1. The auditor must sufficiently direct, supervise and review the work of the audit staff assigned to the audit engagement so as to be satisfied that the audit work is being performed in accordance with the Auditing Standards and any other legal requirements relevant to the conduct of the audit.
(para 2518)
2. The auditor should carry out a degree of direction, supervision and review appropriate for the complexity of the assignment, and the experience and proficiency of the audit staff assigned to the audit engagement.
(para 2519)
3. Procedures should be designed and applied to achieve direction, supervision and review with particular attention to:
(para 2520)
 - i) The assignment of work to audit staff who have an appropriate level of training, experience and proficiency.
 - ii) Communication to audit staff assigned to the engagement at all levels of their responsibilities and of the objectives of the procedures which they are to perform.
 - iii) Communication to audit staff assigned to the engagement of all matters which may affect the nature, extent or timing of the procedures they are to perform.
 - iv) Directions as to the form and content of working papers.

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- v) Instructions to the audit staff assigned to the engagement to bring to the attention of those to whom they are responsible any potentially significant accounting or auditing problems that they encounter.
 - vi) The review of working papers by supervisory personnel and by the responsible auditor.
 - vii) Supervision of the progress of the audit by comparison with the audit plan.
 - viii) Maintenance of the confidentiality of the client's affairs.
4. If another auditor is involved, the work performed by the other auditor must be reviewed to establish whether such audit work has been performed in compliance with the auditing standards appropriate to the engagement. The scope of the review should be related to the professional qualification, reputation and independence of the other auditor. (para 2521)
5. The responsible auditor must review all significant matters which concern the financial statements and the audit results. (2522)
6. The responsible auditor must consult with another licentiate accountant or an appropriate expert prior to forming his audit opinion in the following circumstances: (para 2523)
- i) Where there is a matter of principle regarding which the auditor has doubt as to the appropriate course of action; or
 - ii) Where a contentious matter arises which may affect the audit opinion.

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7. The responsible auditor must ensure that the audit report which is issued corresponds with his opinion on the view given by the financial statements taken as a whole.

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8. Audit working papers must be sufficiently complete and detailed to allow an experienced auditor with no previous knowledge of the audit to form reasonable conclusions as to whether the planning, controlling and recording, evidence and reporting standards have been met.
(para 2525)
9. Audit working papers should contain:
 - a) Details of the auditor's study of the enterprise's accounting system and system of internal control; (para 2526)
 - b) Other information which will be of continuing importance to the audit;
 - c) Details of the audit planning performed and the reasons for the decisions made;
 - d) The auditor's preliminary evaluation of the accounting system and system of internal control including the analysis supporting the evaluation;
 - e) The auditor's decision and supporting analysis as to the extent to which he needs to obtain audit evidence from the operation of the enterprise's system, from analytical review and from substantive tests of details;
 - f) Details of the source from which third party information came and when and by whom the information was received.

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- g) Details of the audit work carried out including notes of errors or exceptions found and action taken thereon;
 - h) The auditor's conclusions as to the persuasiveness of the evidence obtained and the reasons for those conclusions;
 - i) Analyses and summaries sufficient to reconcile the amounts included in the financial statements to the detailed figures upon which audit work has been conducted;
 - j) A record of who performed each piece of audit work and the date of performance;
 - k) Evidence that the work of the audit staff has been properly reviewed.
 - l) A summary of significant points affecting the financial statements and the audit report, showing how these points were dealt with;
10. In order that details are not omitted, audit working papers should be prepared as the audit proceeds. (para 2527)
11. Working papers should be legible, systematically filed and adequately referenced.

3.6 Audit Evidence

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3.6.1 The auditor must obtain relevant and reliable audit evidence sufficient to establish a reasonable basis for the expression of an audit opinion on the financial statements in accordance with the terms of the audit engagement.

(para 3024)*

3.6.2 The auditor must express independent opinion on:

(para 3025)*

- i) Whether the financial statements give a fair view of the financial position, the results of operation, and sources and applications of funds of the enterprise on the basis of sufficient presentation and disclosure contained in the said financial statements in conformity with generally accepted accounting practices which are suitable to the specific circumstances of the enterprise.
- ii) Whether the financial statements are in conformity with the Company Law and Articles of Association of the respective enterprise with regard to the preparation and presentation of these financial statements.

In particular, the audit opinion as to whether the financial statements give a fair view of the financial position and of the results of operations, changes in owners' equity and sources and applications of funds of the enterprise must be based upon reasonable conclusions drawn from sufficient, relevant and reliable audit evidence with regard to:

- i) Individual figures in the financial statements; and
- ii) The overall presentation and content of the financial statements.

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The sufficiency of audit evidence to support each conclusion should depend upon the materiality of the conclusion to the audit opinion.

- 3.6.3 Reasonable conclusions regarding individual figures in the financial statements should be made in answer to the following questions:
(para 3026)

For the Statement of Financial Position Figures:

- i) Have all assets and liabilities been recorded?
- ii) Do the recorded assets and liabilities exist?
- iii) Are the recorded assets owned by the enterprise and are the recorded liabilities properly those of the enterprise?
- iv) Have the amounts attributed to the assets and liabilities been arrived at in accordance with the stated accounting policies and are those policies in accordance with generally accepted accounting standards appropriate to the circumstances of the business?
- v) Have the assets, liabilities and owners' equity been properly disclosed?

For Statement of Income Figures: (para 3027)

- i) Have all revenues, expenses, gains and losses that are properly associated with the reporting period been recorded?

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- ii) Are the recorded revenues and gains properly regarded as revenues or gains of the enterprise and are the recorded expenses and losses properly regarded as those of the enterprise?
- iii) Have the revenues, gains, expenses and losses been recognized and measured in accordance with the stated accounting policies and are those policies in accordance with generally accepted accounting standards appropriate to the circumstances of the business?
- iv) Have revenues, gains, expenses and losses been properly presented and disclosed?

For Statement of Sources and Applications of Funds Figures:

(para 3028)

- i) Have all sources of funds during the period been reflected in the statement?
- ii) Have all applications of funds during the period been reflected in the statement?
- iii) Does the statement properly reflect other investing and financing transactions during the period which did not affect the funds?
- iv) Have all disclosure and presentation requirements of generally accepted accounting standards been met?

3.6.4 Reasonable conclusions regarding the overall presentation and content of the financial statements should be made in answer to the following questions: (para 3029)

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- i) Have the financial statements been prepared in accordance with accounting policies that are in accordance with generally accepted accounting standards?
- ii) Are there any special circumstances affecting the enterprise or the industry in which the enterprise operates, that might cause generally accepted accounting standards to be inappropriate?
- iii) Have the accounting policies been applied on a basis consistent with that of the preceding accounting period, or if not, has the change been properly accounted for and disclosed in accordance with generally accepted accounting standards? Have assets and liabilities, revenues and expenses, gains and losses been measured in line with the same principles applied in the previous year in conformity with articles 123 and 124 of the company Law?
- iv) Are the accounting policies consistent with each other and are they consistently applied throughout the enterprise?
- v) Are the accounting policies which have been used adequately disclosed?
- vi) Are the figures contained in the financial statements consistent with each other and consistent with related information contained in previous financial statements?
- vii) Is there adequate disclosure of all appropriate matters and is the information contained in the financial statements suitably classified and presented?
- viii) Is the financial position, results of operations, sources

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and applications of funds as reported in the financial statements consistent with the auditor's knowledge of the underlying transactions, events and circumstances of the business?

- ix) Are there any inappropriate disclosures, misstatements or omissions relating to the financial statements which are likely to distort the view presented to the reasonably competent reader of the financial statements?

3.6.5 The auditor must enquire, in writing, from the previous auditor as to the reasons for his discontinuity to audit the accounts of the respective enterprise, request any relevant information that affect the financial statements, and be acquainted with relevant work papers for the previous audit period-with prior consent of the enterprise, and record this as part of his own work papers.
(para 3030)

3.6.6 The auditor must obtain the required letter of general disclosure which specifies the basis for the preparation of financial statements and confirms that all information relevant to giving a fair view of the enterprise's financial statements have been provided.
(para 4031)

X 3.6.7 The auditor must ascertain and make a preliminary assessment of both the enterprise's accounting system and system of internal controls as a source of audit evidence. The auditor should also make a preliminary assessment of the availability of evidence from analytical review and other substantive tests of details of transactions and balances. The auditor must give consideration to all the available evidence ^{or a} regardless of whether or not it appears to support the representations made in the financial statements.

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3.6.8 Following completion of the preliminary assessments required by the Auditing Standard on Audit Planning and the previous paragraph of this Standard, the auditor must decide the extent to which, in accumulating sufficient evidence for his conclusions, he intends to rely upon:
(para 3033)

- i) The operation by the enterprise of systems, particularly the accounting system and the system of internal control,
- ii) Analytical review procedures,
- iii) Other substantive tests of details of transactions and balances.

3.6.9 In selecting the audit approach, the auditor should be influenced by the anticipated cost effectiveness of the alternatives. As the audit proceeds, the selected approach must be kept under review and should be revised if necessary in the light of the results of the audit procedures performed. In addition to the three sources of evidence listed above, the auditor should obtain the representations of management and staff on any significant matter where the particular knowledge and experience of management or staff is relevant. However, the auditor should obtain sufficient corroborative evidence of the representations received. In particular, the auditor should design his audit procedures to give him reasonable assurance that there are no errors or irregularities which materially distort the view given by the financial statements.
(para 3034)

3.6.10 If the auditor wishes to place reliance on the performance of procedures within the accounting system or on the performance of internal controls, he must obtain compliance evidence. If reliance is being

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placed on the operation of procedures or controls during the period between the Interim and final audits, appropriate compliance evidence must be obtained for that period.

(para 3035)

3.6.11 Because of inherent limitations in even the most effective systems, the auditor must not rely solely on systems evidence, including evidence from the accounting system or the system of internal control, as the basis for his conclusions on the financial statements. He must always obtain substantive evidence to support his conclusions.

3.6.12 The auditor must evaluate the cumulative persuasiveness of all the evidence obtained in support of each conclusion and he must relate his evaluation to:

- i) The consistency of the various relevant items of evidence;
- ii) The persuasiveness of each of the various items of evidence; and
- iii) The extent to which the various items of evidence were obtained from independent sources.

The auditor should give due care to all evidence obtained whether they are supporting the financial statements or not.

3.6.13 The auditor should relate the persuasiveness of the evidence obtained by a study of the accounting system and the system of internal control to:

(para 3038)

- i) The cumulative effect of relevant procedures within the accounting system and relevant application controls within the system of internal control upon the likelihood of the type of the error or irregularity under examination.

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- ii) The effect of general controls upon the likelihood of the relevant procedures and application controls being properly performed; and
 - iii) The persuasiveness of the compliance evidence that the relevant procedures, application control and general controls had operated throughout the period for which reliance on the systems is being placed.
- 3.6.14 The auditor should relate the persuasiveness of the evidence provided by the results of analytical review procedures to:
(para 3039)
- i) The reliability of the relationship used to substantiate the financial statement figure under examination.
 - ii) The validity of the data used, on the basis of the identified relationship, to substantiate the financial statement figure.
 - iii) The differences that appear to be unusual which have been identified by analytical review procedures together with the persuasiveness of the explanations for any significant difference.
- 3.6.15 The auditor should relate the persuasiveness of the evidence provided by the results of substantive tests of details of transactions and balances or compliance tests conducted on a sampling basis to:
(para 3040)
- i) The size and design of the sample,
 - ii) The method of selection of the sample,

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- iii) The nature and frequency of the errors or exceptions found in the sample,
- iv) The reliability of the evidence obtained with respect to individual items in the sample.

When errors or exceptions are found in the sample, the circumstances in which the errors or exceptions occur must be investigated and their possible effect on conclusions drawn elsewhere in the audit assessed.

3.6.16 When the conduct of a substantive test or any other audit procedure involves reliance on the evidence of third parties, including specialists, the auditor should relate the persuasiveness of the third party evidence to: (para 3041)

- i) The form which the evidence takes (oral or written)
- ii) The objectives and scope of the third party's work in producing the report which is to be used as audit evidence.
- iii) The degree of detailed explanation produced by the third party and the ability of the auditor to understand and assess the reasonableness of the methods and assumptions used.
- iv) The extent to which the third party might reasonably be expected to have knowledge of the matters which are the subject of the third party report. This includes an assessment of the expertise and, if relevant, professional qualifications of the third party.
- v) The independence of the third party from the enterprise.

- 3.6.17 If, after evaluating the persuasiveness of all the evidence obtained in support of any conclusion, the auditor is of the opinion that insufficient evidence has been obtained, he should conduct further audit work. Where the failure to obtain sufficient assurance is the result of errors or exceptions being found during substantive or compliance testing, the auditor should examine the reasons for the occurrence of the errors or exceptions and these reasons should influence the nature and extent of further work.
(para 3042)
- 3.6.18 Where sufficient audit evidence from the sources listed in paragraph 3033 is not and could not reasonably be expected to be available in respect of any material matter, the auditor should obtain written representations of management concerning the matter in question. Such matters will mainly be those affecting judgement and opinion or matters of fact where knowledge is confined to management. After written management representations have been obtained, the auditor must consider whether those representations, together with such other audit evidence as he has obtained, are sufficient to enable him form a conclusion on the matter in question. (para 3043)
- 3.6.19 When, and only when, after performing further audit work and, if appropriate, obtaining the representations of management, the auditor is of the opinion that either sufficient evidence does not exist or is impractical to obtain regarding a material matter, then the auditor must qualify his opinion or disclaim an opinion in accordance with the Audit Reports Standard.
(para 3044)
(para 3539 follows)

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3.7 Audit Reports

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3.7.1 ADDRESSING THE AUDIT REPORT

The auditor must identify those to whom his audit report is addressed.

(para 3539)

3.7.2 SCOPE OF AUDIT

The auditor must refer expressly to the scope of his audit in a paragraph separately identified as the "Scope of Audit" paragraph and to the following:

(para 3540)

- i) the financial statements to which the audit report relates;
- ii) The persons with the overall responsibility for the preparation of the financial statements;
- iii) The attitude of such persons as far as placing at the auditor's disposal all of the particulars and explanations called for;
- iv) Whether the financial statements have been audited in accordance with the Auditing Standards promulgated by the Saudi Arabian Institute of Chartered Accountants;
- v) Whether he has been able to perform all the audit procedures that he considered necessary in the circumstances.
- vi) Whether he has been reasonably convinced to express an audit opinion on the financial statements.

3.7.3 EXPRESSION OF OPINION

(para 3541)

3.7.3.1 The auditor must refer expressly to his opinion and state whether he has obtained reasonable assurance that the financial statements taken as a whole:

- i) Give a fair view of the financial position at the period end and of the results of the operations, and sources and applications of funds for the accounting period based upon sufficient presentation and disclosure contained in the financial statements in accordance with generally accepted accounting standards appropriate to the particular circumstances of the business.
- ii) Comply with the provisions of Company Law, Articles of Association and any other such legal requirements with regard to the preparation and presentation of financial statements relevant to the enterprise.

If the auditor has no reservations which in his opinion materially affect these matters, he must express an unqualified opinion in a paragraph separately identified as the "unqualified opinion" paragraph. Examples of such an opinion are given in Nos. 1 and 2 of the Illustrative Audit Reports.

3.7.3.2 Emphasis of a Matter

(para 3542)

If the auditor wishes to draw particular attention to some fundamentally important condition or event which does not affect his opinion paragraph, the emphasis of a matter paragraph must be separately identified as such and must be introduced by a statement "I/We draw particular attention to....." followed by a

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recital of the relevant matters and any reference to information contained in the financial statements that the auditor considers to be necessary. The auditor must not use the emphasis of a matter paragraph as a substitute for a reservation paragraph. An example of such a paragraph is given in No. 3 of the Illustrative Audit Reports.

3.7.3.3 Reservations in the Auditor's Report (para 3543)

The auditor must exercise judgement as to whether a reservation of opinion is necessary and, if so, which type of reservation is appropriate in the circumstances. A reservation of opinion may be necessary as a result of one or more of the following circumstances:

- X i) Audit scope deficiencies definitions;
- ii) Accounting deficiencies;
- iii) Uncertainties not relating to going concern;
- X iv) Uncertainties Uncertainties relating to going concern;
- v) Noncompliance with the requirements of the Company law or the Articles of Association of the Enterprise, as relates to the preparation and presentation of financial statements.

If the auditor concludes that a reservation of opinion is necessary, he must:

(para 3544)

- i) Inform the reader of all of his reservations in a separate paragraph following the "Scope of Audit" paragraph of his

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report. This paragraph should be clearly labeled as a "Reservation(s)" paragraph; and

- ii) Express in a separate paragraph, following the "Reservation" paragraph, a qualified opinion, an adverse opinion or disclaim an opinion as appropriate. This paragraph should clearly

identify

→ identify the type of opinion expressed by the auditor or his disclaimer of an opinion.

A) Audit Scope Deficiencies

When audit scope deficiencies exist, the auditor would not be able to determine whether the financial statements are free from material misstatements and/or omissions. If the auditor concludes that the financial statements may be affected by possible material adjustments that he might have determined had he been able to apply all the audit procedures he considered necessary in the circumstances, he should qualify his opinion or disclaim an opinion on the statements taken as a whole.

(para 3545)

When audit scope deficiencies exist, the auditor should express a qualified opinion if he concludes that the financial statements may be affected by possible material adjustments, unless, in his judgement, the effects on the financial statements of the possible adjustments could be so pervasive or so material that he has no basis for an opinion on the financial statements taken as a whole. In the latter case, he should disclaim an opinion.

(para 3546)

When qualifying his opinion for an audit scope deficiency, the auditor must:

- i) Modify the "audit scope" paragraph by reference to the audit scope deficiencies described in the reservation paragraph;

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- ii) Indicate clearly in the reservation paragraph how and, when reasonably determinable, to what extent the financial statements may be affected by possible adjustment.
- iii) Introduce his qualification with the phrase "Except for"; and
- iv) Using wording in his opinion paragraph that bases his qualification on the effects of possible adjustments on the financial statements.

(form No. 9)

(para 3547)

When the auditor is disclaiming an opinion on the financial statements taken as a whole because of audit scope deficiencies, the working of the disclaimer of an opinion paragraph of his report must indicate that the disclaimer pertains to the auditor's inability to obtain reasonable assurance to express an opinion on the financial statements taken as a whole because of the possible material effects of the matters described in the reservation paragraph. An example of a disclaimer of an opinion because of audit scope deficiencies is given in No. 10 of the Illustrative Audit Report.

(para 3548).

B) ACCOUNTING DEFICIENCIES

When the financial statements are affected by material accounting deficiencies, the auditor should express a qualified or an adverse opinion. In either case, the auditor must include a reservation(s) paragraph in his report to:

- i) Provide a clear description of the accounting deficiencies; and

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- ii) Indicate clearly how and to what extent the financial statements are affected by the accounting deficiencies and/or, if practicable, provide any information which have been omitted but is considered necessary for adequate disclosure.
(para 3549)

The auditor should express a qualified opinion if the financial statements are materially affected by misstatements, inadequate or inappropriate disclosures unless, in his judgement, the accounting deficiencies render the financial statements misleading or virtually useless even when read in conjunction with his report. In the latter case, he should express an adverse opinion.

(para 3550)

The auditor should consider the financial statements misleading or virtually useless if the effects of misstatements, inadequate or inappropriate disclosures are:

- i) So pervasive that the auditor is not able to describe clearly how the financial statements are affected; or
- ii) So material that they overshadow any clear description of how the statements are affected.

When qualifying his opinion for material accounting deficiencies, the auditor must:

- i) Introduce his qualification with the phrase "Except for"; and
- ii) Use wording in the opinion paragraph which bases his qualification on the effects of the accounting deficiencies on the financial statements.
(para 3551)

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Examples of qualified opinions for material accounting deficiencies are given in Nos. 5 and 7 of the Illustrative Audit Reports.

(para 3552)

When the auditor expresses an adverse opinion on the financial statements taken as a whole because of accounting deficiencies the wording in the adverse opinion paragraph of his report must indicate that the adverse opinion pertains to the effects of the accounting deficiencies or the omission of the information described in the reservation paragraph. An example of an adverse opinion audit report because of inadequate disclosure is given in Nos. 6&8 of the Illustrative Audit Reports. An example of an adverse opinion audit report because of significant material departures from generally accepted accounting standards is given in No. 8 of the Illustrative Audit Reports.

(para 3553)

C) UNCERTAINTIES NOT RELATING TO A GOING CONCERN

If the auditor concludes that the financial statements may be affected by possible material adjustments that might have been determined had the future outcome of the uncertainties been known, he should express a qualified opinion or disclaim an opinion on the statements taken as a whole. In either case, the auditor must:

(para 3554)

- i) Provide in the reservation paragraph an adequate description of the uncertainties; and
- ii) Indicate clearly in the reservation paragraph how and, when reasonably determinable, to what extent the financial statements may be affected by possible adjustments.

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When uncertainties not relating to a going concern exist, the auditor should express a qualified opinion if he concludes that the financial statements may be affected by material adjustments, unless, in his judgement, the effects on the financial statements of the possible adjustments could be so pervasive or so material that he has no basis for an opinion on the financial statements taken as a whole. In the latter case, he should disclaim an opinion.

(para 3555)

When qualifying his opinion for uncertainties not relating to a going concern, the auditor must: (para 3556)

- i) Introduce his qualification with the phrase "Subject to"; and
- ii) Use wording in his opinion paragraph that bases the qualification on the effects of possible adjustments on the financial statements.

An example of a qualified opinion for uncertainties not relating to a going concern is given in No. 11 of the Illustrative Audit Report.

When the auditor disclaims an opinion on the financial statements taken as a whole due to uncertainties not relating to a going concern, the wording in the disclaimer of an opinion paragraph must indicate that the disclaimer pertains to the auditor's inability to obtain reasonable assurance to express an opinion on the financial statements taken as a whole because of the possible material effects of the uncertainties described in the reservation paragraph.

(para 3557)

An example of a disclaimer of an opinion due to uncertainties is given in No. 12 of the Illustrative Audit Reports.

D) UNCERTAINTIES RELATING TO A GOING CONCERN

A particular uncertainty exists when there are doubts as to the ability of the enterprise to continue as a going concern. After considering the audit evidence on this subject the auditor may conclude:

- i) That he has obtained adequate audit evidence to remove the doubts that he had about the ability of the enterprise to continue as a going concern. In such a case, the auditor should not modify his report because of any going concern consideration.
- ii) That, although doubt exists as to the ability of the enterprise to continue, in his opinion, there is a reasonable probability that the enterprise will continue and there is adequate disclosure of all the relevant circumstances in the financial statements. In such a case, he should not modify his opinion because of any going concern considerations. However, he should draw the reader's attention to the relevant information in the financial statements in an emphasis of a matter paragraph.
- iii) That, although doubts exist as to the ability of the enterprise to continue, in his opinion, there is a reasonable probability that the enterprise will continue but that management has refused to disclose all the relevant circumstances adequately. In such a case, the auditor should modify his report because of inadequate disclosure. The modification of the audit report involves:
 - a) The addition of a reservation paragraph in which the auditor must describe the circumstances that gave rise to the doubt about the ability of the enterprise to continue and disclose the information that management has refused to disclose; and

- b) The expression of a qualified opinion or an adverse opinion, as appropriate, because of the omission of the information described in the reservation paragraph.
- iv) That substantial doubts remain about the enterprise's ability to continue. In this case, the auditor should disclaim an opinion on the financial statements taken as a whole.

When the auditor concludes that he should disclaim an opinion due to uncertainties relating to a going concern, the reservation paragraph in his report must:

(para 3559)

- i) Provide a clear description of all the substantive reasons for the substantial doubt about the ability of the enterprise to continue; and
- ii) Indicate clearly how and, when reasonably determinable, to what extent the financial statements may be affected by possible adjustments.

When substantial doubts remain about the enterprise's ability to continue as a going concern, the auditor would not be able to determine whether the financial statements should be adjusted or in what amount. Accordingly, the wording of the disclaimer of an opinion paragraph of his report must indicate that the disclaimer pertains to the auditor's ability to obtain reasonable assurance to express an opinion on the financial statements taken as a whole because of possible material effects of the matters described in the reservation paragraph. An example of a disclaimer of an opinion due to uncertainties relating to a going concern is given in No. 13 of the Illustrative Audit Reports.

(para 3560)

E) NONCOMPLIANCE WITH THE COMPANY LAW OR THE ARTICLES
OF ASSOCIATION OF THE COMPANY THAT HAVE NO MATERIAL
EFFECT ON FAIR VIEW (para 3561)

When the auditor concludes, based on available evidence, that the financial statements, taken as a whole, and in all material respects, give a fair view but there has been noncompliance with the provisions of the Company Law and/or the Articles of Association of the Company with regard to the preparation and presentation of the financial statements, he should:

- i) Set forth in a separate reservation paragraph the nature of the noncompliance with Company Law and/or Articles of Association;
- ii) Express an unqualified fair view opinion on the financial statements taken as a whole; and
- iii) Qualify his opinion with respect to compliance with the Company Law and/or Articles of Association that relate to the preparation and presentation of financial statements.

An example of this report is given in No. 15 of the Illustrative Audit Reports.

3.7.3.4 Signing and Dating the Audit Report

The auditor must sign the Audit Report and must insert next to his name the number of his registration in the relevant list of accountants entitled to perform an audit and indicate his qualification either as a chartered or public accountant. No person other than a partner in the same firm who is suitably qualified to do so must sign an audit report on behalf of the auditor. The auditor must not sign the audit report before he has obtained

AUDITING STANDARDS

reasonable assurance about the contents of his report in accordance with the requirements of the Auditing Standards and before the financial statements as presented have been approved by the persons with overall responsibility for their preparation.

The date of the audit report should be the date of completion of the field work. The auditor must obtain reasonable assurance that no events have occurred between the end of the period upon which he is reporting and the date of his report which are not properly disclosed or, if necessary, accounted for in the financial statements and which may have materially affected the fair view given by the financial statements.

(para 3562)

3.7.3.5 Other Auditors

The auditor must not refer in his report to work performed by other auditors. If the auditor expresses a joint opinion, both auditors must sign the audit report.

(para 3563)

~~AUDITING STANDARDS~~

Illustrative Audit Reports

8.2.4.1 ILLUSTRATIVE AUDIT REPORTS

EXAMPLE 1 UNQUALIFIED OPINION - COMPANY ACCOUNTS

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at XX and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on page x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

UNQUALIFIED OPINION

In our opinion the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X Company Limited as at XX and of the results of its operations, and the sources and applications of its funds for the year then ended, based upon sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.

AUDITING STANDARDS

- ii) Comply with the provisions of the Company Law and the Articles of Association of the company with regard to the preparation and presentation of financial statements by this company.

Signature

Licentiate No.

Date

X
Professional Qualification

8.2.4.2 EXAMPLE 2 - UNQUALIFIED OPINION - COMPANY CONSOLIDATED
GROUP ACCOUNTS

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE
MEMBERS OF X LIMITED

SCOPE OF AUDIT

We have audited the consolidated statement of financial position of X Company and its subsidiaries as at xx and the related consolidated statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x which form part of these financial statements as prepared by the company. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

UNQUALIFIED OPINION

We have obtained reasonable assurance that in our opinion the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X company and its subsidiaries as at xx and of the results of operations, and sources and applications of funds for the year then ended, based upon sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.

AUDITING STANDARDS

- ii) Comply with the provisions of Company law and the Articles of Association of the company with regard to the preparation and presentation of financial statements by this company.

Signature

Licentiate No.

Date

AUDITING STANDARDS

8.2.4.3 EXAMPLE 3 - UNQUALIFIED OPINION AND EMPHASIS OF MATTER

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages xx to xx. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with generally accepted auditing standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

UNQUALIFIED OPINION

We have obtained reasonable assurance that in our opinion the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X Company Limited as at xx and of the results of its operations, changes in owners' equity and the sources and applications of funds for the year then ended, based upon sufficient presentation and the disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.

AUDITING STANDARDS

- ii) Comply with the provisions of the Company Law and the Articles of Association of the company with regard to the preparation and presentation of financial statements by this company.

EMPHASIS OF MATTER

We draw particular attention to the statement in the directors' report that net income for the year ended xxx has improved by 180% and was mainly attributable to the industrial sector. As disclosed in Note X to the financial statements, the comparative fiscal period was only five months long. Net income for the industrial sector is reported in Note X as having been SR 200 million for the year ended xx compared with 100 million for the 5 months ended xxx.

Signature

Licentiate No.

Date

X 8.2.4.4 EXAMPLE 4 - UNQUALIFIED OPINION: CONCURRENCE WITH A DEPARTURE FROM GENERALLY ACCEPTED ACCOUNTING STANDARDS

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, *included* includes such audit procedures as we considered necessary in the circumstances.

UNQUALIFIED OPINION

We have obtained reasonable assurance that in our opinion the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of x Company Limited as at xx and of the results of its operations, changes in owners' equity and the sources and applications of funds for the year then ended, based upon ~~adequate~~ sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.

- ii) Comply with the provisions of Company Law and the Articles of Association of the company with regard to the preparation and presentation of financial statements by this company.

EMPHASIS OF MATTER

We draw particular attention to the accounting policy on long-term contracts work-in-progress set out on page xx. Although this accounting policy does not comply with generally accepted accounting standards, we concur with this departure for the reasons disclosed in Note X to the financial statements.

Signature

Licentiate No.

Date

8.2.4.5 EXAMPLE 5 - QUALIFIED OPINION DUE TO THE OMISSION OF INFORMATION
NECESSARY FOR A FAIR VIEW

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, *included* → includes such audit procedures as we considered necessary in the circumstances.

RESERVATION

On xxx the company signed a loan agreement in the amount of SR _____ for the purposes of financing plant expansion. The loan agreement requires the company to maintain minimum working capital in the amount of SR _____ and restricts the payment of cash dividends. At (date of financial statements), retained earnings available for dividends amounted to SR _____. This information was not disclosed in the financial statements. In this respect, the financial statements are not in accordance with generally accepted accounting standards.

QUALIFIED OPINION

In our opinion, except for the omission of the information described in the reservation paragraph, the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X Company Limited as at xx and of the results of its operations, sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.
- ii) Comply with the requirements of the Company Law and the Articles of Association of the company with regard to the preparation and presentation of the financial statements by this company.

Signature

Licentiate No.

✓ *AA*
Firm

Date

8.2.4.6 EXAMPLE 6 - ADVERSE OPINION - OMISSION OF INFORMATION NECESSARY FOR A FAIR VIEW (INADEQUATE DISCLOSURE)

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with Generally Accepted Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

On (date subsequent to the date of the financial statements) the Company signed an agreement to sell substantially all of the assets of its xx division for SR _____ in cash subject to approval by the shareholders. Division xx accounts for 40% of the company assets as at xxx and has contributed 60% of its total revenues for the year then ended. The accompanying financial statements do not disclose this information. In addition, the company has not presented a statement of sources and applications of funds for the year ended xx. In these respects, the financial statements are not in accordance with generally accepted accounting standards.

ADVERSE OPINION

We have obtained reasonable assurance that, in our opinion, because of the omission of the statement of sources and applications of funds and the information referred to in the reservation paragraph, the financial statements, referred to above, taken as a whole:

- i) Do not give a fair view of the financial position of X Company Limited as at xx and of the results of its operations, and sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.
- ii) Do not comply with the requirements of the Company Law and the Articles of Association of the company with regard to the preparation and presentation of the financial statements by this company.

Signature

Licentiate No.

Date

AUDITING STANDARDS ✓

8.2.4.7 EXAMPLE 7 - QUALIFIED OPINION - MATERIAL DEPARTURE FROM
GENERALLY ACCEPTED ACCOUNTING STANDARDS

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

As explained in Note X to the financial statements, the company was found liable for SR _____ for non-fulfillment of certain construction contracts. Management has advised us that they will not record the amount until paid in _____. Failure to record the amount as a current liability is not in accordance with generally accepted accounting standards. Had the liability been recorded, net income for the year and retained earnings at the end of the year would have been reduced by SR _____ and working capital provided from operations during the year and working capital at the end of the year would have been reduced by SR _____.

QUALIFIED OPINION

In our opinion, except for the effects of the Company's failure to record the liability described in the reservation paragraph, the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X Company Limited as at xx and of the results of its operations, changes in owners' equity and the sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.
- ii) Comply with the provisions of Company Law and the Articles of Association of the company with regard to the preparation of financial statements by this company.

Signature

Licentiate No.

Date

AUDITING STANDARDS

8.2.4.8 EXAMPLE 8 - ADVERSE OPINION - DEPARTURE FROM GENERALLY ACCEPTED ACCOUNTING STANDARDS

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

As explained in Note X to the financial statements, commencing this year the company ceased to consolidate the financial statements of its subsidiary companies because it considers this basis to be inappropriate when there are substantial minority interests. These investments are now accounted for on a cost basis. Under generally accepted accounting standards, the existence of such minority interest is not an acceptable reason for not consolidating the financial statements of subsidiary companies with those of the parent. Had consolidated financial statements been prepared, virtually every account in, and the information

AUDITING STANDARDS

provided by way of notes to, the accompanying financial statements would have been materially different. The audited financial statements of the subsidiaries reveal that, while the company's proportionate share in the underlying book values is greater than cost, substantial losses have been incurred in the current year of which the company's share on consolidation would approximate SR ____.

ADVERSE OPINION

In our opinion, because of the material effects of not accounting for the investment in subsidiary companies on a consolidated basis as explained in the reservation paragraph, the financial statements, referred to above, taken as a whole:

- + i) Do not give a fair view of the financial position of the company as at xx and of the results of its operations, and sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.
- ii) Do not comply with the requirements of Company Law and the Articles of Association of the company with regard to the preparation and presentation of financial statements by this company.

Signature

Licentiate No.

Date

8.2.4.9 EXAMPLE 9 - QUALIFIED REPORT - AUDIT SCOPE DEFICIENCIES

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. ^{Except as mentioned in the next paragraph,} Our audit has been performed in accordance with the Generally Accepted Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

The recent introduction of a computerized accounts receivable system resulted in errors and, although the system deficiencies causing these errors have now been rectified, management is concerned about preserving customer goodwill. As a result, we were instructed not to obtain confirmation of certain accounts receivable totalling SR _____ and were not able to satisfy ourselves concerning the validity of these accounts by alternative means. Accordingly, we were not able to determine whether any adjustments might be necessary to accounts receivable, sales, net income and working capital.

QUALIFICATION OF OPINION

In our opinion, except for the effects of any adjustments which we might have determined to be necessary had we been able to confirm the accounts receivable specified in the reservation paragraph, the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X Company Limited as at xx and of the results of its operations, and the sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.
- ii) Comply with the provisions of article 123 of the Company Law and the Articles of Association of the company with regard to preparation and presentation of financial statements by this company.

Signature

Licentiate No.

Date

8.2.4.10 EXAMPLE 10 - DISCLAIMER OF AN OPINION BECAUSE OF AUDIT SCOPE DEFICIENCIES

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements are set out on pages x to x. In accordance with the provisions of article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

We were not appointed auditors until after (year end date) and thus did not observe the taking of physical inventories at either the beginning of the year or the end of the year and were not able to satisfy ourselves concerning inventory quantities by alternative means. Also, our examination indicated serious deficiencies in the accounting records and in the system of internal control. As a consequence, we were unable to satisfy ourselves that all revenues and expenditures of the company had been recorded or that the recorded transactions were proper. As a result, we were unable to determine whether adjustments were required in respect

AUDITING STANDARDS

of recorded or unrecorded assets, recorded or unrecorded liabilities and the components making up the statements of income, retained earnings and sources and applications of funds.

DISCLAIMER OF AN OPINION

In view of the possible material effects on the financial statements of the matters described in the reservation paragraph, we do not have reasonable assurance to express an opinion, and we do not express an opinion on the financial statements, referred to above.

Signature

Licentiate No.

Date

AUDITING STANDARDS

8.2.4.11 EXAMPLE 11 - QUALIFIED OPINION - UNCERTAINTIES NOT RELATING TO A GOING CONCERN

AUDITORS' REPORT TO THE PARTNERS OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements and notes are set out on pages x to x. In accordance with the provisions of article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

As discussed in Note X to the financial statements on page x, the accompanying statement of financial position includes a receivable stated at SR _____, which represents a claim against a supplier for defective goods. The collectibility of this claim receivable is not susceptible of reasonable estimation at the present time.

QUALIFIED OPINION

In our opinion, subject to the possible effects, if any, on the financial statements of the ultimate resolution of the collectibility of the claim receivable discussed in the reservation

AUDITING STANDARDS

paragraph, the financial statements, referred to above, taken as a whole:

- i) Give a fair view of the financial position of X Company Limited as at xx and of the results of its operations, changes in owners' equity and sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of the information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the particular circumstances of the business.
- ii) Comply with the provisions of Company Law and the Articles of Association of the company with regard to the preparation and presentation of financial statements by this company.

Signature

Licensee No.

Date

AUDITING STANDARDS

8.2.4.12 EXAMPLE 12 - DISCLAIMER OF AN OPINION BECAUSE OF UNCERTAINTIES
NOT RELATING TO A GOING CONCERN

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements and notes are set out on pages x to x. In accordance with the provisions of article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the generally accepted Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

As discussed in Note X to the financial statements on page x, the company is a defendant in product liability lawsuits totaling SR _____ and is under investigation by various government agencies concerning safety aspects of its products. The ultimate outcome of the lawsuits and investigations can not presently be determined, and no provision for any liability or impairment of assets carrying value that may result has been made in the financial statements.

DISCLAIMER OF AN OPINION

In view of the possible material effects on the financial statements of the matters described in the reservation paragraph, we do not have reasonable assurance to express an opinion and, we do not express an opinion on the financial statements, referred to above.

Signature

Licentiate No.

Date

AUDITING STANDARDS

8.2.4.13 EXAMPLE 13 - DISCLAIMER OF OPINION - UNCERTAINTIES RELATING TO A GOING CONCERN

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements and notes are set out on pages x to x. In accordance with the provisions of article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the generally accepted Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATION

As shown in the financial statements, the company incurred a net loss of SR ____ for the year ended xx and has incurred substantial net losses for each of the past x years. At (date of financial statements), current liabilities exceed current assets by SR ____ and total liabilities exceed total assets by SR _____. In addition, in connection with a note payable to a bank, the company must comply with the provisions of the loan agreement. The bank claims that during the year ended xx the company violated certain of these provisions. On xx, the bank demanded immediate payment of the outstanding balance of SR _____. These factors, and others discussed in Note X to the financial statements on

AUDITING STANDARDS

page x, indicate that the company may be unable to continue as a going concern. Should the company be required to liquidate its assets, it is possible that it would not be able to realize the recorded amounts of accounts receivables, inventories, fixed assets and prepayment without substantial losses. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the company can not continue as a going concern.

DISCLAIMER OF AN OPINION

X In view ^{of} the possible material effects on the financial statements of the matters described in the reservation paragraph, we do not have reasonable assurance to express an opinion, and we do not express an opinion on the financial statements, referred to above.

Signature

Licentiate No.

Date

8.2.4.14 EXAMPLE 14 - MODIFIED DISCLAIMER BECAUSE OF UNCERTAINTIES
RELATED TO A GOING CONCERN AND A DEPARTURE FROM GENERALLY
ACCEPTED ACCOUNTING STANDARDS

AUDITORS' REPORT TO THE GENERAL MEETING OF THE MEMBERS
OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements and notes are set out on pages x to x. In accordance with the provisions of article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the generally accepted Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATIONS

1) UNCERTAINTY

Continuation of the company's activities depends upon a successful outcome to current negotiations between the management of the company and various banks for loans of SR _____ million as explained in Note X to the financial statements on page x. The financial statements have been prepared on the basis that the company will be able to continue. Should the company be required to liquidate its

AUDITING STANDARDS

assets, it is possible that it would not be able to realize the recorded amounts of accounts receivable, inventories, fixed assets and prepayments without substantial losses.

2) ACCOUNTING DEFICIENCY

No provision has been made for depreciation on certain items of plant and machinery acquired during the year ended (date of financial Statements). Generally accepted accounting standards require depreciation to be provided on a systematic basis over the useful life of such fixed assets. The effect of not providing depreciation on these assets has been to reduce the company's net loss for the year ended (date of financial statements) by SR _____ and to increase its net assets as at year end by the same amount.

DISCLAIMER OF AN OPINION

In view of the possible material effects on the financial statements of the matters described in the first reservation paragraph, we do not have reasonable assurance to express an opinion, and we do not express an opinion on the financial statements, referred to above.

Signature

Licentiate No.

Date

AUDITING STANDARDS

- 8.2.4.15 EXAMPLE 15 - QUALIFIED OPINION BECAUSE OF NON COMPLIANCE WITH THE COMPANY LAW AND/OR ARTICLES OF ASSOCIATION THAT HAS NO MATERIAL EFFECT ON FAIR VIEW

AUDITORS' REPORT TO THE ANNUAL GENERAL MEETING OF THE MEMBERS OF X COMPANY LIMITED

SCOPE OF AUDIT

We have audited the statement of financial position of X Company Limited as at xx and the related statements of income, retained earnings and sources and applications of funds for the year then ended. The financial statements and notes are set out on pages x to x. In accordance with the provisions of article 123 of the Company Law, the overall responsibility for the preparation of the financial statements is that of management who has placed at our disposal all the particulars and explanations called for. Our audit has been performed in accordance with the generally accepted Auditing Standards and, accordingly, included such audit procedures as we considered necessary in the circumstances.

RESERVATIONS

As required by Company Law, the Articles of Association of the company specify the manner of remunerating directors and include a provision that each director shall be paid 1/2% of net income of the company in addition to his specified salary. Provision has been made in the financial statements for such sums payable to three of the directors but not to the other directors.

QUALIFIED OPINION

In our opinion the financial statements, referred to above, taken as a whole:

- X i) give a fair view of the financial position of X Company Limited as at xx and of the results of its operations and sources and applications of funds for the year then ended, based upon the sufficient presentation and disclosure of information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the circumstances of the business.
- ii) Except for the non compliance relating to the matters referred to in the reservation paragraph, comply with the provisions of Company Law and the Articles of Association with regard to the preparation and presentation of financial statements by this company.

Signature

Licentiate No.

Date

4. APPENDICES

- o Preface
- o Introduction
- o Analytical Study

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PREFACE

HISTORICAL REVIEW OF THE PROJECT

In mid 1399H a discussion was held with HE Mr. Yousaf Al-Hamdan, the Deputy Minister of Commerce, with regard to the condition of the auditing profession in Saudi Arabia and aspects of its development. At that time the situation seemed critical and disclosed certain deficiencies which would impact the economic and financial activities in the country. The discussion concluded with an agreement on the necessity of taking practical measures to remedy such deficiencies and to develop the auditing profession in a manner that would enable auditors cope with the radical changes that took place in this field. Three months later the ideas referred to in this discussion were further elaborated with HE the Minister of Commerce Dr. Sulaiman Al Saleem whereby it was determined that the public accounting profession in Saudi Arabia is not keeping abreast with the changes that the country is undergoing. However, deficiencies were not determined for areas concerned to be able to handle them in a proper manner.

To determine such deficiencies in general in order for the Ministry to take appropriate measures to seek the means of developing the profession of public accounting, Al-Rashed firm formed a team of researches, with the participation of Dr. Abdullah Al-Faisal from King Saud University, to conduct a preliminary survey in order to determine the status quo of the Public Accounting Profession. The results of this study were summed up in a memorandum which specified the major deficiencies in the conduct of this profession.

This memo was used as a basis for discussions with the areas concerned at the Ministry who confirmed that this preliminary study reflects in a general manner all the deficiencies in the public accounting profession and is deemed to be a suitable starting point for a project that would handle the issue of developing this profession. Al-Rashed firm was requested to

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prepare a proposal for this project which would take into consideration the possibility of making use of the experience of other countries and the specific circumstances of the Kingdom.

Al-Rashed firm prepared a comprehensive proposal for a three phased project that would cover the standards relevant to public accounting, auditing and a comprehensive internal organisation and development of the accounting profession in general.

This proposal was further discussed with the authorities concerned at the Ministry and it was deemed suitable to handle the issue of development of the accounting profession in two phases as follows:

PHASE I

Following a detailed study by the Ministry of Commerce of the proposal submitted by Al-Rahsed, the Ministry commissioned the firm to conduct the comparative study, that is , phase one of the project. Three foreign countries had to be selected for this comparative study. To make the selction, nine countries were identified and classified into three groups based on the state of development of their accounting profession; similarities of their economic circumstances to that of the kingdom and the ability of Saudi Arabia to benefit from their established organizations. The three groups were as follows:

<u>The First Group:</u>	U.S.A., England and Canada
<u>The Second Group:</u>	France, West Germany and Sweden
<u>The Third Group:</u>	Tunisia, Venezuela and Brazil

The USA, West Germany and Tunisia were selected for the comparative study.

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The comparative study consisted of:

- i) Review of authoritative pronouncements, laws and regulations of the three countries which relate to:
 - a) Accounting standards and financial reporting requirements;
 - b) Auditing standards and auditing requirements;
 - c) Professional ethics; and
 - d) The organization of the accounting profession.
- ii) Interviews with officials of the institutes representing the accounting profession in the three countries.
- iii) Analysis of data gathered as a result of the previous two steps.
- iv) The preparation of a comprehensive report in Arabic setting forth:
 - a) A comparison of the organization of the accounting profession; the authoritative standards and pronouncements that govern financial reporting and auditing; and the code of professional ethics in the three countries.
 - b) Tentative conclusions as to the implications of the study to the development of the accounting profession in Saudi Arabia.

The comparative study report was submitted to the Ministry of Commerce. After review of the report, the Ministry of Commerce held discussions

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with the firm to determine the most appropriate approach for the execution of phases two and three of the project. The approaches were considered as follows:

APPROACH ONE:

Combine phases two and three in one comprehensive study to develop recommendations for a highly regarded accounting profession that would cope with the development in other areas in the Kingdom and accommodate the best available in other advanced countries. However it was contemplated that combining the two phases required substantial effort and field survey in order to specify the beneficiaries from the financial statements in the Kingdom, the information required by them to make their decisions and the extent of the accounting profession's capability to provide such information.

APPROACH TWO:

Limit phase two to the development of recommendations that would address the most immediate requirements. Specifically, limit this phase to developing recommendations with respect to auditing standards, the organization of the accounting profession, the code of professional ethics, objectives of financial statements of business enterprises, the basic concepts of financial accounting for business enterprises and the general presentation and disclosure standard, because the accounting profession in Saudi Arabia required immediate organisation.

After careful consideration of the two approaches, a contract was signed between the Ministry of Commerce and the firm on 11.10.1402H to proceed with phase two of the project in accordance with the second approach described above.

PHASE II

The Ministry reviewed the results of phase one of the project and selected the second approach which copes with current circumstances in the Kingdom. This approach covered the following aspects of the accounting profession:

1. Selected subjects from financial accounting which cover the following:
 - a) Determine the objectives of financial accounting.
 - b) Select and define the most important concepts of financial accounting.
 - c) Prepare standards of presentation and general disclosure.
2. Auditing Standards
3. Internal Organisation of the accounting profession.

A) METHOD OF IMPLEMENTATION

Extensive research was made and a variety of methods were explored to determine the best approach for the implementation of this phase in order to arrive at recommendations suitable to the existing circumstances in the Kingdom within a reasonable time frame and to establish a basis for continuous development with the assistance of national calibre who are capable of updating such recommendations. Due care and attention was taken to involve technical experts from the selected countries who master the Arabic language. Saudi professors and advisors were also invited to review the recommendations of the experts. Al-Rashed firm's top management, particularly Messrs Abdul Aziz Al-Rashed and Yousaf Al-Mobarak have extended all possible efforts to

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organize the work of both the experts and the advisors. Experts from other Arab countries were also called to assist with respect to other aspects of the project.

The proper organisation and coordination of work among the participants (experts, advisors, management personnel and Arab experts) has contributed to the achievement of the stated objectives of the project.

The project has been divided into three major parts, each of which was assigned to a team of experts under the supervision of an advisor. Following is an overview of the method of implementation of this project and its effect on the final recommendations.

1. A number of meetings were held among team members and advisors to prepare a background paper setting forth the status quo of the accounting profession and laws and regulations which cover this profession and the audit of financial statements in the kingdom. This paper was prepared in both Arabic and English and referred to the team members who were instructed to take the information stated therein into consideration in preparing the initial drafts for each part of the project.
2. Visits to the kingdom were arranged for team members on as many occasions as practically possible to get acquainted with the accounting profession and its environment and to conduct actual case studies which relate to their respective areas of responsibilities.
3. Upon deliberate and in-depth study of all aspects of the project and visits to a number of specialized institutes in this field and deliberations with reference to their experience and work environment, it was decided that the suitable

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approach to implement this project is to divide it into the following segments:

- a) The study of selected subjects in financial accounting, including:
 - o Objectives of financial accounting
 - o Basic concepts in financial accounting
 - o General presentation and disclosure

These issues were handled by the following experts:

1. Dr. Sabry Heakal, Ph.D. in accounting, 1968 and an affiliate of the American Institute, with 11 years of experience in teaching accounting and auditing in the U.S.A. where he has been promoted to the level of a full professor and head of the accounting department at the University of Minnesota, St. Claude. Dr. Heakal has 5 years of experience as the partner in-charge with the technical aspects of accounting and auditing in one of the major accounting and auditing companies in the United States. Dr. Heakal also contributed to the various activities of the American Institute of Accounting and has recently been appointed as a member in one of the technical committees of this institute.
2. Dr. Mohamed E. Mostafa: Ph.D. in Accounting Illinois University, 1965 with a number of research works and publications in a variety of academic subjects of international concern. Dr. Mostafa conducted a research work for the United

nations

Nations on the use of accounting data in industrial projects in developing data in industrial projects in developing (national). Dr. Mostafa has been holding the position of advisor to the International Labour Organisation since 1975. Most of Dr. Mostafa's research work is devoted to the development of financial accounting. With respect to academic career, Dr. Mostafa was promoted to a number of posts in the US. Universities and now occupies the post of the dean of the school of business administration in California State University.

3. Dr. Abdul Rehman I. Al Homaid, advisor, PhD. in accounting with diversified experience as advisor to a number of government agencies and academic career in King Saud University until he has been recently promoted to the post of the head of the accounting department in the faculty of administrative sciences.

- b) Auditing Standards, which cover: Planning, Control, Recording, Evidence, Reporting and relevant procedures. These areas were handled by the following team members:

1. Mr. David Hatherly holds a Master's degree in Accounting and is an affiliate of the British Institute of Chartered Accountants. Mr. Hatherly is presently a member of the technical division for accounting and auditing research at the Institute of Chartered Accountants in Scotland. He has 11 years of experience in accounting, auditing and

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field work with a major accounting company. Mr. Hatherly also wrote a book on the "Collection of Evidence for Auditing".

2. Mr. Peter Skuze, Licentiate in Law and an affiliate of the British Institute of Chartered Accountants. Mr. Skuze is a partner in charge of the technical aspects of accounting and auditing in a medium sized company. He represented his company in the discussions held to finalize the draft recommendations relevant to the auditing standards prepared by the British Institute of Chartered Accountants. Mr. Skuze has over 13 years of experience in the fields of accounting and auditing.
 3. Dr. Abdullah Al-Faisal, Advisor, PhD in Accounting, with more than four years of experience as professor of accounting at King Saud University. Dr. Al-Faisal is a part-time consultant to a large number of government agencies. He has been acquainted with this project since its initial stages of development.
- c) Internal organisation of the accounting profession, which was handled by the following team members:
1. Mr. Ivan Q. Bull, affiliate of the American Institute of Certified Public Accountants and Chairman of the board of directors of said institute in 1976. Mr. Bull was also head of the committee in charge of the affairs of small businesses at the American Institute of Certified Public Accountants and a member of the executive committee in charge of the

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operations of this institute and the adhoc committee formed to study the problems confronting the accounting profession in Saudi Arabia which developed into the council presently in charge of issuing the accounting and auditing standards. Mr. Bull is also a member of the committee in charge of the preparation of consolidated financial accounts for the federal government of the United States. Mr. Bull has over 35 years of experience in the fields of accounting and auditing. The latest post in his career was the partner and managing director to one of the major accounting and auditing companies in the United States.

2. Mr. Wallace E. Olson, affiliate of the American Institute, deputy chairman of the board of directors of the A.I.C.P.A. (1972-1973), head of the executive committee and managing director of the Institute (1973-1988), head of the division incharge of the code of ethics of the accounting profession formed by the A.I.C.P.A. (1970-1972), and a partner (managing director) of a major accounting and auditing company in the United States.
3. Dr. Abdullah Al-Moneef, Advisor, PhD. in accounting, part time consultant to many government agencies and professor of tax accounting at the faculty of administrative sciences.
4. Each team had to prepare and submit to the firm a preliminary draft of recommendations.
5. The preliminary draft of each team was reviewed by Mr. Al-Rashed and his advisory group.

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6. The preliminary draft was returned to each team after review with suggested additions, changes and deletions.
7. A meeting chaired by Mr. Al-Rashed was held in Riyadh from 8.1.1403H to 12.1.1403H attended by all team members, the advisory group and several members of the firm to discuss the second draft of the recommendations.
8. An overview presentation of draft recommendations was made to HE the Minister of Commerce, HE the Deputy Minister of Commerce and other officials concerned from the Ministry. The meeting was also attended by their excellencies the Minister and Deputy Ministers of Finance, as well as the Governor and Deputy Governor of SAMA. The significance of this meeting was manifested in clarifying the appropriate trends and giving the firm an impetus through asserting that authorities concerned are giving due care and attention to the accounting and auditing profession.
9. Team members and the advisory group held further meetings to discuss the results of their presentation held on 10.1.1403 and team members were instructed to adjust their draft recommendations as necessary in accordance with the results of the Riyadh meeting. One of the experts was commissioned to read the adjusted draft recommendations in their final form.
10. The final draft recommendations were handed to areas concerned and reviewed by the advisors in Al-Rashed firm. A meeting was then held by the areas concerned

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and advisors in Al-Rashed office and attended by Dr. Sabry Heakel to discuss this revised copy of the draft recommendations.

11. Another general meeting was held at the Riyadh Hyatt Regency for a few days to finalize the revised copy of the draft recommendations. This meeting was attended by the persons concerned at Al-Rashed firm, the advisors and Dr. Sabry in order to discuss the results of the three teams' revisions of the said draft recommendations.
12. Team members were then called in for further discussion with the advisors and Al-Rashed personnel concerned. This discussion resulted in further ramifications of the final product.

On 9.6.1403H a meeting was held in Riyadh attended by the advisors, Dr. Sabry and Al-Rashed personnel concerned. In this meeting, all aspects of the project were discussed and issues left from the previous meeting were tackled. Each advisor was assigned a certain segment of the project in order to ensure its adaptability to the circumstances of the Kingdom in general and the present condition of the accounting profession in particular, and to verify its accuracy from the technical point of view, clarity of style, general consistency and feasibility of application in Saudi Arabia.

13. During this period, the various stages of the project were translated into Arabic, reviewed by the respective experts and handed over to the advisors and other experts at Al-Rashed firm for final review.

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14. The Ministry of Commerce forwarded this study to the government areas concerned and to a selected group of certified public accountants to seek their advice and opinion accordingly.
15. The notes received and were summarised and the study was adjusted in accordance with the suggestions that the Ministry deemed to be acceptable.
16. Ministerial Resolution No. 692, dated 28.2.1406 was finally issued to approve this study which is concerned with the objectives and concepts of financial accounting, and the standards of presentation and disclosure, and to consider them as an official reference and guidelines to all certified public accountants who are licensed to practise this profession in Saudi Arabia.

1. INTRODUCTION

Following is a brief description of the scope of auditing standards which will help the reader appreciate the recommendations relevant to the application of each of these standards.

(para 101)

2. WHY ARE AUDITING STANDARDS NEEDED

Professors Stamp and Moonitz in their study of "International Auditing Standards", 1979, p. 29 stated the overall objective auditing standards as follows:

"...the primary function of the auditor is to lend credibility to the financial statements prepared by management. But if the auditor's opinion is to do this it follows that the auditor himself must have credibility as an independent, objective and expert judge of the fairness of financial statements. Auditors' reports are relied upon by outsiders who need to have sufficient confidence in the auditor to be willing to rely upon his opinion.

(para 102)

Thus, if the function of the auditor in lending credibility to financial statements is to be confirmed, the outsiders who rely upon his opinion must be able to judge what the auditor's opinion means and how useful it is likely to be. So the auditing profession itself needs a set of auditing standards, in order to lend credibility to the role of the auditor and his functions in much the same way that the work of the auditor lends credibility to management's financial statements.

In other words, if outsiders are to rely on the work of an auditing profession, it is necessary for the profession to have an objective and impressive set of standards that are clearly accepted and enforced by all members of the profession.

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This fact has long been recognized in the United States, where a set of auditing standards were adopted by the profession as long ago as 1948. Several other countries have also adopted a formal set of auditing standards, including Japan, Australia, Canada and most recently Germany."

(para 103)

Thus the reason for auditing is to add credibility to financial statements and this can only happen if the work of auditors is highly regarded. The purpose of auditing standards is to ensure that the work of auditors is highly regarded but auditing standards can only achieve this objective if they are clearly understood and enforced by all the auditors concerned. Execution and enforcement are essential to the success of any auditing standards and these are seen as two crucial issues to be dealt with, given appropriate legal backing, by the proposed Saudi Institute.

(para 104)

Since Professors Stamp and Moonitz conducted their study, the United Kingdom profession has issued a set of auditing standards to add to those of the professions of Japan, Australia, Canada, Germany and the United States. It is significant that the need for auditing standards has been felt so widely and given that the Saudi economy is both large and fast developing it is appropriate to consider whether there is a need for Saudi auditing standards to establish both nationally and internationally the credibility of auditing in Saudi Arabia. We believe that there is such a need. Credible auditing is necessary if there are to be credible financial statements which are in turn essential if there is to be proper allocation and control of resources. This is as important in Saudi Arabia as it is in other major economies.

(para 105)

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3. WHAT ARE THE AUDITING STANDARDS ABOUT

For an audit to properly add credibility to financial statements, the reader of those financial statements must:

- i) Believe that the auditor is a man of integrity and that he is sufficiently independent of the management of the enterprise to reach an objective opinion on the financial statements produced by management.
- ii) Believe that the auditor is a man of sufficient experience and education in matters of finance, accounting and auditing, so that his opinion on the financial statements is worth having.
- iii) Believe that the auditor has obtained sufficient evidence on which to base his audit opinion.
- iv) Clearly understand the audit opinion expressed in the auditor's report.

Since there is at present no Saudi Institute of Accounting and, therefore there are no Institute statements on auditing, it is necessary to go to Saudi law to see whether these four requirements are currently given proper recognition. It is found that Saudi Arabian law already recognizes the importance of the integrity and independence of the auditor and the importance of proper education and training for the auditor. For example, Article 131 of The Company Law prohibits the auditor from taking part in organizing the company, being a director thereof, or performing any technical or administrative work for the company, even in an advisory capacity. In addition, the auditor is required to perform his functions in a faithful, honest and serious manner and not to divulge any confidential matters to which he becomes

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privileged. Furthermore, an auditor may not be a partner, or employee or be related within four degrees of consanguinity to any founder or director of the company.

(para 107)

On the question of education and training, Article 2 of the Law of Chartered Accountants sets out the requirements which must be met before a person can become a registered article clerk. Similarly, Articles 3 and 4 deal with the education and training requirements of a Public Accountant and Articles 5 and 6 with those of a Chartered Accountant.

(para 108)

Although the Saudi Company Law guarantees the auditor's right of access to any data deemed necessary to form an audit opinion, it did not specify the quality and degree of sufficiency of evidence that must be acquired by the auditor. This is a gap that must be bridged by auditing standards. Company Law has not also treated, in sufficient detail, the form and content of the auditor's report. For example, article 132 of this law states that the auditor shall submit a report to the annual general assembly of the shareholders in which he refers to the attitude of the company's management in providing the required data and clarifications and in clearing the irregularities disclosed by the auditor as a result of deviation from company law in general and the by-laws of the company being audited in particular. Such information will be the basis for the auditor's judgement whether the financial statements fairly present the financial position of the company.

However this article did not explain other important matters relating to the auditor's report (for example, circumstances which should lead to a qualified report and the form of such qualification....etc.).

A → Auditing standards on the other hand, give detailed explanation of the requirements that should be considered in the auditor's report on financial statements.

(para 109)

4. WHO ARE THE AUDITING STANDARDS FOR

The ultimate beneficiaries of auditing standards are the competent readers of the financial statements and relevant audit report. The statement of objectives of financial accounting defines the readers of financial statements as investors, present and prospective creditors, importers, clients, employees, besides government departments concerned which depend to a great extent on the financial statements of firms for legal purposes, such as tax/zakat collection, determination of government subsidies needed by the firm or even to determine the trend of national economic activity.

However, it is important to distinguish the beneficiaries of auditing standards from those to whom the auditing standards are addressed. Auditing standards are addressed to the community of licentiate accountants in Saudi Arabia. They are written in terms designed to be understood by the reasonably competent and reasonably educated auditor. It is he who has to put the standards into operation and he does so by judgementally selecting procedures which both meet the required standards and are appropriate to the circumstances of the particular client.
(para 110)

5. THE DISTINCTION BETWEEN THE AUDITOR OF FINANCIAL STATEMENTS AND OTHER ACTIVITIES PERFORMED BY AN AUDITOR

We believe that the primary purpose of an audit is to add credibility to financial statements. We define an audit as 'The expression of opinion by a duly qualified and properly appointed person based on reasonable assurance as to whether the financial statements of an enterprise, taken as a whole, give a fair view of the financial position of the enterprise and of the results of its operations and other changes in its financial position and comply with the requirements of the Company Law and the Articles of Association of the

Enterprise with regard to the preparation and presentation of financial statements."

The principal factor which influences the credibility of financial statements is the auditor's opinion as to whether or not those financial statements give a fair view. The proposed Saudi standards are primarily directed toward the formation of this audit opinion.

(para 112)

It is important to distinguish the formation of an opinion on the financial statements from other activities which may be performed by the auditor, since under the Saudi Company Law the auditor must ascertain compliance with many of the provisions of the Articles of the Company Law that are not directly related to the financial statements. For example, under Article 138, the auditor has a legal responsibility to prepare and certify a statement of the origin of the debt that is settled through the issuance of new shares and under Article 142 the auditor's responsibility extends to cover the reduction of the company's capital by setting forth in a report the reasons necessitating the reduction, the liability of the company and the effect of the reduction on the liabilities. Although such activities are undertaken by the auditor they should be distinguished from the audit of financial statements which is the activity to which auditing standards relate.

(para 113)

6. SCOPE OF AUDITING STANDARDS

An audit report comprises the expression of an opinion on the financial statements of an enterprise by a duly qualified and properly appointed independent auditor following his examination of the enterprise's financial statements. Company Law requires certain corporate entities to submit audited financial statements to an annual general meeting of

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shareholders or partners; the rules of certain other associations may require the financial statements to be audited. The auditing Standards apply whenever an auditor is engaged to express an opinion on the financial statements of an enterprise.

(para 114)

7. AUDITING STANDARDS AND AUDIT THEORY

Auditing standards prescribe the basic principles which must be followed in the course of an audit. As such, they may be used as a benchmark against which the competence of an individual auditor and the quality of his work can be judged. Auditing theory provides the justification

and explanation of the reasons for such prescribed principles. The details of auditing theory are to be found in textbooks of auditing.

forewords → The explanatory *fore*words to the auditing standards provide a link or bridge between the auditing standards and the underlying theory of auditing by providing a further explanation of the thinking behind the standards and a guide to their interpretation for reasonably competent auditors who are qualified to practise in Saudi Arabia.

(para 115)

8. AUDITING STANDARDS AND AUDIT PROCEDURES

Auditing standards prescribe principles which are of universal application on all audits, but they do not specify auditing procedures in detail. Such procedures are selected judgementally by the licentiate accountant so as to apply the standards in the circumstances of his particular client. Hence, auditing standards are of universal application but auditing procedures may vary from client to client.

forewords → Although the explanatory *fore*words do not give listings of audit procedures such as might be found in an audit manual, they do give helpful illustrative examples of how auditing standards may be applied. These

illustrative examples can be thought of as giving a link or a 'bridge' between the standards and the typical audit manual containing details of audit procedures.

(para 116)

9. DEGREE OF COMMITMENT TO AUDITING STANDARDS

Texts of auditing standards contain varying degrees of commitment. Where an Auditing Standard prescribes that the auditor 'should' apply a particular principle, the auditor must use his judgement as to whether such a principle is appropriate or whether an alternative would be more appropriate due to especially unusual circumstances. In the latter case, the auditor must always record the justification for his decision. Where an Auditing Standard prescribes that the auditor 'must' apply a particular principle, the auditor is subject to a mandatory requirement in that respect.

(para 117)

10. SCOPE OF AUDITING STANDARDS

Auditing standards are divided into three main categories, as follows:
(para 118)

10.1 GENERAL STANDARDS

These general standards relate to the basic principles which govern aspects of professional qualification, neutrality, objectivity and independence of the auditor. They also relate to the degree of professional care required for the implementation of audit procedures. This category is subdivided into the following three standards:

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- A) Standard of proficiency
- B) Standard of neutrality, objectivity and independence
- C) Standard of due professional care

(para 119)

10.2 STANDARDS OF FIELD WORK

These standards relate to the basic principles which govern the formation of a sufficient basis for the expression of an audit opinion on the financial statements. This category is subdivided into the following three standards:

(para 120)

A) STANDARD OF PLANNING:

This standard relates to the basic principles for the planning of the audit function.

B) STANDARD OF CONTROL AND RECORDING:

This standard relates to the basic principles of control, supervision of the audit function, the recording of its procedures as well as the evidence obtained by the auditor.

C) STANDARD OF EVIDENCE:

This standard relates to the basic principles for the collection of evidence required for the expression of an opinion in the financial statements and the location of sources of such evidence.

1 AUDITING STANDARDS

10.3 STANDARD OF REPORTING

This standard prescribes the basic principles which control the contents of the report that must be prepared by the external auditor on the financial statements, the format of this report and the reservations or qualified opinion expressed in this report, if any.

(para 121)

11. ASPECTS OF THE AUDIT FUNCTION NOT COVERED BY THE AUDIT STANDARDS

There are certain aspects that were not specifically covered by audit standards, mainly for the sake of being concise at this stage of standard development. Some of these aspects which still need to be developed are as follows:

(para 122)

- 11.1 Duties of the chartered accountant when he discovers certain accounting errors in the financial statements after the audit report has been issued.
- 11.2 The duties of chartered accountants relevant to the procedures which should be followed to obtain a letter from the client's legal counsel which gives clarification of any existing or expected legal suits or claims which may leave an impact on the financial statements and the auditor's report.
- 11.3 Accountability of the chartered accountant towards the financial statements of previous years that are used for comparative purposes.
- 11.4 The procedures to be followed by chartered accountants when requested to reissue their audit reports.

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- 11.5 Methods of determining the level of materiality for the purpose of audit tests, the degree of validity of audit test results, and the relationship between the level of materiality and validity on the one hand and the size of sample which is subject to the audit tests on the other hand.
- 11.6 The responsibility of the chartered accountant when he discovers certain legal irregularities which might be of significance to the financial statements.
- 11.7 The report of the chartered accountant on financial statements which are prepared in accordance with standards other than generally accepted accounting practices and the responsibility of chartered accountants towards preparing nonstandard and detailed audit reports.
- 11.8 Expression of opinion on one or more segments of the financial statements.

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ANALYTICAL STUDY

1. Standard of Proficiency
2. Standard of Neutrality, Objectivity and Independence
3. Standard of Due Professional Care
4. Standard of Planning
5. Standard of Control and Recording
6. Standard of Audit Evidence

ADDITING STANDARDS

1. Standard of Proficiency

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1. STANDARD OF PROFICIENCY

1.1 COMMENTARY

1.1.1 INTRODUCTION

The practice of audit function requires a high degree of proficiency. This is especially important due to the fact that the external auditor's opinion gives further confidence to the authenticity of the financial statements. Users of these audited and certified financial statements depend on the auditor's opinion in ~~their~~^{his} evaluation of the performance of the enterprise and in taking the appropriate decisions. It is, therefore, imperative for the external auditor to be confident in his opinion which shall be based on professional qualification and practical experience. Such qualification and experience will assist him in understanding the activities of the enterprise and better comprehension of the information contained in its financial statements, in order to become in a better position to apply audit standards and accounting procedures in the appropriate manner. Proficiency is, in fact, not limited to the scope of auditing of accounts, but is applied to other areas which may, or may not, be dependent on the nature of business of the enterprise that is being audited. For example, an auditor may find it difficult to express an opinion on the financial statements of financial institutions, such as banks, to ensure that such financial statements present fairly the financial position and results of operations of the bank unless he has acquired a sufficient degree of knowledge and experience in the laws and rules which govern the activities of such institutions and unless he is totally aware of the impact of the economic and social conditions on the activities of these institutions.

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1.1.2 RELATIONSHIP OF PROFICIENCY TO THE ACQUISITION OF THE PROPER LICENSE FOR THE PRACTICE OF AUDIT WORK

The Law of Chartered Accountants defines the conditions for the acquisition of the required license for the practice of the profession of a "chartered Accountant". Among these conditions are to pass the examination held by competent areas to entitle the accountant for a fellowship in the Saudi Institute of Chartered Accountants and to have sufficient training and practical experience to qualify him for such fellowship. Due to varying degrees of professional qualifications needed for the audit of various enterprises, the law of chartered accountants has defined certain conditions for the audit of financial statements of stock companies, banks, public corporations besides the other general conditions for obtaining this license. Conditions contained in the Law of Chartered Accountants specify the minimum professional qualification required to practise the audit function of the financial statements of stock companies, banks and public corporations. However, abiding by these conditions does not necessarily ensure the commitment of the auditors to the application of the standard of proficiency. This standard stipulates that external auditors have to review and evaluate their professional training and experience as well as those of their permanent staff in order to ensure that they are sufficiently qualified to perform any audit job prior to signing the relevant audit contract. Such evaluation should also take into consideration the nature of the activities of the enterprise and its size; the capabilities of his professional and technical personnel to prepare for the job and to have access to up to date information; references and professional journals as may be deemed necessary prior to the implementation of any audit work.

(para 502)

1.2 ANALYSIS

The following table (1.3) gives a comparative account of the requirements of the standard of proficiency as applied in Saudi Arabia, USA, UK, and West Germany. From this comparative survey it is clear that the standard of proficiency is more specific and detailed in Saudi Arabia than in the remaining countries cited in this comparison. This standard, however, is based on the following three principles:

- A) Due professional qualification is a prerequisite for the proper implementation of the audit function in accordance with the standards of auditing. The auditor shall therefore review and evaluate his professional qualifications as well as that of his technical personnel prior to taking over any audit function.
- B) The degree of proficiency needed may vary from one enterprise to another and from one time to another. Therefore, the following should be taken into consideration:
 - 1) Responsibility towards the evaluation of the proficiency of the auditor and that of the technical personnel is of a continuous nature. In other words, the acquisition of the auditor of the license does not necessarily mean that he is professionally qualified to carry out the audit of any enterprise irrespective of the nature of its activity, diversity and difficulty of its transactions without due regard to the conditions or events which impact the activities of the enterprise.

AUDITING STANDARDS

- 2) Evaluation of proficiency is the responsibility of the auditor himself because he is more aware than others of his capabilities and those of his technical staff.
- C) Lack of the sufficient degree of proficiency prior to concluding an agreement to perform the audit may not withhold the auditor from doing the job properly if, in his judgement, he has the capability to eliminate any such deficiencies through formal study or attendance of proper training courses prior to taking over the job.
(job 504)*

*

Missing paragraph (503) has already been mentioned in the introduction.

AUDITING STANDARDS

1.3 STANDARD OF PROFICIENCY-COMPARATIVE STUDY

KINGDOM OF SAUDI ARABIA	U.S.A.	WEST GERMANY
<ol style="list-style-type: none"> 1. The auditor and his professional personnel should be at a sufficient degree of professional qualification in order to be capable of performing the audit engagement. 2. The auditor shall evaluate his professional qualification and that of his team of professional staff to determine if he is capable of performing the audit work prior to entering into any contractual commitment. 3. The auditor shall have proper documentation of the process of evaluation as stated in this standard. 4. The auditor may sign a contract to audit the financial statements of a given enterprise, if in his judgement he believes that he is capable of acquiring a sufficient degree of proficiency through formal study or attendance of suitable training courses prior to the commencement of the audit. 	<p>The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor. This means that however capable a person may be in other fields he cannot meet the requirements of auditing standards without proper education and experience in the field of auditing.</p> <p>(The first general standard)</p>	<p>The law of accounting issued in 1975 in Germany states that auditors shall be professionally qualified through completion of an official course of academic study in any field relevant to management.</p> <p>Additionally, an auditor is also required to have practical training for a minimum period of five years.</p> <p>An auditor is also required to be fully acquainted with commercial laws and publications issued by agencies concerned with the accounting and auditing profession.</p>

AUDITING STANDARDS

2. Standard of Neutrality, Objectivity and Independence

2. STANDARD OF NEUTRALITY, OBJECTIVITY AND INDEPENDENCE

2.1 COMMENTARY

2.2.1.1 INTRODUCTION

The independence of the external auditor is essential to the confidence which the auditor's report will extend to the financial statements of the enterprise. The impartiality and objectivity of an auditor depend on his intrinsic mental attitude in all matters relating to the audit engagement particularly those of review and evaluation of evidence elicited from audit examinations and the expression of opinion on the financial statements. The external auditor should also refrain from establishing any financial administrative or social relations which would lead the public to suspect his impartiality and objectivity. An auditor, however unbiased, should not give the competent readers and the public any chance to suspect his independence.

The impartiality, objectivity and independence of the external auditor is considered of primary significance in Saudi Arabia due to the rapid social change that the country is undergoing, particularly in the public trend towards financial investment. This trend incurs a need for certified and highly authentic financial statements which are considered among the sources of information available to them for the evaluation of investment alternatives in order to take the appropriate decisions. Reluctance of the public to believe in the impartiality, objectivity and independence of the external auditor may lead to the loss of dependability and confidence vested in the auditor's report and the financial statements themselves. This lack of confidence may divert the public opinion from financial investments which, in turn, will have an adverse effect on the national economy as a whole. (para 1001)

2.2.1.2 STANDARD OF INDEPENDENCE VS THE CODE OF PROFESSIONAL ETHICS:

There is an intrinsic relationship between the standard of independence and the code of professional ethics. Rule No. 102 of this code emphasised the importance of impartiality and objectivity in the performance of this profession. Rule No 103 of this same code has also confirmed the significance of total independence in the practice of the audit profession and further emphasised the necessity for the independent auditor to refrain from establishing any financial, administrative or social relations that would lead to any doubt in his independence.

(para 1002)

2.2.1.3 STANDARD OF INDEPENDENCE VS THE COMPANY LAW

Article (130) of the Company Law referred to the kind of relationships which the auditor should avoid to safeguard his professional independence. The emphasis of the Saudi Company Law on matters which would lead to any suspicion on part of the public in the independence of the auditor without any reference to the intrinsic independence of the external auditor is a matter of personal quality rather than of rules that formulate certain objective tests. In so far as these precepts have been incorporated in the profession's code of ethics, they will have the force of law for the independent auditor.

(para 1003)

2.2.2 ANALYSIS

The following table gives a comparative account of the standard of Independence as applied in Saudi Arabia, USA, West Germany and

AUDITING STANDARDS

U.K. From this comparison it is clear that this standard of Independence is based on four common principles for all the four countries, as follows:

- A) Quality of the examination and the effectiveness of the opinion expressed by the auditor depend to a great extent on the intrinsic independence of the auditor as well as on his impartial and objective thinking.
- B) Quality of the examination and the effectiveness of the opinion expressed by the auditor depend on the public confidence in the intrinsic independence of the auditor which renders his report impartial and objective.
- X C) Lack of independence on ^{the} part of the auditor will render the whole audit function totally futile. In this case, the auditor should refrain from expressing an opinion ^{on} ~~in~~ the financial statements of the enterprise. In other words, all audit procedures applied by the auditor who lacks independence shall be considered a deviation from the standards of audit, because the evidence resulting from such examination cannot form a sufficient basis for the expression of an opinion on the financial statements.
- D
E) Independence, impartiality and objectivity of the audit staff carrying out the examination of financial statements is considered to be at the same level of significance as that of the auditor in charge of the audit assignment.
(para 1005)*

*

Missing paragraph (No. 1004) relates to the text of the standard and has already been stated in the introduction.

KINGDOM OF SAUDI ARABIA	U.S.A.	WEST GERMANY
<ol style="list-style-type: none"> 1. The auditor shall be totally independent in all matters relating to examination and shall also be impartial and objective in the evaluation of evidence and in the expression of his opinion on the financial statements. 2. The auditor shall avoid any act which may involve doubt on part of others in his independence, impartiality and objectivity. 3. The auditor in charge shall ensure the independence of his audit staff who carry out the examination of the financial statements of any given enterprise. 4. The auditor shall refrain from expressing an opinion on the financial statements, if, after his appointment, he finds out that he or his team of examiners are not independent from the enterprise being audited. 5. The auditor shall document his independence and that of the examination team from the enterprise they are appointed to audit. 	<p>In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or the auditors.</p> <p>To be recognised as independent, the auditor must be free from any obligation to or interest in the client, The management or its owners Independent auditors should not only be independent in fact but they should avoid situations that may lead outsiders to doubt their independence.</p> <p>(The second general standard, of American auditing standards)</p>	<p>No auditors shall be appointed to examine the financial statements of a given enterprise under the following circumstances:</p> <ol style="list-style-type: none"> 1. If he was a member of the board of directors or counsellors or an employee of this enterprise during the previous years. 2. If he was a legal representative, or member of the consultancy council, a partner, owner, or has any vested interest in the enterprise. 3. If he is presently an employee of this enterprise. <p>Additionally, the auditor should refrain from accepting an audit assignment in any situation which may involve lack of independence, even if he believes that that he can maintain his independence and impartiality.</p> <p>(Article 164 of the German Company Law)</p>

3. Standard of Due Professional Care

FOREWARD

AUDITING STANDARDS

3. STANDARD OF DUE PROFESSIONAL CARE

3.1

FORWARD

3.1.1

INTRODUCTION

One of the distinctive features of a professional practitioner is to exercise due professional care in obtaining the required evidence and to make the necessary evaluation in order to express an objective opinion on the financial statements. There is no doubt that due professional care depends on the personal judgement of the auditor relevant to the circumstances of the enterprise, the nature of its activities and the exercise of prudence with regard to the prospective application of the audited financial statements and the relevant auditor's report. (para 1501)

3.1.2

REQUIREMENTS OF THIS STANDARD AS RELATES
TO EXTERNAL AUDITORS

This standard requires that the external auditor:

1. Should be sufficiently aware of the affairs of the enterprise, its circumstances and plans.
2. Should be sufficiently aware of the prospective applications of the financial statements and the audit report.
3. Should apply auditing procedures with the same level of diligence as that exercised by another of equal proficiency. (auditor)
4. Should verify information until he reaches objective results free from any bias.

5. Should not hesitate to consult with others in matters which require a certain degree of expertise and experience which he does not possess.

2.3

ANALYSIS

The following table gives a comparison between the standard of due professional care as applied in the Kingdom of Saudi Arabia and similar standards applied in the USA, West Germany and the U.K. It is worth mentioning at this point that the standard of due professional care is generally based on the following four main principles:

1. The extent of due professional care exercised may vary from one enterprise to another and from time to time.
Therefore, the degree of due professional care is usually measured in terms of the degree of diligence expected of another auditor operating under the same circumstances provided that he possesses sufficient professional qualification. The application of the audit procedures at the level of care referred to in this standard gives sufficient evidence of the exercise of the audit examination with the required degree of due professional care.
2. The capability of the auditor to apply audit standards with the required degree of care that would have been exercised by another auditor of the same level of proficiency in fact depends to a great extent on the auditor's familiarity with the affairs of the enterprise being audited and of the general circumstances and plans of this enterprise besides his awareness of the expected uses of the financial statements and the auditor's report on those statements.

AUDITING STANDARDS

- The*
3. Due professional care requires a commitment on ~~the~~^{the} part of the examiner or examiners to exercise the required degree of objectivity in arriving at results or opinions on the basis of the examination of the financial statements.
 4. One of the distinctive features of a professional auditor is his awareness of the limits of his professional capabilities and of the need to resort to the other experienced and skilled persons in order to make up for any deficiency in his experience or skills.

In comparing these main principles with those contained in the standards applied by other countries, we find out that in the United States of America, the standard of due professional care in the performance of audit work was connected with the standards of field work (planning, study and evaluation of the internal control system, and audit evidence) as well as with the standards of reporting. In West Germany, however, abiding by professional standards is considered as only one element among a variety of factors which determine the required degree of due professional care. In addition to that, the German standard is more detailed in terms of elaboration on the requirements of the standard of due professional care among other standards of audit work. The reason for that is attributed to the fact that this standard was incorporated in the code of professional ethics of Chartered Accountants rather than the standards of auditing. In this way, the German standard reflects the experience of the practitioners of this profession in that country and its impact on the required degree of due professional care, which is normal with codes of ethics especially when they have been in effect for a reasonable period of time.

(para 1504)

AUDITING STANDARDS

3.3 STANDARD OF DUE PROFESSIONAL CARE-COMPARATIVE STUDY

KINDDOM OF SAUDI ARABIA	UNITED STATES OF AMERICA	WEST GERMANY
<p>1. The auditor should have due professional care at all phases of the examination and to apply the standards of audit with the same degree of care expected of another auditor with sufficient professional qualifications.</p> <p>2. The auditor should be sufficiently aware of the affairs, circumstances, and plans of the enterprise as well as of the expected applications of its financial statements and the audit report.</p> <p>3. The auditor should verify all relevant information until he arrives at objective results that are free from any biased point of view.</p> <p>4. The auditor should seek the assistance of other experienced and skilled persons in matters which require a degree of experience and skill not available to him.</p>	<p>Due professional care is to be exercised in the performance of the examination and the preparation of the report.</p> <p>When the work of the auditor or auditors abides by the standards of field work and when his report is in compliance with the standards of reporting, the auditor will be considered as having given the required due professional care.</p> <p>(Standard No. 3 of the American Auditing Standards)</p>	<p>In the practice of his profession, the auditor should abide by the respective standards and rules, and should be aware, faithful and capable of justifying his acts in an objective manner. Besides, the auditor should do the following:</p> <ol style="list-style-type: none"> 1. Evaluate his capability of performing any audit assignment prior to its acceptance. 2. Abide by the standards issued by the competent technical committee of the institute of accountants and select applicable standards to any audit assignment. In case of contradiction between local and foreign standards, the auditor shall abide by the local standards even though West Germany may be a member in the committee, which issued those standards. 3. Indicate the method of obtaining the information, whether by himself or through others. 4. Report any act on part of the management that would jeopardise the interest of the enterprise and notify the board of directors immediately in

3.3 STANDARD OF DUE PROFESSIONAL CARE-COMPARATIVE STUDY

KINDDOM OF SAUDI ARABIA	UNITED STATES OF AMERICA	WEST GERMANY
		<p>cases of emergency or, otherwise, refer to that issue in his audit report.</p> <p>5. Prepare his report and his opinion on pure technical facts and objective evidence free from any emotional touches.</p> <p>6. Adopt a dependable method for the planning of the various milestones of the examination and the preparation of the audit report.</p> <p>7. Handle workpapers with care and maintain them in an organized manner.</p> <p>8. Supervise the work of his assistants and assist them in the implementation of work as planned.</p> <p>9. Safeguard the confidentiality of information during discussions held with clients or assistants.</p> <p>10. Cooperate with areas concerned to correct any technical fault or errors which he might have caused to occur.</p> <p>11. Perform his work and supervise his assistants with prudence</p>

AUDITING STANDARDS

3.3 STANDARD OF DUE PROFESSIONAL CARE-COMPARATIVE STUDY

KINDDOM OF SAUDI ARABIA	UNITED STATES OF AMERICA	WEST GERMANY
		<p>and avoid indulgence which would render him as negligent of his technical duties.</p> <p>12. Notify the client in case he confronts time constraints which might delay the performance of the assignment as set out in the time schedule.</p> <p>13. Keep the client's assets in his custody, if any, separate from his own assets or funds. In the event that there is an agreement to employ such funds on behalf of the client, he has to abide by the conditions of such an agreement.</p> <p>14. Update his information and follow up all the developments and publications of the regulatory authorities relating to accounting and auditing professions and other areas concerned with commercial law. Failure to fulfil this requirement will be interpreted as a violation and default on the auditor's part to fulfill his commitments.</p>

AUDITING STANDARDS

2.3

STANDARD OF DUE PROFESSIONAL CARE-COMPARATIVE STUDY

KINDDOM OF SAUDI ARABIA	UNITED STATES OF AMERICA	WEST GERMANY
		15. In the event of changing the auditor before he completes his assignment for any given reason, his successor shall obtain sufficient information on the assignment he is going to take over and on the status of the predecessor and the nature of his relationship with the client before he decides to take over the assignment or, otherwise, he has to refrain from accepting the job.

4. Standard of Planning

4. STANDARD OF PLANNING

X 4.1 EXPLANATORY FORWARD

4.1.1 INTRODUCTION

Each audit assignment is affected by the scope of the audit engagement, the size and complexity of the enterprise to be audited and the technical skills and experience required by the auditor and his staff.

(para 2001)

4.1.2 OBJECTIVES

The auditor needs to consider each assignment separately by reviewing the nature of the enterprise's business, its accounting systems, probable sources of audit evidence and the work performed by the staff of the enterprise, particularly with regard to the preparation and review of the financial statements, management accounts and any internal audit procedures so that he can assess the effect on his audit procedures. In order to ensure that the auditor has considered all the essential features of the audit and to assist the auditor and his staff to complete the audit work as efficiently as possible, adequate audit planning is required regardless of the size of the enterprise to be audited.

(para 2002)

4.1.3 TIMING OF AUDIT PLANNING

The auditor should always remember that adequate audit planning is required at all stages of the audit. Most audit planning procedures will be performed before the start of any detailed audit tests. However, the results of such tests may significantly affect the original audit plan particularly with regard to

the outline audit approach relating to probable sources of audit evidence. In such circumstances, the auditor may need to amend his original plan.

(para 2003)

4.1.4 SCOPE OF THE AUDIT

The auditor needs to consider the scope of the audit engagement in order to devise appropriate procedures to obtain the audit evidence to support his opinion. Although most audits may arise from the provisions of the Company Law, the auditor needs to consider the terms of each audit engagement separately especially with regard to engagements imposed by the rules of the enterprise as to the preparation and presentation of the financial statements.

(para 2004)

4.1.5 UNDERSTANDING THE ENTERPRISE

The auditing standard recognizes that an auditor's understanding of the nature of the enterprise's business is an essential feature of adequate audit planning. Also suitably experienced staff must be employed and the extent of their supervision determined by the complexity of the particular assignments assigned to them. The absence of such an understanding can fundamentally diminish the auditor's ability to obtain reasonable assurance to support his audit opinion. There can be radical differences in business activities, legal status, personnel, accounting systems, internal controls, appropriate accounting policies, etc. Even if one enterprise alone is considered, there can be substantial changes in such matters between one year and the next. The auditor may have to make changes in the staff assigned to the audit from one visit to another. If such changes are not to have a detrimental effect on the progress of each

audit, good audit planning is essential. In many cases, in order to assist himself and his staff, the auditor may consider documenting the most relevant features of the particular business by establishing a permanent record which can be updated on each audit.

(para 2005)

4.1.6 DOCUMENTATION

The auditor needs to record the audit planning performed and the reasons for the decisions made in accordance with the Auditing Standard on controlling and recording. The procedures for documentation adopted by the auditor may include the use of standard documentation such as a planning audit program or checklist. For smaller clients, the auditor may use a staff briefing session, adequate details of which should be recorded in the audit working papers.

(para 2006)

4.1.7 TIMING OF AUDIT PROCEDURES

The timing of audit work is usually critical to ensure that any reporting deadlines are met and that the audit work to be performed is in accordance with the timing of the work performed to prepare the financial statements by the staff of the enterprise. It is particularly important to recognize the potential involvement of specialists such as computer auditors where necessary.

In scheduling audit work, the auditor may need to give particular attention to:

- and circularization of*
- i) The timing of the performance of specific detailed substantive tests such as ~~the performance of~~ debtors' and creditors' *balances.*
attendance at physical stocktakes, ~~etc~~

- ii) The timing of the performance of audit tests so as to ensure that adequate audit evidence has been obtained for the whole of the period which is being audited;
 - iii) The review of the interim or management accounts where these are available;
 - iv) The effect of any information to be prepared by the staff of the enterprise being audited;
 - v) The necessity for meetings with the enterprise's employees as appropriate before the commencement of the audit and once the detailed audit work has been completed.
- (para 2007)

4.1.8 EFFICIENCY

If the auditor is to perform the audit work as efficiently as possible, he may need to prepare a budget for the audit work in terms of both time and cost. The auditor can then monitor the actual hours taken as the work is performed so that corrective action can be taken to avoid wasted time and excess cost. It is important that the auditor and his staff are not inhibited from completing the procedures necessary to obtain adequate audit evidence by a budget of time and cost, particularly with regard to the investigation of the explanations of errors revealed by audit tests. However, the auditor should always plan to complete the audit work planned as efficiently as possible.

(para 2008)

4.2 COMMENTARY

4.2.1 INTRODUCTION:

The following table gives a comparative account of the requirements of audit planning in Saudi Arabia, USA, UK and West Germany. The results of the comparative study among the three other countries were used in eliciting the basic features of audit planning in order to determine the elements of the standard of planning and group such features within the framework applied to all other standards of auditing, taking into consideration the procedures which the auditor "must" apply and those which he "should" apply.

standard → The explanatory survey has been used to give further clarification and elaboration on the requirements of this standard. In this respect, almost all information relevant to the planning of the audit assignment mentioned in the standard of "Adequacy of Planning and the Timing of Field Work" in the USA and those stated in the "guidelines to Audit Work" in the UK have been incorporated in this proposed standard of planning. It is worth mentioning at this point that the audit guidelines of the UK require that the auditor should only plan his work in an adequate manner", while the US standard of "Adequacy of planning and timing of field work" states that, the work is to be adequately planned and assistants, if any, are to be properly supervised. However, the mandatory requirements of the Saudi Standard of planning as stated in paragraphs 2009, 2011, and 2012 aim at establishing the essential features of the process of audit planning without adding too many lengthy procedures as explained in the introductory forward to the general standards of auditing.
(para 2015)*

foreword
*Missing paragraphs are concerned with the statement of the standard that is contained in the introduction.

ESSENTIAL FEATURES

The requirement in paragraph 1 (b) relating to audit staff is identified in the American first standard of fieldwork with regard to the supervision of staff. This is dealt with in more detail in the controlling and recording as is the requirement with regard to documentation in the recording standard. As such, there is bound to be some degree of overlap. However, the need to plan the audit is recognized as an essential part of auditing standards. It seems logical, therefore, to stress the importance of both planning the use of suitably skilled and experienced staff and recording the planning procedure itself. Otherwise, there is a danger that audit planning becomes merely an exercise in staff planning and audit budgeting performed by the auditor's staff. The requirement of paragraph 1(a) in effect states the objective of audit planning. Paragraph 2 then summarizes the essential features of audit planning. The paragraph's subsections deal with these essential features in a logical order that the auditor might well find a useful aid when designing his own audit planning checklist. (para 2016)

AUDITING STANDARDS

4.3 STANDARD AUDIT PLANNING—COMPARISON OF REQUIREMENTS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>1. The auditor must sufficiently plan his work examination to:</p> <p>i) Establish appropriate audit procedures to provide reasonable assurance to support his audit opinion.</p> <p>ii) Ensure that, if the auditor uses staff other than himself, all audit procedures are performed under adequate supervision by suitably qualified and experienced staff.</p> <p>iii) Be satisfied that the audit work will be performed in accordance with the Auditing Standards and any legal requirements relevant to the conduct of the audit.</p>	<p>The work is to be adequately planned. (1st Standard of Fieldwork)</p> <p>In planning his examination the</p> <p>....assistants, if any, are to be properly supervised (1st Standard Fieldwork).</p> <p>In planning his examination, the auditor should prepare a written audit program...(AU311.05).</p>	<p>The auditor should adequately plan his work (paragraph 2, Operational Standard).</p> <p>The auditor will need to determine the number of audit staff required the experience and special skills they need to possess.... (paragraph 10, Guideline).</p> <p>The most important elements of control are the direction and supervision of the audit staff.... (Paragraph 13, Guideline)</p> <p>The preparation of a memorandum setting out the outline audit approach may be useful (Guideline Paragraph 10).</p> <p>Audit working papers will typically contain....</p> <p>b) Audit planning information (Guideline para 21).</p>	<p>A properly conducted audit requires planning . (Statement 1/1977 IV)</p> <p>The auditor should determine the nature and scope of his audit procedures in such a manner that he is able to make an informed judgement on the compliance of the financial statements with law and generally accepted accounting principles (Statement 1/1977 V).</p> <p>The principles of professional ethics relating to individual responsibility and conscientiousness require the auditor to exercise proper supervision of personnel involved in the audit. (1/1977, IV note 4).</p> <p>The working papers have, in particular, to observe the following objectives:</p> <p>- audit planning (2/1981 II).</p>
<p>2. When establishing effective audit procedures the auditor should consider:</p> <p>i) The scope of the audit engagement;</p>	<p>In planning his examination, the auditor should consider the nature</p>	<p>The form and nature of the planning required for an audit will be</p>	<p>The auditor must determine the nature and scope of his audit procedures in</p>

AUDITING STANDARDS

4.3 STANDARD AUDIT PLANNING-COMPARISON OF REQUIREMENTS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
	and extent of work to be performed (AU 311.05).	affected by...the method of processing transactions and the reporting requirements to which it is subject. (Guideline para. 4).	a conscientious manner and with the professional care (1/1977V).
ii) The business and organization of the particular enterprise especially in order to determine those transactions and events most likely to have a significant effect on the financial statements;	The auditor should obtain a level of knowledge of the entity's business that will enable him to plan and perform his examination in accordance with generally accepted auditing standards. The level of knowledge should enable him to obtain an understanding of the events, transactions and practices that, in his judgement, may have a significant effect on the financial statements (AU 311.06).	In order to plan his work adequately, the auditor needs to understand the nature of the business of the enterprise, its organization, its method of operating and the industry in which it is involved, so that he is able to appreciate what events and transactions are likely to have a significant effect on the financial statements (Guideline-Para. 6). <i>operation</i>	Internal organization and technical level of the accounting system will determine the nature and scope of the audit procedures to be applied. (1/1977 V Note 2).
iii) The effect of any significant changes either in legislation and accounting practices relevant to the enterprise or in the enterprise's testing activities and accounting procedures;	The auditor should obtain a knowledge of matters that relate to the nature of the entity's business, its organization and its operating characteristics.... The auditor should also consider matters affecting the industry in which the entity operates, such as economic conditions, government regulations and changes in technology as they relate to his examination. Other matters such as accounting practices common to the industry could be considered by the auditor.	Preparatory procedures which the auditor should consider include the following: b) Assessing the effects of any changes in legislation or accounting practice affecting the financial statements of the enterprise; c) matters which should be considered include current trading circumstances and significant changes in: i) The business carried on; ii) The enterprise's management (Guideline Para. 9).	

AUDITING STANDARDS

4.3

STANDARD AUDIT PLANNING-COMPARISON OF REQUIREMENTS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>iv) His experience of the reliability of the enterprise's management staff and accounting records together with an assessment of any management bias resulting from the financial position of the enterprise or other causes.</p> <p>v) The audit strategy to be adopted for the particular enterprise including decisions as to materiality, the likely significance of past or anticipated problems, the sources of audit evidence on which the auditor proposes to rely and the timing of audit procedures.</p>	<p>Audit planning involves developing an overall strategy for the expected conduct and scope of the examination In planning his examination the auditor should consider among other matters:</p> <p>a) Matters relating to the entity's business and the industry to which it relates;</p> <p>b) The entity's accounting policies and procedures;</p> <p>c) Anticipated reliance on internal accounting controls;</p> <p>d) Preliminary estimates of materiality levels for audit purposes;</p> <p>e) Financial statement items likely to require adjustments;</p> <p>f) Conditions that may require extensions or modifications of audit tests.... (AU 311.03).</p>	<p>The auditor should consider the outline audit approach he proposes to adopt, including the extent to which he may wish to rely on internal controls and any aspect of the audit which need particular attention.... (Guideline (Para. 7)</p> <p>Preparatory procedures which the auditor should consider include:</p> <p>a) Reviewing matters raised in the audit of the previous year which may have continuing relevance in the current year. (Guideline Para 8).</p> <p>The auditor will need to determine the timing of their audit visits. (Guideline Para. 10).</p>	<p>Important criteria for this are the systems operated by the enterprise under audit, the significance of the individual item being audited and the probability of error or of non-compliance with prescribed accounting rules ('error margin') (I/1977 V) <i>with</i></p> <p>An appropriate degree of supervision includes specifically the proper guidance of the audit personnel and the review of their findings and conclusions (Statement 1/197 IV).</p>

AUDITING STANDARDS

4.3 STANDARD AUDIT PLANNING-COMPARISON OF REQUIREMENTS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>3. If the auditor proposes to use staff other than himself he must:</p> <p>x</p> <p>i) Consider the number and calibre of staff likely to be required and the timing of their involvement taking into account the time required for the preparation of the financial statements by the management of the enterprise;</p> <p>ii) Brief the audit staff as to the nature of the business and organization of the enterprise, the objectives of the audit work and the methods to be adopted;</p> <p>Are</p> <p>iii) Consider the extent of supervision that will be required after taking into account the complexity of the particular assignments</p> <p>4. If other auditors are involved, the auditor must:</p>	<p>Supervision involves directly the efforts of assistants who are involved in accomplishing the objectives of the examination..... x</p> <p>Assistants should be informed of their responsibilities and the objectives of the procedures that they are to perform. They should be informed of matters that may affect the nature, extent and timing of procedures they are to perform such as the nature of the entity's business as it relates to their assignments and possible accounting and auditing problems (AU 311.10)</p> <p>The extent of supervision appropriate in a given instance depends on many factors, including the complexity of the subject matter and the qualifications of persons performing the work.</p> <p>He should adopt appropriate measures to assure the co-ordination of his activities with those of the other auditors in order to achieve a proper</p>	<p>The auditor should also consider:</p> <p>a) The timing of significant phases of the preparation of the financial statements (Guidelines Para 9).</p> <p>The auditor will need to determine the number of audit staff required, the experience and special skills they need to possess and the timing of their audit visits. He will need to ensure that all audit staff are briefed regarding the enterprise's affairs and the nature and scope of the work they are required to carry out.... (Guideline para 10).</p> <p>The reporting partner needs to be satisfied that on each audit the work is being performed to an acceptable standard.</p> <p>On joint audits there should be consultation between the joint auditors to determine the allocation of the work to be undertaken and the</p>	

✓ AUDITING STANDARDS

4.3 STANDARD AUDIT PLANNING—COMPARISON OF REQUIREMENTS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>i) Be fully aware of the scope and responsibilities of his own engagement;</p> <p>ii) Consult with the other auditors to determine how the responsibility for completion of the detailed audit procedures is to be allocated.</p>	<p>review of matters affecting the consolidating or combining of accounts in the financial statements. (AU 543.10).</p>	<p>procedures for its control and view. (Guideline Para 11).</p>	<p><i>review</i></p>

5. Standard of Controlling and Recording

5. STANDARD OF CONTROLLING AND RECORDING

5.1 EXPLANATORY FORWARD

FOREWORD

5.1.1 INTRODUCTION

In order to enable an audit to be carried out effectively and efficiently, the audit work needs to be planned, controlled and recorded. Separate standards deal with planning and with controlling and recording. Within the controlling and recording standard, controlling and recording are considered separately but they are not mutually exclusive.

The need to control and record audit work exists regardless of the size of the enterprise concerned although in the case of the smaller enterprise the work involved in meeting the requirements of the standard will be less.

(para 2501)

5.1.2 CONTROLLING

5.1.2.1 OBJECTIVES

(para 2502)

The responsible auditor needs to be satisfied that on each audit the work is being performed to an acceptable standard. The most important elements of control of an audit are the direction and supervision of the audit staff and review of their work. This direction, supervision and review must provide the auditor with sufficient assurance that the audit work is being performed in accordance with Saudi Arabian Auditing Standards and other relevant legal requirements. The auditor relates the degree of level of control to the complexity of the assignment and to the experience and proficiency of the audit staff.

(AUDITING STANDARDS)

5.1.2.2 CONTROLLING STRUCTURES

Controlling structures vary between firms of auditors. The particular procedures needed to control an audit cannot be specified as they depend on the organization of the audit firms and the degree of delegation of the audit work. However, the procedures chosen should be designed to ensure that the objectives of the standard are satisfied. Each audit firm needs to consider the extent to which it would be appropriate to formalize its procedures, bearing in mind the controlling structure and management style of the firm.
(para 2504)

5.1.2.3 REVIEW

It is most important that the work of audit staff is reviewed by supervisory personnel. In order to enable this review to take place, adequate working papers must be prepared and the audit staff must, therefore, be adequately instructed as to form and content of the working papers. Procedures designed to achieve the latter might vary from formal instruction on a training course to informal briefing, depending on the degree of formalization of procedures considered appropriate by the firm.
(para 2505)

5.1.2.4 TIMING OF PROCEDURES

The majority of the procedures concerned with direction will normally be toward the beginning of the audit whilst the majority of procedures concerned with the review will normally be towards the end. However, the auditor should

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remember that a certain amount of direction and review is necessary at all stages during the audit. Supervision of the audit progress needs to be carried out at all stages and the progress should be compared against the audit plan. Revisions to the audit plan require a fresh set of directions to be issued.

5.1.2.5 OTHER AUDITORS

If a joint auditor is involved, the work performed by the joint auditor must be reviewed to establish whether such work has been performed in compliance with the auditing standards and in a manner appropriate to the audit. A group auditor needs to review the work performed by the auditor of a subsidiary to see that the work has been performed in compliance with auditing standards and in a manner appropriate to the group audit.

(para 2507)

5.1.2.6 THE FINAL STAGES OF THE AUDIT

The final stages of the audit require particular attention since it is at this time, when pressures are greatest, that mistakes and omissions are most likely to occur. The use of an audit completion checklist with sections to be filled in by the responsible auditor and his staff may be helpful.

(para 2508)

5.1.2.7 THE RESPONSIBLE AUDITOR

It is important to distinguish between the auditor responsible for the audit and his audit staff, and to specify any measures which must be carried out by the responsible auditor rather than by his staff to comply with the controlling requirements of the standard. The responsible auditor must:

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- i) review all significant matters arising;
- ii) Consult, in certain specified circumstances, with another licentiate accountant, or appropriate expert;
- iii) Ensure that the audit report contains his opinion rather than that of a member of staff or a consultant.
(para 2509)

5.1.2.8 CONSULTATION

Consultation is required when there is a matter of principle about which the responsible auditor is in doubt as to the appropriate course of action or where a significant contentious matter arises. Such consultation would normally be with another licentiate accountant who is a member of the responsible auditor's firm. If it is necessary to consult with a licentiate accountant who is not a member of the responsible auditor's firm, confidentiality of the client's affairs must be maintained. On occasions it may be necessary for the responsible auditor to consult with an expert in another field. For example, he may consult with a surveyor over the value or condition of a building.

(para 2510)

5.1.2.9 QUALITY CONTROL

Each audit firm needs to consider how the overall quality of the work carried out within that firm can best be monitored and maintained. Such monitoring would normally include monitoring of the operation of procedures designed to achieve adequate control of audits.

(para 2512)

5.1.3 RECORDING

5.1.3.1 OBJECTIVES

The main reasons for preparing working papers are:

- i) The responsible auditor and his staff need to be satisfied that work delegated has been properly performed. The responsible auditor and his staff can generally only do this by having available detailed working papers prepared by those who performed the work. Hence, working papers are a necessary prerequisite of the review function.
- ii) Working papers provide, for future reference, details of problems encountered, together with evidence of work performed and conclusions drawn therefrom in arriving at the audit opinion. In particular, working papers are necessary if there is to be an effective inspection system of auditors' work designed to enforce auditing standards.
- iii) The preparation of working papers encourages the auditor to adopt a methodical approach.
- iv) Working papers provide the principal support for the auditor's report, including his representation regarding observance of auditing standards.

The general standard of recording required is that the working papers must be sufficiently complete and detailed to allow an experienced auditor with no previous knowledge of the audit to form reasonable conclusions as to whether the Saudi Arabian Auditing Standards have been met. (para 2513)

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5.1.3.2 CONTENTS OF WORKING PAPERS

Hence the content of working papers will be information relevant to audit planning, controlling, evidence and reporting. The contents of working papers are specified in detail in the standard.

(para 2514)

5.1.3.3 MATTERS OF JUDGEMENT

In particular, audit working papers should include a summary of all significant matters identified which may require the exercise of judgement, together with the auditor's conclusions thereon. If difficult questions of principle or of judgement arise, the auditor should record the relevant information received and summarize both the management's and his conclusions. It is in such areas as these that the auditor's judgement may subsequently be questioned, particularly by a third party who has the benefit of hindsight. It is important to be able to tell what facts were known at the time the auditor reached his conclusion and to be able to demonstrate that, based on those facts, the conclusion was reasonable.

(para 2515)

5.1.3.4 PREPARATION REQUIREMENTS

The main requirements are that working papers should:

- i) Be prepared as the audit proceeds and
- ii) Be legible, systematically filed and adequately referenced.

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Audit working papers need to be prepared as the audit proceeds so that details and problems are not omitted. Legibility, systematic filing and referencing are prerequisites of an effective review by supervisory staff.

(para 2516)

5.1.3.5 STANDARDIZED WORKING PAPERS

Each firm needs to consider the extent to which the standardization of working papers may improve the efficiency with which they are prepared and reviewed. Such standardization might include the use of internal control questionnaires and evaluation sheets, checklists, specimen letters, etc. Used properly, standardized working papers help to instruct audit staff and enable work to be delegated while providing a means to control its quality. It should be borne in mind, however, that too much standardization can lead to a mechanical, 'unthinking' approach on the part of audit staff.

(para 2517)

5.2 COMMENTARY

5.2.1 INTRODUCTION

In order to enable an audit to be carried out effectively and efficiently, the audit work needs to be planned, controlled and recorded. Separate standards deal with planning and with controlling and recording. Within the controlling and recording standard, controlling and recording are considered separately but they are not mutually exclusive. The need to control and record audit work exists regardless of the size of the enterprise concerned although in the case of the smaller enterprise the work involved in meeting the requirements of the standard will be less.
(para 2529)

5.2.2 CONTROLLING

The reporting partner needs to be satisfied that on each audit the work is being performed to an acceptable standard. The most important elements of control of an audit are the direction and supervision of the audit staff and review of their work. Paragraph 251 of the Controlling and Recording Standard specifies that this direction, supervision and review must be sufficient to satisfy the auditor that the audit work is being performed in accordance with Auditing Standards and other relevant legal requirements. This paragraph briefly sets out:

- i) What is to be done (the auditor must direct, supervise and review the work of the audit staff)
- ii) The standard to which it is to be done (sufficiently) and

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- iii) The overall object (to be satisfied that the audit work is being performed in accordance with Saudi Arabian Auditing standards, etc.)

Hence, paragraph 2518 clearly states, in three parts, the general standard for controlling. We believe that summarizing very briefly what is to be done, the standard to which it is to be done and why it is to be done makes for a clearer presentation than is contained in the equivalent paragraphs of the UK, US and German statements. (See comparison of requirements at the end of this commentary)

(para 2530)

5.2.2.1 OTHER FEATURES OF CONTROLLING STANDARD

The main features of paragraphs 2519 to 2524 of the Saudi standard are highlighted in figure 1.

Paragraph 2519 instructs the auditor to relate the level of control to the complexity of the assignment and the experience and proficiency of the audit staff. Similar instructions are implicit in the UK and US statements (see Comparison of Requirements at the end of this Commentary). The US statement comments that there are many factors, in addition to those listed in the US statement, which determine the level of supervision. It is not clear what these many other factors might be, but the Saudi standard should not in any case be taken to preclude the consideration of other factors not mentioned in paragraph 2519.

(para 2531)

Paragraph 2520 lists the more important objectives for which procedures should be designed and applied in order to meet the general controlling standard. This list is compiled

from the UK, U.S. and German statements (see Comparison of Requirements at the end of this Commentary). The maintenance of confidentiality is included as an objective since confidentiality is seen as an important requirement of Saudi Companies Law.
(para 2532)

Company

	<u>Relevant paragraph of standard</u>
DETERMINE LEVEL OF ASSURANCE REQUIRED	2519
DESIGN AND APPLY DETAILED PROCEDURES	2520
REVIEW WORK OF OTHER AUDITORS, IF RELEVANT	2521
AUDITOR REVIEW OF ALL SIGNIFICANT MATTERS	2522
CONSULT WITH ANOTHER ACCOUNTANT, IF NECESSARY	2523
REVIEW AUDIT REPORT	2524

Figure 1. Main features of the Saudi Arabian controlling standard.

The German statement distinguishes between the auditor responsible for the audit and the audit staff and it specifies measures (see Appendix, Section 3) which should be taken by the auditor responsible rather than by his staff. Similarly, paragraphs 2522, 2523 and 2524 of the Saudi standard specify measures which must be undertaken by the responsible auditor in Saudi Arabia. These measures are less extensive than those given in the German statement since it may not be practical in Saudi Arabia for the responsible auditor himself to carry out all the measures listed in the German statement, given the present state of development of the Saudi profession with its small number of licentiate accountants available to serve as the responsible auditor. The requirements listed in paragraphs 2522 and 2524 are the minimum necessary if the audit opinion is to be that of the responsible auditor rather than, in effect, the opinion of his staff. Paragraph 2523 requires the responsible accountant to consult with another accountant in certain circumstances. However, the final audit opinion must, as specified by paragraph 2524, remain his own.

5.2.3 RECORDING

Reasons for preparing audit working papers include the following:

- a) The reporting partner needs to be able to satisfy himself that work delegated by him has been properly performed. The reporting partner can generally only do this by having available to him detailed working papers prepared by the audit staff who performed the work;
- b) Working papers provide, for future reference, details of problems encountered, together with evidence of work performed and conclusions drawn therefrom in arriving at the audit opinion;

~~AUDITING STANDARDS~~

- c) The preparation of working papers encourages the auditor to adopt a methodical approach.
(paragraph 2534)

Paragraph 2525 of the Standard sets out the general standard of recording required. It is that the working papers must be sufficiently complete and detailed to allow an experienced auditor with no previous knowledge of the audit to form reasonable conclusions as to whether the Auditing Standards have been met.

Once again, the general standard is in three parts:

- 1) What is to be done (prepare working papers),
- 2) The standard to which it is to be done (sufficiently complete and detailed), and
- 3) The objective (to allow an experienced auditor, etc.)
(para 2535)

X

The object of the Saudi general standard is to allow an experienced auditor with no previous knowledge of the audit to tell whether or not Saudi auditing standards are being complied with. This is the necessary object of working papers given that there is to be quality inspection of the work of licentiate accounts in Saudi Arabia in order to see that standards are being followed. The Saudi general standard is similar to that of the UK and German statements but dissimilar to the US statement which indicates (SAS 41 - note 3) that in the US, working papers may not by themselves provide the necessary evidence of compliance with auditing standards (see comparison of Requirements at end of Commentary). [para 2536]

accountants

5.2.3.1 OTHER FEATURES OF RECORDING STANDARD

The other main features of the Saudi standard are set out in figure 2. Paragraph 2526 details the contents of working papers and is derived from the UK, U.S. and German statements (see comparison of requirements at end of commentary). *a*

Accordingly, it is a more comprehensive list than that contained in any of those three countries' statements. However, the Saudi list, as with all lists contained in the Saudi standards, is not to be regarded as exhaustive (para 2537)

	<u>Relevant Paragraph of Standard</u>
DETERMINE CONTENTS OF WORKING PAPERS	2526
PREPARE WORKING PAPERS AS THE AUDIT PROCEEDS	2527
SYSTEMATICALLY FILE AND ADEQUATELY REFERENCE	2528
<u>Figure 2: Main features of the recording standard</u>	

Paragraph 2527 is identical to a requirement of the UK statement that working papers should be prepared as the audit proceeds. Paragraph 2528 is based on the requirements of the German statements for working papers to be systematically filed and properly referenced.

AUDITING STANDARDS

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
1. The auditor must sufficiently direct, supervise and review the work of the audit staff to provide him with sufficient assurance that the work is being performed in accordance with the auditing standards and any other legal requirements relevant to the conduct of the audit.	<p>The reporting partner needs to be satisfied that on each audit the work is being performed to an acceptable standard. The most important elements of control of an audit are the direction and supervision of the audit staff and the review of the work they have done.</p> <p>201 para 13</p>	<p>The work is to be adequately planned and assistants if any are to be properly supervised.</p> <p>- first field work standard</p> <p>Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide reasonable assurance that the work performed meets the firm's standards of quality.</p> <p>AU 160.11</p>	<p>....one has to ensure that the staff in an audit practice when carrying out audits observe conscientiously legislation, jurisdiction and technical regulations.</p> <p>Statement Vol/1982 section BV</p> <p>A properly conducted examination requires planning and an appropriate degree of supervision ... An appropriate degree of supervision includes specifically the proper guidance of the audit personnel and the review of their findings and conclusions.</p> <p>Statement 1/1977 Section B. IV</p>
2. The auditor should carry out a degree of direction, supervision and review appropriate for the complexity of the assignment and the experience and proficiency of the audit staff assigned to the audit engagement.	<p>The degree of supervision required depends on the complexity of the assignment and the experience and proficiency of the audit staff.</p> <p>201 para 13</p>	<p>The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work and the extent of consultation available and used.</p> <p>AU 160.11</p>	<p>Guidance and examination are undertaken by the auditor responsible for the audit and by graded supervision of differently qualified staff in an audit team.</p> <p>Statement Vol/1982 Section CII</p>
3. Procedures should be designed and applied to achieve the following:	<p>The procedures established should be designed and applied to ensure the following:</p>	<p>AU 160.11</p> <p>In pursuing the quality control objectives with respect to supervision, a firm may use policies and procedures such as providing direction as to the form and content of working papers and as to the nature and extent of instructions to be included in an audit program;</p>	<p>During the conduct of the audit the auditor responsible should at least take the following measures:</p> <p>- Examination of the audit data or the review of the internal control system and its weak points and also its effects on the nature, scope and date of the audit procedures carried out.</p>
i) The assignment of work to audit staff who have an appropriate level of training, experience and proficiency.	<p>a) Work is allocated to audit staff who have appropriate training, experience and proficiency.</p>		

AUDITING STANDARDS

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>ii i) Communication to audit staff assigned to the engagement at all levels of their responsibilities and of the objectives of the procedures which they are to perform.</p> <p>iii ii) Direction as to the form and content of working papers.</p> <p>iv) Instructions to the audit staff assigned to the engagement to bring to the attention of those to whom they are responsible any potentially significant accounting or auditing problems that they encounter.</p> <p>v vi) The review of working papers by supervisory personnel and by the responsible auditor.</p>	<p>b) Audit staff at all levels clearly understand their responsibilities and the objectives of the procedures they are to perform. Audit staff should be informed of any matters identified during the planning stage that may affect the nature, extent or timing of the procedures they are to perform. They should be instructed to bring to the attention of those to whom they are responsible any significant accounting or auditing problems that they encounter.</p> <p>c) The working papers provide an adequate record of the work that has been carried out and the conclusions that have been reached.</p> <p>d) The work performed by each member of the audit staff is reviewed by more senior persons in the audit firm ...</p> <p>201 para 14</p> <p>Working papers are the property of the auditor and he should adopt appropriate procedures to ensure their safe custody and confidentiality.</p> <p>201 para 24</p>	<p>developing and using standard audit forms, checklists, and questionnaires; requiring that working papers be reviewed by supervisory personnel; and requiring that auditors' reports and accompanying financial statements be reviewed by qualified personnel for conformity with generally accepted auditing standards and generally accepted accounting principles.</p> <p>AU 160.12</p>	<ul style="list-style-type: none"> - Supervision of the audit progress on the basis of the audit plan. - Decision about the use of audit results and investigations of third parties in particular of the results of the internal audit of the enterprise to be audited and of other auditors. - Decision about consulting specialists in the audit practice or external experts. <ul style="list-style-type: none"> - Information and review of all essential facts which concern the annual accounts and the audit results, in particular apparent questions of doubt. - Examination of compliance with audit instructions. - Review of the draft audit report insofar as this is not drawn up by the responsible auditor himself. <p>Statement Vol/1982 Section CII</p>

1 AUDITING STANDARDS

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>vi y11) Supervision of the progress by comparison with the audit plan.</p> <p>vii y111) Maintenance of the confidentiality of the client's affairs as required by the Chartered Accountant Act and the Company Law and the Code of Professional Ethics of the Saudi Arabian Institute of Chartered Accountants.</p> <p>4. If another auditor is involved the work performed by the other auditor must be reviewed to establish that such audit work has been performed in compliance with the auditing standards appropriate to his engagement. The scope of the review should be related to the professional qualification, reputation and independence of the other auditor.</p>	<p>On joint audits there should be consultation between the joint auditors to determine the allocation of the work to be undertaken and the procedures for its control and review. 201 para 11</p>	<p>Whether or not the principal auditor decides to make reference to the examination of the other auditor, he should make inquiries concerning the professional reputation and independence of the other auditor. He also should adopt appropriate measures to assure the co-ordination of his activities in order to achieve a proper view of matters affecting the consolidating or combining of accounts in the financial statements.</p> <p>AU 543.10</p>	<p>In certain instances (e.g., in the event of consolidated financial statements according to 336, para 3, sentence 2 with 164, para. 1 Aktiengesetz) the auditor is exempted from performing further audit work himself where an audit has been conducted by other Wirtschaftsprüfer. It is permissible to accept the audit results of other Wirtschaftsprüfer or of similarly qualified independent foreign auditors, especially the results of statutory audits or those conducted according to similar standard, unless there are indications that the audit conclusions are incorrect. It can be appropriate or even necessary to agree on the nature and scope of the audit work of the other auditor. In the case of examinations performed by foreign auditor (especially statutory audits or those conducted according to similar standards) the auditor should compare the foreign accounting principles, the professional qualifications and the independence of the foreign</p>

AUDITING STANDARDS

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>5. The responsible auditor must review all significant matters which concern the financial statements and/or the audit results, especially apparent questions of doubt.</p>	<p>Audit working papers should include a summary of all significant matters identified which may require the exercise of judgement, together with the auditor's conclusions thereon.</p> <p>102 para 20</p>	<p>Working papers.....would includeappropriate commentaries prepared by the auditor indicating his conclusions concerning significant aspects of the engagement.</p> <p>AU 338.05</p>	<p>auditor with the relevant German requirements and then decide where and in what form he can accept the audit results in whole or in part. Use of the audit results can be aided by co-operation, e.g., agreement on the nature and scope of audit procedures review of working papers, participation in final meetings with the client.</p> <p>Statement 1/1977, Section C VIII</p>
<p>6. The responsible auditor must consult with another licentiate accountant or an appropriate expert, prior to forming his audit opinion, in the following circumstances:</p>	<p>When matters of principle or contentious matters arise which may affect the audit opinion the auditor should consider consulting another experienced accountant. This accountant may be a partner, a senior colleague, or another practitioner. If another</p>	<p>Policies and procedures for consultation should be established to provide reasonable assurance that auditors will seek assistance on accounting and auditing questions, to the extent required, from persons having appropriate levels of</p>	<p>During the conduct of the audit, the auditor responsible should at least take the following measures.....</p> <ul style="list-style-type: none"> - information and review of all essential facts which concern the annual accounts and the audit results, in particular apparent questions of doubt. <p>Statement Vol/1982 Section CII</p> <ul style="list-style-type: none"> - The review of the findings and conclusions of the audit personnel will usually require a critical review of the working papers and draft reports. <p>Statement 1/1977, Section IV, Note 5</p>

ADDITIONAL STANDARDS

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
7. The responsible auditor must ensure that the audit report which is issued corresponds with his opinions on the view given by the financial statements taken as a whole.	<p>practitioner is consulted confidentiality of the client's affairs must be maintained.</p> <p>201 para. 16</p>	<p>knowledge, competence, judgement and authority.</p> <p>AU 160.09</p>	<p>During the conduct of the audit, the auditor responsible should at least take the following measures.....</p> <p>- Review of the draft audit report insofar as this is not drawn up by the responsible auditor himself.</p> <p>Statement Vol/1982 Section CII</p>
8. Audit working papers must be sufficiently complete and detailed to allow an experienced auditor with no previous knowledge of the audit to form reasonable conclusions as to whether the planning, controlling and recording, evidence and reporting standards have been met.	<p>Audit working papers should always be sufficiently complete and detailed to enable an experienced auditor with no previous connection with the audit subsequently to ascertain from them what work was performed and to support the conclusions reached.</p> <p>201 para 19</p>	<p>However there is no intention to imply that the auditor would be precluded from supporting his report by other means in addition to working papers.</p> <p>Footnote 3 SAS 41</p> <p>Factors affecting the auditor's judgement about the quality, type, and content of the working papers for a particular engagement include (a) the nature of the engagement, (b) the nature of the auditor's report, (c) the nature of the financial statements, schedules, or other information on which the auditor is reporting, (d) the nature and condition of the client's records, (e) the degree of reliance on internal accounting control, and (f) the needs in the particular circumstances for supervision and review of the work. Para 4 SAS 41</p>	<p>The contents, form and arrangement of the working papers are determined by the circumstances of the actual audit. However, they are to be set out in such a way that an auditor who was not involved with the audit may, at the appropriate time form a picture of the conclusion of the audit, as a replacement for the audit report, and from this can get information necessary in whole or in part for the subsequent completion of the audit results.</p> <p>Statement HFA 2/1981 section C</p> <p><i>particular</i></p>

1 AUDITING STANDARDS

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>9. Audit working papers should contain:</p> <p>a) Details of the auditor's study of the enterprise's accounting system and system of internal control;</p> <p>b) Other information which will be of continuing importance to the audit;</p> <p>c) Details of the audit planning performed and the reasons for the decisions made;</p> <p>d) The auditor's preliminary evaluation of the accounting system and system of internal control including the analysis supporting the evaluation;</p> <p>e) The auditor's decision and supporting analysis as to the extent to which he needs to obtain audit evidence from the operation of the enterprise's system, from analytical review and from substantive test of details;</p> <p>f) Details of the source from which third party information came and when and by whom the information was received;</p> <p>g) Details of the audit work carried out including notes of errors or exceptions</p>	<p>Audit working papers will typically contain:</p> <p>a) Information which will be of continuing importance to the audit (e.g. Memorandum and Articles of Association);</p> <p>b) Audit planning information;</p> <p>c) The auditor's assessment of the enterprise's accounting system and, if appropriate, his review and evaluation of its internal controls;</p> <p>d) Details of the audit work carried out, notes of errors or exceptions found and action taken thereon, together with the conclusions drawn by the audit staff who performed the various sections of the work;</p> <p>e) Evidence that the work of the audit staff has been properly reviewed;</p> <p>f) Records of relevant balances and other financial information including analysis and summaries supporting the financial statements;</p> <p>g) A summary of significant points affecting the financial statements and the audit report, showing how these points were dealt with.</p> <p>201 para 21</p>	<p>The quantity, type, and content of working papers vary with the circumstances (see paragraph 4), but they should be sufficient to show that the accounting records agree or reconcile with the financial statements or other information reported on and that the applicable standards of file work have been observed. Working papers ordinarily should include a documentation showing that:</p> <p>a) The work has been adequately planned and supervised, indicating observance of the first standard of field work.</p> <p>b) The system of internal accounting control has been studied and evaluated to the degree necessary to determine whether, and to what extent, other auditing procedures are to be restricted, indicating observance of the second standard of field work.</p> <p>c) The audit evidence obtained, the auditing procedures applied, and the testing performed have provided sufficient competent evidential matter to afford a reasonable basis for an opinion, indicating observance of the third standard of field work.</p> <p>Para 5 SAS 41</p>	<p>The preceding principles are particularly taken into account by:</p> <p>a) Details of when and by whom they were prepared and possibly verified;</p> <p>b) Note of the nature, scope and outcome of the audit procedures in particular. Their importance has to be explained by the use of audit marks.</p> <p>c) Details of the source from which the information came and when and by whom the data recorded in the working papers was received;</p> <p>d) Ability to perceive the way from summary to detail or vice versa with the final balance sheet as the reference figure;</p> <p>e) Legibility of the test and figures</p> <p>Statement HFA 2/1981 section C</p>

AUDITING STANDARDS5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
<p>found and action taken thereon;</p> <p>h) The auditor's conclusions as to the persuasiveness of the evidence obtained and the reasons for those conclusions;</p> <p>i) Analyses and summaries sufficient to reconcile the amounts included in the financial statements to the detailed figures upon which audit work has been conducted;</p> <p>j) A summary of significant points affecting the financial statements and the audit report, showing how these points were dealt with;</p> <p>k) A record of who performed each piece of audit work and the date of performance;</p> <p>l) Evidence that the work of the audit staff has been properly reviewed.</p> <p>10. In order that details are not omitted audit working papers should be prepared as the audit proceeds.</p> <p>11. Working papers should be legible, systematically filed and adequately referenced.</p>	<p>Audit working papers should be prepared as the audit proceeds so that details and problems are not omitted.</p>		<p>Regardless of the fact that working papers are not intended to be passed to third parties they must be systematically filed and be comprehensible.</p>

~~1. AUDITING STANDARDS~~

5.3 CONTROLLING STANDARD; A COMPARATIVE ANALYSIS

PROPOSED SAUDI AUDIT STANDARD	UNITED STATES	UNITED KINGDOM	GERMANY
			<p>Statement 1/1977 Section X Note 3</p> <p>The preceding principles are particularly taken into account by</p> <p>f) The content of the order and layout of the working papers (e.g., table of contents, systematic numbering). When necessary, cross-references are required.....</p> <p>Statement HFA 2/1982 Section C</p>

6 Standard of Audit Evidence

6 STANDARD OF AUDIT EVIDENCE

6.1 INTRODUCTION

Audit evidence is ^{the} information obtained by the auditor in arriving at the conclusions on which he bases his opinion on the financial statements. The Audit Evidence Standard sets out the objectives which the auditor seeks to meet by obtaining evidence, it specifies the factors which influence the selection and evaluation of audit evidence and it details the steps to be taken should insufficient audit evidence be obtained. Unless the user of the financial statements believes that the auditor has sufficient evidence, the user will not place credibility on the auditor's opinion and the benefit of an audit is lost.

(para 3001)

6.1.2 AUDIT APPROACH

The audit approach is the extent to which the auditor decides, in accumulating sufficient audit evidence, to obtain reasonable assurance about a particular audit objective from:

- i) The operation by the enterprise of systems, especially the accounting system and the system of internal control;
- ii) Analytical review procedures;
- iii) Other substantive tests, that is, substantive tests of details of transactions and balances. (para 3002)

Prior to selecting his audit approach the auditor must make a preliminary assessment of all the available evidence. Without

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- X such a preliminary assessment the auditor cannot make an informed choice of audit approach. Moreover, consideration should be given to all the available evidence regardless of whether or not it appears to support the financial statements.

The auditor should adopt a cost effective approach, i.e., one that provides sufficient assurance to justify the auditor's conclusion and is one of the relatively low cost alternatives.

(para 3003)

6.1.3 MANAGEMENT REPRESENTATIONS DURING THE AUDIT

The auditor will obtain the representations of management and staff throughout the audit in response to specific inquiries. During the audit such representations will normally be oral rather than written. While management representations constitute audit evidence, the auditor should not, in respect of any significant aspect of the audit, rely solely on unsupported oral representations of management or staff as being sufficient evidence. Representations should be corroborated by obtaining evidence from one or more of the three principal sources.

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(para 3004)

6.1.4 THE SYSTEMS EVIDENCE

Management is responsible for producing a set of financial statements which give a fair view and which comply with law and the enterprise's constitution, and it is the responsibility of management to introduce appropriate systems which are capable of reliably producing such financial statements.

(para 3005)

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Complete reliance on systems evidence is not a viable option. No internal control system, however elaborate, can by itself guarantee efficient administration and the completeness and accuracy of the records; nor can it be proof against fraudulent collusion, especially on the part of those holding positions of authority or trust. Internal controls depending on segregation of duties can be abused by the person in whom the authority is vested. While the competence and integrity of the personnel operating the controls may be ensured by selection and training, these qualities may alter due to pressure exerted both within and without the enterprise. Human error due to errors of judgement or interpretation, to misunderstanding, carelessness, fatigue or distraction may undermine the effective operation of internal controls.
(para 3006)

6.1.5 COMPLIANCE TESTING

The purpose of compliance evidence is to establish whether the enterprise's personnel are operating properly the system which has been laid down by management. Three approaches which are commonly adopted to the problem of obtaining compliance evidence are:

- i) The auditor examines documentary evidence of the performance of a control;
- ii) The auditor reperforms a control;
- iii) The auditor observes the performance of a control by the enterprise's staff.

Where performance of a control leaves behind documentary evidence of its performance, then the auditor might obtain his compliance evidence by testing a sample of transactions for the existence

of the documentary evidence. It should be remembered, however, that in some cases, such documentary evidence is not highly persuasive of the performance of the control unless the integrity of the control operative is highly rated. This is because it is quite possible for the operative to initiate the document without actually performing the control.

(para 3007)

The ability of reperformance to provide persuasive evidence of compliance is also in doubt in some circumstances. Thus, a reperformance test may not provide persuasive evidence that the control has been performed by the enterprise's staff.

Observation of the operation of a control procedure provides reliable evidence as to the manner of performance at the time of observation, but not at any other time. This is because it is possible for a control operative to perform the control properly when he sees that he is under observation but to lapse when the observation ceases.

(para 3008)

The difficulties involved in obtaining persuasive compliance evidence is a further inherent restriction on the auditor's ability to rely completely upon the operation of systems as a source of evidence supporting the financial statements. Compliance testing is generally done on a sample basis.

(para 3009)

6.1.6 COMPLIANCE TESTS CARRIED OUT AT THE INTERIM AUDIT

If reliance is being placed on the operation of systems for the whole year and if compliance tests are carried out at the interim audit, then compliance evidence must be obtained for the period between the interim and final audits. (para 3010)

The overall evaluation of the systems evidence is, therefore, performed in three stages:

- i) An assessment of the cumulative effect of relevant procedures within the accounting system and relevant application controls (in most cases, application controls will also be procedures within the accounting system) upon the likelihood of the specific type of error or irregularity under examination.
- ii) An assessment of the effect of general controls upon the likelihood of the relevant procedures being properly performed; (para 3011)

X 6.1.7 EVALUATING THE SYSTEMS EVIDENCE

It should be remembered that:

- i) Management establishes procedures to provide for the orderly assembly of accounting information and appropriate analyses to enable financial statements to be prepared (see definition of accounting system in the Glossary of Terms).
- ii) Management introduces application controls to be applied to the transactions and standing data used by each application.
- iii) An assessment of the compliance evidence regarding the performance of relevant procedures and controls. (para 3012)

X It is important to recognize that the auditor should identify the individual controls and then evaluate the cumulative effect of those controls on specific types of errors. Judgements concerning the effect of controls upon the error type under examination then have

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to be combined with judgements regarding the quality of the compliance evidence in order to assess the overall persuasiveness of the systems evidence.

(para 3013)

6.1.8 ANALYTICAL REVIEW PROCEDURES

Analytical review procedures involve the auditor in studying significant ratios, trends and other statistics and investigating any unusual or unexpected variations. The auditor, on the basis of this observation, will satisfy himself with these trends and predictions and, if the results, which materialize in the course of the audit consistently comply with those predictions, these results will give him audit evidence to support his opinion with regard to the financial statement being examined. The key points for the auditor to consider when evaluating the persuasiveness of analytical review evidence are, therefore:

(para 3014)

- i) What is the reliability of the identified relationship?
- ii) What is the validity of the data used to make the prediction?
and
- iii) What is the difference between the actual figure and the prediction and if there is a material discrepancy, can the reasons for the discrepancy be substantiated?

(para 3015)

6.1.9 OTHER SUBSTANTIVE TESTS

Other substantive tests are defined as tests of details of transactions and balances which seek to provide audit evidence as to the

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completeness, accuracy and validity of the financial statement figures. Other substantive tests can involve the auditor in a variety of activities including, but not limited to, the following:

- i) Physically inspecting assets such as stock or cash,
- ii) Inspecting documentary evidence which has been created by the accounting system,
- ~~x~~ iii) ^a Inspecting documentry evidence from outside the enterprise.
(para 3016)

6.1.10 SAMPLING EVIDENCE

When assessing the persuasiveness of the evidence provided by a substantive test of details applied to a sample of transactions or balances or by a compliance test applied to a sample of transactions subject to a particular control, the auditor should be influenced by the following factors which apply equally to statistical or non-statistical sampling:

- i) The size and the design of the sample
- ii) The method of selection of the sample
- iii) The nature and frequency of the errors or exceptions found
- iv) The reliability of the evidence obtained with respect to individual items in the sample. (The commentary contains a detailed accounting of these factors with some selected examples).

Para 30.A7)

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6.1.11 ASSESSING THE CUMULATIVE EFFECT OF EVIDENCE

When assessing the cumulative effect of different items of evidence, the auditor should be influenced by the consistency of the evidence, the persuasiveness of the individual items of evidence and their independence from one another. These three factors apply when the auditor is considering the cumulative effect of systems evidence, evidence obtained through analytical review and other substantive tests of details of transactions and balances. They also apply if the auditor has obtained, during his substantive testing of details, different pieces of evidence to support the examined items. For example, he may test the validity of a sample of sales transactions by reference to sales invoices, despatch notes and cash receipts and he must consider the cumulative effect of obtaining these three pieces of evidence on his conclusion regarding the validity of each sales transaction in the sample.

(para 3018)

6.1.11.1 CONSISTENCY OF EVIDENCE:

The first point is that the auditor should consider whether the conclusions drawn from different types of evidence are consistent with one another. When audit evidence obtained from one type appears inconsistent with that obtained from another, the reliability of each remains in doubt until further work has been done to resolve the inconsistency. However, when the individual items of evidence relating to a particular matter are all consistent, then the auditor may obtain a cumulative degree of assurance higher than that which he obtains from the individual items.

(para 3019)

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6.1.11.2 PERSUASIVENESS OF THE INDIVIDUAL ITEMS OF EVIDENCE

The second point is that in assessing the cumulative effect of items of evidence, the auditor must be influenced by the persuasiveness of the individual items of evidence. If the
× individual items are not persuasive then their cumulative effect cannot be persuasive.

(para 20)

6.1.11.3 INDEPENDENCE OF THE INDIVIDUAL ITEMS FROM EACH OTHER

The third point is that the cumulative effect of individual items of evidence also depends upon their independence from each other. The auditor adds much more to his existing level of assurance if he obtains further evidence arising from sources independent of the evidence he already has. For example, it is necessary for the auditor to consider the independence of the compliance evidence (part of the systems evidence) and the evidence used in his substantive testing of details of transactions and balances. Where they lack independence, for instance, when the same auditor's reperformance of a control is used as both a compliance and a substantive test (this is called a dual purpose test), then the overall assurance obtained from the system evidence and substantive testing is less than when the compliance and substantive testing is independent. Compliance and substantive evidence would be independent when, for instance, the compliance test is reperformance of a control and the substantive test, which is relevant to the same audit objective as the operation of the control, uses evidence such as a creditor's statement which is from a third party and unconnected with the client's system.

(para 3021)

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6.1.12.7 WHEN INSUFFICIENT EVIDENCE IS OBTAINED

X If the auditor has failed to obtain sufficient evidence on any matter which is significant to his audit opinion, then the auditor should not attempt to perform further audit work. If the lack of assurance is the result of ^{errors} ~~errors~~ or exceptions discovered during the audit work, then he should examine the reasons and these reasons should influence the nature and extent of the further work. For instance, if compliance tests have disclosed exceptions which indicate that the control being tested was not operating properly, the auditor should ^{& determine} ~~determine~~ the reasons for this. He needs to assess whether each exception is only an isolated departure or is representative of others. For example, if the exceptions are found to be caused by the absence of the normal control operative on holiday, then it may still be possible to rely on the control for the period when the operative was at work. The further work is designed primarily to:

- i) Validate the explanation given for the compliance exceptions; and
- ii) Determine by substantive testing whether and to what extent monetary errors occurred during the period or periods when the control was not operating properly.
(para 3022)

The auditor should exhaust all practicable sources of audit evidence before concluding that he is unable to form an opinion on any material matter.

(para 3023)

6.2 COMMENTARY

6.2.1 INTRODUCTION

The auditor must have sufficient relevant and reliable audit evidence to support his audit opinion on the financial statements. Unless the user of the financial statements believes that the auditor has sufficient evidence, the user will not place credibility on the auditor's opinion and the benefit of an audit is lost. A standard on audit evidence is, therefore, an essential component of a set of auditing standards.

Audit evidence is information obtained by the auditor in arriving at the conclusions on which he bases his opinion on the financial statements. The three major sources of audit evidence are described in the Standard as being:

- 1) The operation by the enterprise of systems, particularly the Accounting system and the system of internal control.
- 2) Analytical review procedures, and
- 3) Other substantive tests, that is, substantive tests of details of transactions and balances.
(para 3046)

Management is responsible for producing a set of financial statements which give a fair view and which comply with Saudi law and the enterprise's constitution and it is the responsibility of management to introduce appropriate systems which are capable of reliably producing such financial statements. The operation of good systems can provide the auditor with at least some assurance in the financial statements, but the auditor must be satisfied

that the systems laid down by management are appropriate and are actually being operated by the enterprise.

(para 3047)

X Analytical review procedures involve the auditor in studying significant ratios, trends and other statistics and investigating any unusual ^{or} unexpected variations. for example, an auditor may recognize that over the past five years an enterprise's gross profit has remained steady at 25%. The auditor, on the basis of this observation, expects this year's gross profit to be 25% and if it is, he has audit evidence supporting this year's financial statements. If it drops to 20% then the auditor makes further inquiries to find out why. The precise nature of analytical review procedures depends on the circumstances of each audit, but they all involve the auditor in i) determining a relationship (in this case, the relationship is gross profit this year in relation to gross profit over the past five years); ii) making a prediction on the basis of the relationship (in this case, the prediction is that this year's gross profit equals 25%) and iii) investigating any significant differences between the predicted and reported figures (why has the gross profit dropped to 20%).

(para 3048)

Analytical review procedures are substantive testing procedures whose objective is to ascertain the reasonableness of financial information on an overall basis. Analytical review procedures involve the auditor in studying significant ratios, trends and other statistics and investigating any unusual or unexpected variations.

Substantive tests of details of transactions and balances are defined as those tests of transactions and balances which seek to provide audit evidence as to their completeness, accuracy and

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validity by examining the details underlying the transactions or balances. Substantive tests of details of transactions and balances can involve the auditor in:

- a) Physically inspecting assets such as stock or cash,
- b) Inspecting documentary evidence which has been created by the accounting system (e.g., sales invoices),
- c) Inspecting documentary evidence from outside the enterprise (e.g., purchase invoices) or reports from specialists (e.g. a report by a surveyor regarding the value of a building),
- d) Re-performing an operation which has already been done by the enterprise or by a third party to determine whether the same result is obtained, (e.g., where the auditor checks the arithmetic of an invoice).
- e) Enquiring the management, personnel and other parties concerned who may have some information about a certain event or the credit situation in general.

Substantive tests of details of transactions and balances may be performed on a sample basis such as where the auditor writes to a sample of an enterprise's debtors asking each debtor in the sample to confirm his balance outstanding.

(para 3049)

The Audit Evidence Standard sets out the objectives which the auditor seeks to meet by obtaining evidence, it specifies the factors which influence the selection and evaluation of audit evidence and it details the steps to be taken should insufficient audit evidence be obtained.

(para 3050)

6.2.2 THE GENERAL STANDARD

Paragraph 3024 of the Saudi standard sets out the general standard to be achieved in terms of:

- 1) What is to be done (obtain audit evidence);
- 2) The standard to which it is to be done (sufficient to establish), and
- 3) The overall purpose of what is being done (to establish his audit opinion in accordance with the scope of the audit engagement).

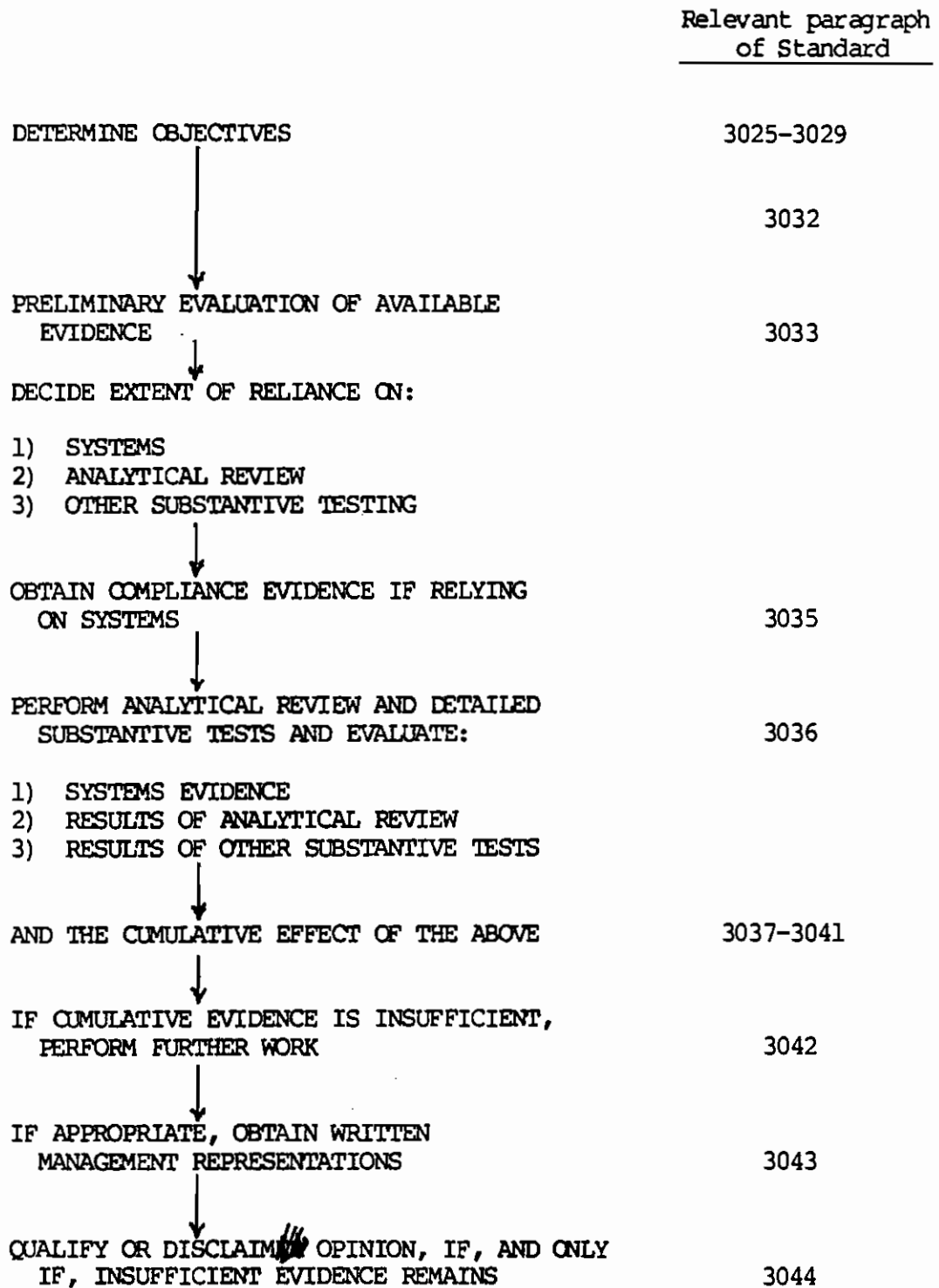
A study of the comparison of requirements at the end of this commentary shows that the structure and content of the UK and US general standards is very similar to those of the Saudi. The object of the German general standard is rather different, reflecting the different objectives of German auditing, which is primarily concerned with compliance with legal requirements.
(para 3051)

6.2.3 THE STRUCTURE OF THE STANDARD

The main features of paragraphs 2 to 16 of the Saudi standard are highlighted in figure 1. It can be seen from figure 1 that the Saudi Standard sets matters out in broadly chronological order. The first step which the auditor must undertake is to detail his objectives.
(para 3052)

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Figure 1 MAIN FEATURES OF THE SAUDI ARABIAN EVIDENCE STANDARD



1 AUDITING STANDARDS 1

6.2.3.1 DETERMINE OBJECTIVES (PARAGRAPH 3025-3029)

Paragraph 3025 specifies that what constitutes sufficient audit evidence is related to the materiality of the particular audit objective or conclusion under consideration to the overall audit opinion being expressed.

(para 3053)

Audit objectives concerned with the fair view opinion are further subdivided into:

- i) Objectives with regard to the validity of individual figures in the financial statements; and
- ii) Objectives concerned with the overall presentation and content of the statements.

(para 3054)

The fair view opinion is an overall opinion on the financial statements and must, therefore, take into account the overall presentation and content of the statements within the framework of generally accepted accounting standards that are appropriate to the circumstances of the business. In addition, the overall opinion can be influenced by the validity of individual figures within the financial statements and the individual figures must also, therefore, be examined.

(para 3055)

The distinction between the overall audit opinion and the individual conclusions from which the overall opinion is derived is explicit in the UK, U.S. and German statements. UK statements include a detailed list of objectives for

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individual balance sheet and profit and loss figures, but support for such a list of objectives can be found in the US standard on Evidential Matter (AU 328 - See comparison of requirements at the end of the Commentary). The detailed list contained in paragraph 3 of the Saudi standard closely follows the list in the UK statement. The UK statements are the only one of the three (UK, US, Germany) to contain separate statements on 'review of financial statements' and the list of detailed objectives with regard to the overall presentation and content of the statements contained in paragraph 4 of the Saudi standard is, therefore, adapted from the UK statement.

(para 3056)

We consider it inappropriate for an auditing standard to detail the legal requirements with which financial statements must comply. However, in view of its particular importance, special mention is made in the Explanatory Foreword of the need for the auditor to examine whether amounts are being transferred to the statutory reserve in accordance with Saudi law. The Saudi legal requirements with regard to the consistency of the headings of the balance sheet and profit and loss account and the consistency of the basis of valuation of assets, liabilities, income and expenses, are also given specific mention in paragraph 3030.

(para 3057)

6.2.3.2 PRELIMINARY EVALUATION OF AVAILABLE EVIDENCE (PARAGRAPH 3032)

The UK, US and German statements all recognize the importance of the study and evaluation of internal control as a factor influencing the nature and extent of audit tests. The auditor must, therefore, make a preliminary assessment of

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the system of internal control prior to the selection of his audit approach, and this requirement, extended to cover the accounting system as well as the system of internal control, is contained in paragraph 5 of the Saudi standard. The UK and U.S. statements recognize that there is a distinction between the accounting system and the system of internal control and requires both to be the subject of a preliminary evaluation. The Saudi standard follows the UK and U.S. in this respect. The UK requirement to record the accounting system is omitted in the Saudi evidence standard since it is included in the Saudi recording standard. Before selecting his audit approach the auditor should also make a preliminary assessment of the availability of evidence from analytical review and other substantive testing. Without a preliminary assessment of all the potentially important sources of evidence the auditor cannot make an informed choice of audit approach. This point is not explicitly recognized in the UK, US or German statements but the US statements do recognize that the performance of analytical review at an early stage will assist in determining the nature, extent and timing of other audit procedures (SAS 23, para 5). The requirement for the auditor to give consideration to all the available evidence regardless of whether or not it appears to support the financial statements is taken from the US statements (AU 330.15). For example, the auditor must not make a preliminary assessment of analytical review and decide to exclude analytical review in his audit approach simply because it appears that the results may be unfavorable to the financial statements.

(para 3058)

6.2.3.3 DECIDE EXTENT OF RELIANCE ON 1) SYSTEMS, 2) ANALYTICAL REVIEW,
3) OTHER SUBSTANTIVE TESTING (PARAGRAPHS 6,8, 9)

We consider it most important for the auditor to recognize that there are three potentially major sources of audit assurance for the individual figures in the financial statements and that he should select a 'cost effective' combination of evidence from these three sources. In this connection, a cost effective approach is one which provides sufficient assurance to justify the auditor's conclusion and is one of the relatively low cost alternatives. There is reference either directly or indirectly in the UK, US and German statements to the need for the auditor to be cost effective in his approach.

In considering the question of the extent of reliance on the different sources of evidence, the UK and German statements stress the relationship between internal control and substantive testing. In so doing, we believe that the UK and German statements give inadequate consideration to the important relationship between analytical review procedures and detailed substantive testing. This relationship is, however, given suitable prominence in the UK statements (AU 320.73 - Appendix). The Saudi standard is written so as to require the auditor to give consideration to each of the three main sources of evidence.

(para 3060)

In addition to the three main sources of evidence, the auditor will obtain the representations of management and staff throughout the audit in response to specific enquiries. During the audit such representations will normally be oral rather than written. Whilst management representations

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constitute valid audit evidence, the auditor should not, in respect of any significant aspect of the audit, rely solely on unsupported oral representations of management or staff as being sufficient evidence.

Representations should be corroborated by obtaining evidence from one or more of the three principal sources listed in paragraph 3033. Paragraph 3034 also contains a positive requirement for the auditor to design his procedures so as to obtain reasonable assurance that there is no errors or irregularities, the non-disclosures of which would distort the view given by the financial statements. We believe that it is desirable to make a positive statement in the evidence standard regarding the auditor's responsibility for irregularities.

(para 3061)

It is important that the auditor keeps his choice of audit approach under review throughout the conduct of the audit and is prepared to amend his approach if necessary in the light of new evidence obtained. The auditor's decision regarding extent of reliance should be made at an early stage of the audit but after completion of the preliminary assessments required by paragraph 3032 and para 3033 of the planning standard. It is, therefore, the subject of paragraph 3034 and the Saudi Arabian Standard continues to follow, as far as possible, the logical sequence of events in the audit evidence gathering process.

Paragraph 3036 is also relevant to the selection of the audit approach. It stresses, in common with the statements of the UK and US, the inherent limitations of the systems evidence and the consequent need for the auditor to support

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the systems evidence with evidence from other sources. Complete reliance on systems evidence is not a viable option. In deciding the audit approach the audit assesses the cost effectiveness of various possible combinations of evidence and it will, therefore, be necessary for him to assess the cumulative effect of evidence from different sources. The factors to be taken into account when assessing this cumulative effect are specified in paragraph 3037. They are discussed in a later section of this commentary.

6.2.3.4 OBTAIN COMPLIANCE EVIDENCE IF RELYING ON SYSTEMS (PARAGRAPH 3035)

evidence

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Paragraph 3035 follows the UK and US statements in requiring compliance evidence if reliance is to be placed on systems. Compliance tests are normally conducted at the interim audit. In the Saudi standard attention is drawn to the fact that if reliance is being placed on the operation of systems during the period between the interim and final audits, then compliance evidence must also be obtained to cover that period. Both the UK and US statements go into detail on the question of the factors which influence the choice of compliance evidence during the period between the interim and final audits. We believe that such a level of detail is inappropriate given the structure of the Saudi standards and that such detail should be contained in explanatory materials supporting the standard rather than the standard itself. Therefore, the main factors are outlined in the Explanatory Forward to the Evidence Standard.

Foreword

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6.2.3.5 PERFORM ANALYTICAL REVIEW AND SUBSTANTIVE TESTS
OF DETAILS AND EVALUATE:

1) Systems evidence, 2) Results of analytical review, 3) results of substantive tests, and assess the cumulative effect.

6.2.3.5.1 PARAGRAPH (3037)

Paragraph 3037 summarizes the factors which influence the auditor's evaluation of the cumulative effect of different items of evidence. It applies when the auditor is considering the cumulative effect of systems evidence, analytical review and other substantive tests and it also applies if the auditor has obtained during his substantive testing of details on a sample basis, different pieces of evidence to support the sampled items. For example, he may test the validity of sales by reference to sales invoices, despatch notes and cash receipts and he must consider the cumulative effect of obtaining these three pieces of evidence.

(para 3065)

The first point mentioned in paragraph 3037 is consistency. The importance of consistency is covered in the UK statements and in the US statements. The second point is the relevance of the persuasiveness of the individual items of evidence and this is self apparent. However, the cumulative effect of individual items of evidence also depends upon their independence from each other and this is the third point mentioned in paragraph 3037. The auditor adds much more to his existing level of assurance if he obtains further evidence which is from sources independent of the evidence he already has. For example, it is necessary for the auditor to consider the independence of the compliance evidence (part of the

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systems evidence) and the evidence used in his detailed substantive testing. Where they lack independence, for instance when the auditor's reperformance of a control is relied upon for both compliance and substantive purposes, then the overall assurance obtained from the systems evidence and substantive testing is less than when the compliance and substantive testing is independent. The significance of the independence of the evidence obtained has been largely overlooked by the UK, US and German statements.

(para 3066)

6.2.3.5.2

PARAGRAPH 3038 - SYSTEMS EVIDENCE

Paragraph 3038 summarizes the factors that should be considered by the auditor when making an overall evaluation of the systems evidence. To understand the construction of paragraph 3038, it should be remembered that:

- i) Management establishes procedures to provide for the orderly assembly of accounting information and appropriate analyses to enable financial statements to be prepared.
- ii) Management introduces application controls to be applied to the transactions and standing data used by each application. The objectives of application controls are to ensure the completeness and validity of the accounting records. Usually application controls are applied by introducing additional procedures, such as authorization and reconciliation of control totals, into the accounting system.

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The overall evaluation is, therefore, performed in three stages:

- i) An assessment of the cumulative effect of relevant procedures within the accounting system and relevant applications controls (in most cases, application controls will also be procedures within the accounting system).
- ii) An assessment of the effect of general controls upon the likelihood of the relevant procedures being properly performed; and
- iii) Compliance evidence regarding the performance of relevant procedures and controls.
(para 3068)

Both the UK and US statements recognize that the auditor should identify the individual controls and then evaluate the cumulative effect of those controls on specific errors. In addition, the US statements recognize that the overall evaluation of controls involve combining judgements on controls and judgements about compliance evidence. The distinction between application and general controls is made in the US statement on 'Effects of EDP on evaluation of internal control'. Since there is no difference in principle between evaluating systems evidence in an EDP or manual system, we consider it appropriate that the distinction between application and general controls should be made for all systems of internal control.
(para 3069)

6.2.3.5.3

PARAGRAPH 3039-ANALYTICAL REVIEW PROCEDURES

Paragraph 3039 summarizes the factors which should be taken into account when the auditor evaluates the evidence provided by analytical review procedures. The definition of analytical review procedures given in the glossary of terms is taken from Westwick 'Do the Figures Make Sense' published by the English Institute. This definition gives the basic steps in analytical review as being:

- i) Identify the principal factors which are likely to govern the size of the accounting number being reviewed;
- ii) Determine the approximate relationship between the factors and the accounting number;
- iii) Predict what the current number should be if the relationship in (b) is still valid;
- iv) Compare the actual number with the prediction;
- v) Investigate the reasons for any material discrepancy;

The key points for the auditor to consider are, therefore:

- i) What is the reliability of the relationship identified in (b) above?
- ii) What is the validity of the data used to make the prediction in (c) above ? and

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- iii) What is the difference between the actual number and the prediction and if there is a material discrepancy, can the reasons for the discrepancy be substantiated (per (d) and (e) above)?
(para 3070)

These are the points included in the Saudi standard. Their relevance can be supported by a study of the US statement on analytical review (SAS 23 - see comparison of requirements at the end of the Commentary).
(para 3071)

6.2.3.5.4 PARAGRAPH 3040 - SAMPLING EVIDENCE

Paragraph 3040 summarizes the factors which should be taken into account when assessing the persuasiveness of the evidence provided by a substantive test of details or a compliance test that is carried out on a sample basis. The factors have been distilled from the US statement on audit sampling (SAS 39) and they apply equally to statistical or non-statistical sampling. They are:
(para 3072)

- X 6.2.3.5.4.1 The size and design of the sample—Other things being equal, the evidence provided by a large sample is more persuasive than evidence provided by a small sample. However, beyond a certain size, further increases in sample size have little effect. For example, if sample size is already 200 items (i.e., a very large sample) then increasing it to 250 items may have relatively little effect on the persuasiveness. However, increasing a sample size from 25 to 75 may have a very significant effect. The design of the sample is also important, and the auditor must be careful to make sure that the design is appropriate to the audit objective under

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consideration. For example, an auditor would not be able to examine the completeness of sales by selecting the sample from the population of recorded sales invoices.

- 6.2.3.5.4.2 The method of selection of the sample--The auditor should use a selection method that has the potential for selecting items from the entire population under examination. When statistical sampling is employed it is usually necessary to select on a random basis. When non-statistical sampling is used it may be appropriate to select a proportion of the sample on a random basis and a proportion of the sample on a key item basis, i.e., the auditor includes in the sample those items which he considers have a particularly high risk of being wrong or are unusually important because of their size or other factors.
(para 3074)

- 6.2.3.5.4.3 The nature and frequency of the errors or exceptions found--Other things being equal, the fewer the errors or exceptions discovered in the sample, the more the support which the sample results give to the audit objective under consideration. It is also important that the auditor considers the relevance of the nature of the errors or exceptions found to the audit objective. for example, if the auditor is conducting a compliance test then all failures to operate the control must be considered to be exceptions regardless of the amount involved in the particular transaction. If, however, the auditor is conducting a substantive test, then a small error in the value of a sample item may or may not be of significance depending upon the circumstances. The circumstances in which errors or exceptions occur should

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X always be investigated, and their possible effect on conclusions drawn elsewhere in the audit, assessed. For example, errors in a substantive test may indicate that controls, ^{operation} which are being relied upon, are in fact not in operation. In addition, the auditor should always be alert to the possible significant cumulative effect of a number of individually small errors.

(para 3075)

- 6.2.3.5.4.4 The reliability of the evidence obtained with respect to individual items in the sample—The persuasiveness of the results of a sample test does not only depend upon sampling issues but also it must be influenced by the quality of the evidence used to support the auditor's conclusions regarding the individual items in the sample. The evidence used to form conclusions about the individual items in the sample is inappropriate, then the auditor would not be persuaded by the test results even if every item in the population were included in the sample.

Paragraph 3040 can be applied to substantive tests of details conducted on a sample basis or to compliance tests conducted on a sample basis. We believe that it is inappropriate, given the structure of the proposed Saudi Auditing Standards, to give details in the standard of the possible different types of compliance and substantive tests. Such detail should be contained in educational material supporting the standard rather than the standard itself. The explanatory ^{as foreword} ~~forward~~ to the Evidence Standard, nevertheless, does discuss the problems associated with some different types of compliance tests and it also indicates some different types of evidence which are commonly employed in detailed substantive testing.

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6.2.3.5.5. PARAGRAPH 3041 - THIRD PARTY EVIDENCE

This paragraph summarizes the factors which the auditor should take into account when evaluating evidence from third parties. Such evidence may relate to individual sample items in a detailed substantive test or it may relate to the total, or sub-total, of a balance shown in the financial statements. An example of the former is the receipt of ~~the~~ debtors confirmation as part of ~~a~~ debtors circularization exercise and an example of the latter is a certificate from a recognized bank confirming the only bank balance of the client enterprise. In addition, third party evidence can take the form of a report from a specialist such as a surveyor, lawyer, architect or a fellow auditor. The considerations listed in paragraph 3041 are relevant to an assessment of the work performed by an internal auditor or by another external auditor. There is not, therefore, a separate paragraph in the Saudi Evidence Standard dealing with the evaluation of work performed by internal or other external auditors. The factors listed in paragraph 13 are closely related to the points made in the US statement (AU 336.07 and 08-see appendix).
(para 3077)

6.2.3.5.6 IF CUMULATIVE EVIDENCE IS INSUFFICIENT, PERFORM FURTHER WORK (PARAGRAPH 14)

If the auditor has failed to obtain sufficient evidence on any matter which is significant to his audit opinion, then the auditor should not qualify but should attempt to perform further audit work. If the lack of assurance is the result of errors or exceptions discovered during the audit work, then he should examine the reasons and these reasons should influence the nature and extent of the further work.
(para 3078)

6.2.3.5.7. OBTAIN MANAGEMENT REPRESENTATIONS (PARAGRAPH 3043)

Paragraph 3043 follows the proposed UK line whereby if sufficient assurance is not and could not reasonably be expected from other evidence sources on any material matter, the auditor should obtain the written representations of management on the matter in question. He must then decide whether in the circumstances, these representations together with the other audit evidence he has obtained, are sufficient to enable him to form an opinion.

Management representations should not be relied upon if corroborating evidence should reasonably be expected to be available but is not forthcoming. This is for two reasons:

- i) The possibility that management is deliberately withholding, or suppressing the creation of evidence, or
- ii) The possibility that management themselves have too little knowledge or evidence on which to base their management representations.

(para 3079)

6.2.3.5.8 QUALIFY OR DISCLAIM IF, AND ONLY IF, INSUFFICIENT EVIDENCE REMAINS (PARAGRAPH 3044)

The auditor should exhaust all practicable sources of audit evidence before concluding that he is unable to form an opinion on any material matter.

Figure 2 shows the role of management representation in the Saudi evidence standard.

(para 3080)

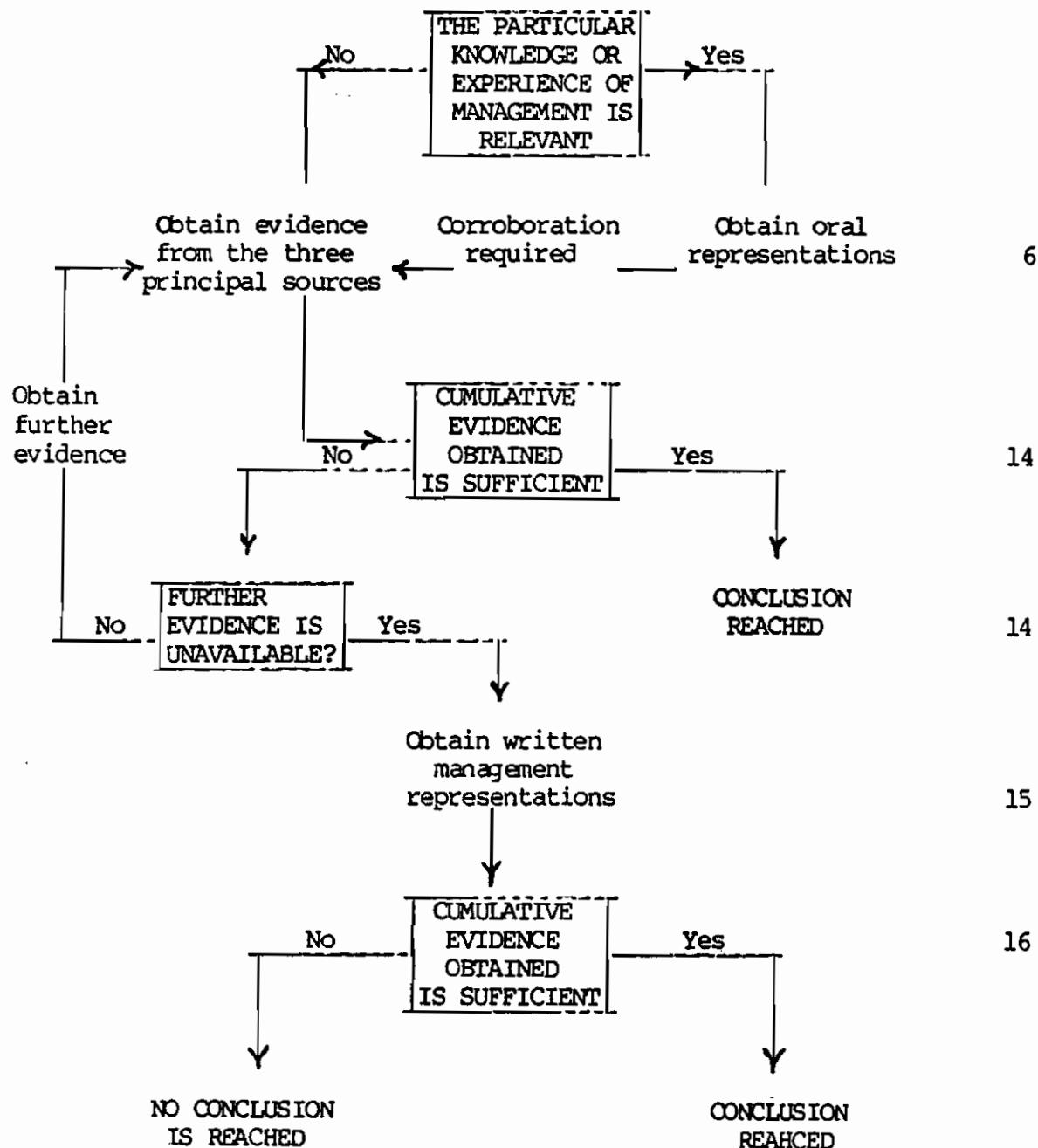
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Figure 2

The Role of Management Representations in the Saudi Evidence Standard

Relevant Paragraph
of Standard

FOR ANY MATERIAL MATTER



X 6.3 COMPARISON OF REQUIREMENTS ACROSS (YOUR) COUNTRIES

6.3.1 References used in the Appendix are as follows:

UNITED STATES

AU -

The relevant section of "Codification of Numbers 1 to 15" American Institute of Chartered Public Accountants 1977.

SAS - para -

The relevant paragraph of the relevant statement on Auditing Standards published by the American Institute of Certified Public Accountants.

Standard of field work-

Refers to the field work standards contained in the U.S. Generally Accepted Auditing Standards

UNITED KINGDOM

- para -

Refers to the relevant paragraph of the relevant Auditing Standard or Auditing Guideline issued by the accountancy bodies in the United Kingdom.

- E.D. -

Refers to the relevant exposure draft issued for comment by the accountancy bodies in the United Kingdom.

GERMANY

Statement-/1977

Section -

Refers to the relevant section of the relevant standard issued in 1977 by the Institut der Wirtschaftsprüfer in Germany

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<p>1. The auditor must obtain relevant and reliable audit evidence sufficient to establish a reasonable basis for the expression of an audit opinion on the financial statements in accordance with the scope of the audit engagement.</p> <p>2. The audit opinion must be based upon reasonable conclusions drawn from sufficient, relevant and reliable audit evidence. In particular, the audit opinion as to a whether the financial statements give a fair view of the financial position and of the results of operations, changes in owners' equity and sources and applications of funds of the enterprise must be based upon reasonable conclusions, drawn from sufficient, relevant and reliable audit evidence, with regard to:</p> <p>i) Individual figures in the financial statements; and</p> <p>ii) The overall presentation and content of the financial statements.</p> <p>The sufficiency of audit evidence to support each conclusion should depend upon the materiality of the conclusion to the audit opinion.</p>	<p>The auditor should obtain relevant and reliable audit evidence sufficient to enable him to draw reasonable conclusions therefrom</p> <p>The auditor is required to form an opinion on the enterprise's financial statements as a whole. Having accumulated audit evidence about individual items or groups of items, he should therefore, carry out an overall review ...</p> <p>205 para 2</p> <p>and ultimately whether:</p> <p>The conclusions drawn from the other tests which he has carried out, together with those drawn from his overall review of the financial statements, enable him to form an opinion on the financial statements.</p> <p>205 para. 2</p> <p>The relevance of the audit evidence should be considered in relation to the overall audit objective of forming an opinion and reporting on the financial statements.</p> <p>203 para. 5</p>	<p>Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.</p> <p>3rd standard of field work.</p> <p>The independent auditor's judgement concerning the "fairness" of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles.</p> <p>AU 411.03</p>	<p>The auditor should determine the nature and scope of his audit procedures in such a manner that he is able to make an informed judgement on the compliance of the financial statements with law and generally accepted accounting principles.</p> <p>Statement 1/1977 Section V</p> <p>The opinion is an overall conclusion. It is not merely the sum of the individual conclusions formed in each area of the audit, but requires the auditor's evaluation of the materiality of the individual conclusions.</p> <p>Statement 3/1977 Section B Note 3</p> <p>In view of these objectives, the auditor must determine the nature and scope of his audit procedures in a conscientious manner and with due professional care. Important criteria for this are the significance of the items being audited.</p> <p>Statement 1/1977 Section V</p>

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<p>3. Reasonable conclusions regarding individual figures in the financial statements should be made in answer to the following questions:</p> <p>For the statement of financial position figures:</p> <ul style="list-style-type: none"> i) Have all assets and liabilities been recorded? ii) Do the recorded assets and liabilities exist? iii) Are the recorded assets owned by the enterprise and are the recorded liabilities properly those of the enterprise? iv) Have the amounts attributed to the assets and liabilities been arrived at in accordance with the stated accounting policies and are those policies in accordance with generally accepted accounting standards appropriate to the circumstances of the business? v) Have the assets, liabilities and owners' equity been properly disclosed? <p>For Statement of Income Figures:</p> <ul style="list-style-type: none"> i) Have all revenues, expenses, gains and losses that are 	<p>To achieve this objective the auditor needs to obtain evidence to enable him to draw reasonable conclusions in answer to the following questions.</p> <p>Balance Sheet Items</p> <ul style="list-style-type: none"> a) Have all the assets and liabilities been recorded? b) Do the recorded assets and liabilities exist? c) Are the assets owned by the enterprise and are the liabilities properly those of the enterprise? d) Have the amounts attributed to the assets and liabilities been arrived at in accordance with the stated accounting policies, on an acceptable and consistent basis? e) Have the assets, liabilities and capital and reserves been properly disclosed. <p>203 para 5</p> <p>Profit and Loss Account Items</p> <ul style="list-style-type: none"> f) Have all income and expenses been recorded? g) Did the recorded income and expense transactions in fact occur? h) Have the income and expenses been measured in accordance with 	<p>Most of the independent auditor's work in forming his opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements.</p> <p>AU 326.02</p> <p>Assertions are representations by management that are embodied in financial statement components. They can be either explicit or implicit and can be classified according to the following broad categories:</p> <ul style="list-style-type: none"> o Existence or occurrence o Completeness o Rights and obligations o Valuation or allocation o Presentation and disclosure <p>Assertions about existence or occurrence deal with whether assets or liabilities of the entity exist at a given date and whether recorded transactions have occurred during a given period.</p> <p>Assertions about completeness deal with whether all transactions and accounts that should be presented in the financial statements are so included.</p> <p>Assertions about rights and obligations deal with whether assets are</p>	<p>The division of the data to be audited into individual audit fields assist in the proper conduct of an examination.</p> <p>Statement 1/1977 Section IV Note 1</p>

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properly associated with the reporting period been recorded?	the stated accounting policies, on an acceptable and consistent basis?	the rights of the entity and liabilities, are the obligations of the entity at a given date.	
ii) Are the recorded revenues and gains properly regarded as revenues or gains of the enterprise and are the recorded expenses and losses properly regarded as those of the enterprise?	i) Have income and expenses been properly disclosed where appropriate? 203 para. 5	Assertions about valuation or allocation deal with whether asset, liability, revenue and expense components have been included in the financial statements at appropriate amounts. Assertions about presentation and disclosure deal with whether particular components of the financial statements are properly classified, described and disclosed. AU 326.03 to 326.08 In obtaining evidential matter in support of financial statement assertions, the auditor develops specific audit objectives in the light of those assertions. In developing the audit objectives of a particular engagement, the auditor should consider the specific circumstances of the entity, including the nature of its economic activity and the accounting practices unique to its industry. For example, one audit objective related to the assertion about completeness that an auditor might develop for inventory balances is that inventory quantities include all products, materials and supplies on hand. AU 326.09	
iii) Have the revenues, gains, expenses and losses been recognized and measured in accordance with the stated accounting policies and are those policies in accordance with the generally accepted accounting standards appropriate to the circumstances of the business?			
iv) Have revenues, gains, expenses and losses been properly presented and disclosed?			
For Statement of Sources and Applications of Funds Figures:			
i) Have all sources of funds during the period been reflected in the statement?			
ii) Have all applications of funds during the period been reflected in the statement?			
iii) Does the statement properly reflect other investing and financing transactions during			

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<p>the period which did not affect the funds?</p> <p>iv) Have all disclosure and presentation requirements of generally accepted accounting standards been met?</p> <p>4. Reasonable conclusions regarding the overall presentation and content of the financial statements should be made in answer to the following questions?</p> <p>i) Have the financial statements been prepared in accordance with accounting policies that are in accordance with the generally accepted accounting standards?</p> <p>ii) Are there any special circumstances affecting the enterprise or the industry in which the enterprise operates, that might cause generally accepted accounting standards to be inappropriate?</p> <p>iii) Have the accounting policies been applied on a basis consistent with that of the preceding accounting periods, or if not, has the change been properly accounted for and disclosed in accordance with generally accepted accounting standards?</p>	<p>...he should therefore carry out an overall review to determine whether in his opinion:</p> <p>a) The financial statements have been prepared using acceptable accounting policies which have been consistently applied and are appropriate to the enterprise's business;</p> <p>b) The results of operations, state of affairs and all other information included in the financial statements are compatible with each other and with the auditor's knowledge of the enterprise;</p> <p>c) There is adequate disclosure of all appropriate matters and the information contained in the financial statements is suitably classified and presented;</p> <p>205 para 2</p> <p>The auditor should review the accounting policies adopted by the enterprise to determine whether such policies:</p>	<p>The auditor's opinion that financial statements present fairly an entity's financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles should be based on his judgement as to whether:</p> <p>a) The accounting principles selected and applied have general acceptance.</p> <p>b) The accounting principles are appropriate in the circumstances;</p> <p>c) The financial statements, including the related notes, are informative of matters that may affect their use, understanding and interpretation;</p> <p>d) The information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed; and</p> <p>e) The financial statements reflect the underlying events and transactions in a manner that presents</p>	<p>The opinion is based on the auditor's conclusion that the company subject to audit complies with the applicable principles. Principles are all requirements prescribed by law and the company's statutes directly and indirectly applicable to accounting, including generally accepted accounting principles.</p> <p>Statement 3/1977 Section B Note 5</p>

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<p>In case of stock companies, has the financial statements been prepared in the same format as previous year/s; and have assets, liabilities, revenues, expenditures, earnings and losses been measured on the same lines as those of previous year and in accordance with the provisions of article 123 and 124 of the Saudi Company Law?)</p> <p>iv) Are the accounting policies consistent with each other and are they consistently applied throughout the enterprise?</p> <p>v) Are the accounting policies which have been used adequately disclosed?</p> <p>vi) Are the figures contained in the financial statements consistent with each other and consistent with related information contained in previous financial statements?</p> <p>vii) Is there adequate disclosure of all appropriate matters and is the information contained in the financial statements suitably classified and presented?</p> <p>viii) Is the financial position, results of operations, changes in owners' equity and sources</p>	<p>a) Comply with statements of standard Accounting practice or, in the absence thereof, are otherwise acceptable;</p> <p>b) Are consistent with those of the previous period;</p> <p>c) Are consistently applied throughout the enterprise;</p> <p>d) Are disclosed in accordance with the requirements of the Statement of Standard Accounting Practice No. 2 "Disclosure of Accounting Policies."</p> <p>205 para. 6</p> <p>In addition to any analytical review procedures carried out during the course of the audit, the auditor should carry out an overall review of the information in the financial statements themselves and compare it with other available data.</p> <p>205 para. 9</p> <p>The auditor should consider the information in the financial statements in order to ensure that the conclusions which a reader might draw from it would be justified and consistent with the circumstances of the enterprise's business.</p> <p>205 para. 10</p>	<p>the financial position, results of operations, and changes in financial position stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.</p> <p>AU 411.04</p>	

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<p>and applications of funds as reported in the financial statements consistent with the auditor's knowledge of the underlying transactions, events and circumstances of the business?</p> <p>ix) Are there any notes or representations that are found invalid or any data that have not been disclosed with regard to the financial statements which would mislead the users of the financial statements?</p> <p>5. The auditor must enquire in writing from the predecessor auditor with regard to the reasons for discontinuing the audit of the enterprise. He must also request any information which may affect the financial statements, and be acquainted with the previous period's work papers (after securing the prior consent of the respective enterprise) which shall be documented and incorporated as part of the work papers of this successor auditor.</p> <p>6. The auditor must obtain a letter of "General Disclosure" from the respective enterprise which shows the basis for the preparation of financial statements and testifies that all relevant information have been supplied to the auditor to enable him examine the financial</p>			

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<p>statements an certify that they give a fair view of the financial position of the enterprise.</p> <p>7. The auditor must ascertain and make a preliminary assessment of both the enterprise's accounting system and the system of internal control as a source of audit evidence. The auditor should also make a preliminary assessment of the availability of evidence from analytical review and other substantive tests of details of transactions and balances. The auditor must give consideration to all the available evidence regardless of whether or not it appears to support the representations made in the financial statements.</p> <p>8. Following his completion of the preliminary assessments required by the auditing Standard on Audit Planning and the previous paragraph of this standard, the auditor must decide the extent</p>	<p>The auditor should ascertain the enterprise's system of recording and processing transactions and assess its adequacy as a basis for the preparation of financial statements.</p> <p>101 para 3</p> <p>The auditor will need to ascertain and record the internal control system in order to make a preliminary evaluation of the effectiveness of its component controls and to decide the extent of his reliance thereon. This recording will normally be carried out concurrently with the recording of the accounting system.</p> <p>204 para. 11</p> <p>The auditor should consider the outline audit approach he proposes to adopt, including the extent to which he may wish to rely on internal controls 201 para. 7</p>	<p>In developing his opinion the auditor must give consideration to relevant evidential matter regardless of whether it appears to support or contradict the representations made in the financial statements.</p> <p>AU 330.15</p> <p>There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.</p> <p>2nd standard of field work.</p> <p>Analytical review procedures may be performed at various times during an examination:</p> <p>a) In the initial planning stages to assist in determining the nature, extent, and timing of other auditing procedures....</p> <p>SAS 23 para. 5</p> <p>The evidential matter required by the third standard is obtained through two general classes of audit procedures (a) tests of details of transactions and balances and (b) analytical review of significant ratios and</p>	<p>All facts which are important in drawing a conclusion on the financial accounting system must also be investigated every time on continuing assignments.</p> <p>Statements 1/1977 Section IV Note 3</p> <p>The audit and evaluation of the internal control system, in particular the extent to which it ensures the preparation of reliable financial reports, give the auditor the possibility of determining the type and scope of his audit procedures in an appropriate manner.</p> <p>Statement 1/1977 Section IV</p> <p>If the auditor has satisfied himself that the controls in force are effective he can establish his subsequent audit procedures accordingly. Material weaknesses or deficiencies in the internal control system</p>

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<p>to which, in accumulating sufficient evidence for his conclusions, he intends to rely upon:</p> <p>i) The operation by the enterprise of systems, particularly the accounting system and the system of internal control.</p> <p>ii) Analytical review procedures.</p> <p>iii) Other substantive tests of details of transactions and balances.</p> <p>The auditor should design his program of audit procedures accordingly.</p>	<p>In this context the auditor should aim to provide an effective and economic service within an appropriate time scale.</p> <p>201 para. 4</p> <p>At an early stage in his work the auditor will have to decide the extent to which he wishes to place reliance on the internal controls of the enterprise. As the audit proceeds, that decisions will be kept under review and, depending on the results of his examination, he may decide to place more or less reliance on these controls.</p> <p>204 para. 2</p> <p>The auditor may rely on appropriate evidence obtained by substantive testing to form his opinion, provided that sufficient amount of such evidence is obtained. Alternatively, he may be able to obtain assurance from the presence of a reliable system of internal control and thereby reduce the extent of substantive testing.</p> <p>203 para. 9</p>	<p>trends and resulting fluctuations and questionable items.</p> <p>AU 320.70</p> <p>The foregoing excerpts recognize not only that the reliance on substantive tests may properly vary inversely with the reliance on internal accounting control, but also that the relative tests that are derived from tests of details and from analytical review procedures may properly vary ... Variations in this respect may arise from differences in circumstances and efficiency of the respective types of procedures. In this context, effectiveness refers to the audit satisfaction that can be obtained from the procedures, and efficiency refers to the audit time and effort required to perform the procedures. Effectiveness necessarily is the overriding consideration, but efficiency is an appropriate consideration in choosing between procedures of similar effectiveness.</p> <p>AU 320.73</p>	<p>require audit procedures to be accordingly extended in scope and depth.</p> <p>In view of these objectives the auditor must determine the nature and scope of his audit procedures in a conscientious manner and with due professional care. Important criteria for this are the systems operated by the enterprise under audit....</p> <p>Statement 1/1977 Section V</p> <p>The auditor must, therefore, tailor his audit procedures so that he can draw the necessary conclusions in a timely and economical manner.</p> <p>Statement 1/1977 Section V Note 2</p>
<p>9. In selecting the audit approach, the auditor should be influenced by the anticipated cost effectiveness of the alternatives. As the audit proceeds, the selected approach must be kept under review and should be revised if necessary in the light of the results of the audit procedures performed. In addition to the three sources of</p>			

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<p>evidence listed above, the auditor should obtain the representations of management and staff on any significant matter where the particular knowledge and experience of management or staff is relevant. However, the auditor should obtain sufficient corroborative evidence for the representations received. In particular, the auditor should design his audit procedures to give him reasonable assurance that there is no error or irregularities which materially distorts the view given by the financial statements.</p>			
<p>10. If the auditor wishes to place reliance on the performance of procedures within the accounting system or on the performance of internal controls, he must obtain relevant compliance evidence. If reliance is being placed on the operation of procedures of controls during the period between the interim and final audits, appropriate compliance evidence must be obtained for that period.</p>	<p>The auditor is not entitled to place any reliance on internal controls based solely on his preliminary evaluation. He should carry out compliance tests to obtain reasonable assurance that the controls on which he wishes to rely were functioning both properly and throughout the period.</p> <p>204 para. 14</p> <p>If the auditor wishes to place reliance on any internal controls he should ascertain and evaluate those controls and perform compliance tests on their operation.</p> <p>101 para. 5</p>	<p>The purpose of tests of compliance is to provide reasonable assurance that the accounting control procedures are being applied as prescribed. Such tests are necessary if the prescribed procedures are to be relied upon in determining the nature, timing or extent of substantive tests.</p> <p>AU 320.55</p>	
<p>11. Because of inherent limitations in even the most effective</p>	<p>Because of inherent limitations in even the most effective internal</p>	<p>The second standard does not contemplate that the auditor will place</p>	

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<p>system, the auditor must not rely solely on systems evidence, including evidence from the accounting system or the system of internal control, as the basis for his conclusions on the financial statements. He must always obtain substantive evidence to support his conclusions.</p> <p>12. The auditor must evaluate the cumulative persuasiveness of all the evidence obtained in support of each conclusion and he must relate his evaluation to:</p> <ul style="list-style-type: none"> i) The consistency of the various relevant items of evidence. ii) The persuasiveness of each of the various items of evidence; and iii) The extent to which the various items of evidence were obtained from independent sources. <p>The auditor must handle all evidence obtained with due care, irrespective of the fact whether they support or contradict with the information contained in the financial statements.</p>	<p>control system, it will not be possible for the auditor to rely solely on its operation as a basis for his opinion on the financial statements.</p> <p>204 para. 8</p> <p>The auditor should consider whether the conclusions drawn from differing types of evidence are consistent with one another.</p> <p>203 para. 7</p>	<p>complete reliance on internal control to the exclusion of other auditing procedures. . . . the inherent limitations on the effectiveness of accounting control . . . are the fundamental reasons underlying this interpretation.</p> <p>AU 320.71</p> <p>The auditor's objective is to obtain sufficient competent evidential matter to provide him with a reasonable basis for forming an opinion under the circumstances. In the great majority of cases, the auditor finds it necessary to rely on evidence that is persuasive rather than convincing.</p> <p>AU 330.10</p> <p>The amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his professional judgement after a careful study of the circumstances in the particular case. In making such decisions, he should consider . . . the kinds and competence of the individual pieces of evidence available.</p> <p>AU 330.09</p> <p>In developing his opinion the auditor must give consideration to relevant evidential matter regardless of whether it appears to support or to</p>	

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<p>13. The auditor should relate the persuasiveness of the evidence provided by a study of the accounting system and the system of internal control to:</p> <p>i) The cumulative effect of relevant procedures within the accounting system and relevant application controls within the system of internal control upon the likelihood of the type of error or irregularity under examination.</p> <p>ii) The effect of general controls upon the likelihood of the relevant procedures and application controls being properly performed, and</p> <p>iii) The persuasiveness of the compliance evidence that</p>	<p>If the auditor wishes to place reliance on any internal controls he should ascertain and evaluate those controls and perform compliance tests on their operation.</p> <p>101 para 5</p> <p>Depending upon the size and nature of the business concerned an accounting system will frequently need to incorporate internal controls to provide assurance that</p> <p>202 para. 6</p> <p>In addition to making an assessment of the adequacy of the accounting system the auditor needs to confirm that the system has operated as laid down throughout the period.</p> <p>202 para. 11</p>	<p>contradict the representations made if the sample results suggest that the auditor's planning assumptions were in error, he should take appropriate action. For example, if monetary errors are discovered in a substantive test of details in amounts and frequency that is greater than is consistent with the degree of reliance initially placed on internal accounting control, the auditor should alter his preliminary evaluation of the internal accounting control system SAS 39 para. 28</p> <p>A conceptually logical approach to the auditor's evaluation of accounting control, which focuses directly on the purpose of preventing or detecting material errors and irregularities in financial statements, is to apply the following steps in considering each significant class of transactions and related assets involved in the audit:</p> <p>a) Consider the types of errors and irregularities that could occur,</p> <p>b) Determine the accounting control procedures that should prevent or detect such errors and irregularities.</p> <p>c) Determine whether necessary procedures are prescribed and are being followed satisfactorily.</p> <p>d) Evaluate any weaknesses . . .</p> <p>AU 320.65</p>	<p>The examination of internal control is best performed during interim audits before the end of the financial year; care should be taken to ensure that possible changes in the internal control system between the date of the interim audit and the financial year end are also subject to audit.</p> <p>Statement 1/1977 Section VI Note 1</p>

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<p>the relevant procedures, application controls and general controls had operated throughout the period for which reliance on the system is being placed.</p>	<p>The evaluation of internal controls will be assisted by the use of documentation designed to help identify the internal controls on which the auditor may wish to place reliance. Such documentation may take a variety of 2 forms but might be based on questions asking either:</p> <p>a) Whether controls exist which meet specified overall control objectives; or</p> <p>b) Whether there are controls which prevent or detect particular specified errors or omissions.</p> <p>204 para. 12</p> <p>If reliance is to be placed on the operation of controls, the auditor should ensure that there is evidence of the effectiveness of those controls throughout the whole period under review.</p> <p>204 para. 17</p>	<p>Since EDP accounting control procedures relate to all EDP activities (general controls and some relate to a specific accounting task such as preparation of account listing or payrolls (application controls).</p> <p>AU 321.06</p> <p>Weaknesses in general controls often have pervasive effects. When general controls are weak or absent, the auditor should consider the effect of such weakness or absence in the evaluation of application controls.</p> <p>AU 321.07</p> <p>The auditor's overall evaluation of controls for a particular purpose involves combining judgements about the prescribed controls, the sample results of compliance tests, and the results of observation and inquiry about controls not leaving an audit trail of documentary evidence.</p> <p>SAS 39 para. 32</p> <p>Evaluation of EDP aspects of a system of accounting control is not different conceptually from the evaluation of other aspects of the system . . .</p> <p>AU 321.31</p> <p>The auditor should consider the following factors when planning and performing analytical review procedures:</p>	
<p>14. The auditor should relate the persuasiveness of the evidence provided by the results of analytical review procedures, to:</p>			

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<p>i) The reliability of the relationship used to substantiate the financial statement figure under examination.</p> <p>ii) The validity of the data used, on the basis of the identified relationship, to substantiate the financial statement figure.</p> <p>iii) The differences that appear to be unusual which have been identified by analytical review procedures together with the persuasiveness of the explanation for any significant difference.</p>	<p>These (Analytical Review) procedures include studying significant ratios, trends and other statistics and investigating any unusual or unexpected variations. The precise nature of these procedures and the manner in which they are documented will depend on the circumstances of each audit.</p> <p>203 para. 11</p> <p>The comparisons which can be made will depend on the nature, assessability and relevance of the data available. Once the auditor has decided on the comparisons which he intends to make in performing his analytical review, he should determine what variations he expects to be disclosed by them.</p> <p>203 para. 12</p> <p>Unusual or unexpected variations, and expected variations which fail to occur, should be investigated. Explanations obtained should be verified and evaluated by the auditor to determine whether they are consistent with his understanding of the business and his general knowledge.</p> <p>203 para. 13</p>	<p>a) the nature of the entity</p> <p>b) The scope of the engagement . . .</p> <p>c) The availability of financial information about the entity's financial position and results of operations</p> <p>d) The availability of relevant nonfinancial information</p> <p>e) The reliability of financial and nonfinancial information.</p> <p>f) The availability and comparability of financial information regarding the industry in which the entity operates</p> <p>SAS 23 para. 7</p> <p>The auditor should investigate fluctuations that are not expected, the absence of fluctuations that are expected and other items that appear to be unusual When investigating such significant fluctuations, the auditor ordinarily would begin by making suitable enquiries of management If management is unable to provide an acceptable explanation of significant fluctuations, the auditor should perform additional procedures to investigate those fluctuations further.</p> <p>SAS 23 para. 9</p>	

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<p>15. The auditor should relate the persuasiveness of the evidence provided by the results of a substantive test of details of transactions and balances or compliance tests conducted on a sampling basis to:</p> <ul style="list-style-type: none"> i) The size and design of the sample ii) The method of selection of the sample iii) The nature and frequency of the errors or exceptions found in the sample iv) The reliability of the evidence obtained with respect to individual items in the sample. <p>When errors or exceptions are found in the sample, the circumstances in which the errors or exceptions occur must be investigated and their possible effect on conclusions drawn elsewhere in the audit, assessed.</p>		<p>The sufficiency of evidential matter is related to the design and size of an audit sample, among other factors.</p> <p>SAS 39 para. 5</p> <p>In a strict sense, the sample evaluation relates only to the likelihood that existing monetary errors or deviations from prescribed procedures are proportionately included in the sample, not to the auditor's treatment of such items. Thus the choice of nonstatistical or statistical sampling does not directly affect the auditor's decisions about the auditing procedures to be applied, the competence of the evidential matter obtained with respect to individual items in the sample sampling does not directly affect the auditor's decisions about the auditing procedures to be applied, the competence of the evidential matter obtained with respect to individual items in the sample</p> <p>SAS 39 para. 6</p> <p>In addition to the evaluation of the frequency and amounts of monetary misstatements, consideration should be given to the qualitative aspects of errors.</p> <p>SAS 39 para. 27</p> <p>The sample results suggest that the auditor's planning assumptions were in error, he should take appropriate action.</p>	<p>In sampling specific audit areas the auditor may, where appropriate, use statistical methods.</p> <p>Statement 1/1977 Section V Note 5</p>

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<p>16. When the conduct of a substantive test or any other audit procedure involves reliance on the evidence of third parties, including specialist, the auditor should relate the persuasiveness of the third party evidence to:</p> <p>i) The form which the evidence takes (oral or written)</p> <p>ii) If known, the objectives and scope of the third party's work in producing the report which is to be used as audit evidence.</p> <p>iii) The degree of detailed explanation produced by the third</p>	<p>Although the reliability of audit evidence is dependent upon the particular circumstances, the following general presumptions may be found helpful:</p> <p>a) Documentary evidence is more reliable than oral evidence;</p> <p>b) Evidence obtained from independent sources outside the enterprise is more reliable than that secured solely from within the enterprise;</p> <p>203 para. 6</p> <p>The extent to which the external auditor is able to take account of</p>	<p>SAS 39 para. 28</p> <p>In addition to the evaluation of the frequency of deviations from pertinent procedures, consideration should be given to the qualitative aspects of the deviations.</p> <p>SAS 39 para. 41</p> <p>Sample items should be selected in such a way that the sample can be expected to be representative of the population . . . ideally the auditor should use a selection method that has the potential for selecting items from the entire period under audit.</p> <p>SAS 39 para. 38</p> <p>When evidential matter can be obtained from independent sources outside an enterprise, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the enterprise.</p> <p>AU 330.08</p> <p>An understanding should exist among the auditor, the client and the specialist as to the nature of the work to be performed by the specialist. Preferably the understanding should be documented and should cover the following:</p> <p>a) The objectives and scope of the</p>	<p>The results of work performed by other parties or experts which are of relevance to the financial statements of the enterprise under audit should also generally be reviewed but should always be subject to a critical evaluation by the auditor.</p> <p>Statement 1/1977 Section VIII Note 4</p> <p>This obligation does not preclude the auditor from accepting the audit results and other work of other audit institutions or other parties on his own responsibility. To what extent and at what level their conclusions may be used depends on the competence and professional qualification of the institutions in question according to</p>

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6.4 AUDIT EVIDENCE STANDARD: COMPARISON OF REQUIREMENTS

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<p>party and the ability of the auditor to understand and assess the reasonableness of the methods and assumptions used.</p> <p>iv) The extent to which the third party might reasonably be expected to have knowledge of the matters which are the subject of his report. This includes an assessment of the expertise and, if relevant, professional qualifications of the third party.</p> <p>v) The independence of the third party from the enterprise.</p>	<p>the work of the internal auditor will depend on his assessment of the effectiveness of the internal audit function. In making this assessment, the external auditor will be concerned with:</p> <p>a) The degree of independence of the internal auditor from those whose responsibilities he is reviewing;</p> <p>b) The number of suitably qualified and experienced staff employed in the internal audit function;</p> <p>c) The scope, extent, direction and timing of the tests made by the internal auditor;</p> <p>d) The evidence available of the work done by the internal auditor and of the review of that work;</p> <p>e) The extent to which management takes action based upon the reports of the internal audit function.</p> <p>204 para. 19</p>	<p>specialist's work.</p> <p>b) The specialist's representations as to his relationship, if any, to the client.</p> <p>c) The methods of assumptions to be used.</p> <p>d) A comparison of the methods or assumptions to be used with those used in the preceding period.</p> <p>e) The specialist's understanding of the auditor's corroborative use of the specialist's findings in relation to the representations in the financial statements.</p> <p>f) The form and content of the specialist's report that would enable the auditor to make the evaluation described in</p> <p>AU 336.07</p> <p>Although the appropriateness and reasonableness of methods or assumptions used and their application are the responsibility of the specialist, the auditor should obtain an understanding of the methods of assumptions used by the specialist to determine whether the findings are suitable for corroborating the representations in the financial statements.</p> <p>AU 336.08</p>	<p>the principles of independence, conscientiousness, impartiality, absence of bias and sole responsibility valid for the auditor.</p> <p>Statement 1/1977 Section VIII</p> <p>The auditor should take note of examinations performed by internal audit departments of the enterprise or group. They may be taken into account in determining audit scope but cannot replace his own audit and conclusions.</p> <p>Statement 1/1977 Section VIII Note 3</p>

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6.4 AUDIT EVIDENCE STANDARD: COMPARISON OF REQUIREMENTS

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<p>17. If after evaluation the persuasiveness of all the evidence obtained in support of any conclusion, the auditor is of the opinion that insufficient evidence has been obtained, he should conduct further audit work. Where the failure to obtain sufficient assurance is the results of errors or exceptions being found during substantive or compliance testing the auditor should examine the reasons for the occurrence of the errors or exceptions and these reasons should influence the nature and extent of the further work.</p>	<p>If the compliance tests have disclosed exceptions which indicate that the control being tested was not operating properly in practice, the auditor should determine the reasons for this. He needs to assess whether each exception is only an isolated departure or is representative of others, and whether it indicates the possible existence of errors in the accounting records. If the explanation he receives suggest that the exception is only an isolated departure, then he must confirm the validity of the explanation, for example, by carrying out further tests. If the explanation or the further tests confirm that the control being tested was not operating properly throughout the period, then he cannot rely on that control. In these circumstances the auditor is unable to restrict his substantive testing.</p> <p>204 para. 16</p>	<p>An addition to the evaluation of the frequency and amounts of monetary misstatements, consideration should be given to the qualitative aspects of errors. These include (a) the nature and cause of misstatements, such as whether they are differences in principle or in application, are errors or irregularities, or are due to misunderstanding of instructions or to carelessness, and (b) that possible relationship of misstatements to other phases of the audit. The discovery of an irregularity ordinarily requires a broader consideration of possible implications than does the discovery of an error.</p> <p>SAS 39 para. 27</p> <p>....consideration should be given to the qualitative aspects of the deviations. These include (a) the nature and cause of the deviations, such as whether they are errors or irregularities or are due to misunderstanding of instructions or to ...</p>	
<p>18. <u>General</u></p> <p>Where sufficient audit evidence from the sources listed in paragraph 3032 is not and could not reasonably be expected to be available in respect of any material matter, the auditor should obtain the written representations of management concerning the matter in question. Such matters will mainly be</p>	<p>Oral representations will be made throughout the audit in response to specific enquiries. Whilst management representations constitute valid audit evidence, the auditor should not, in respect of any significant aspect of the audit, rely solely on unsupported oral representations of management as being sufficient reliable evidence. Most representations</p>	<p>During the examination, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures</p>	<p>The auditor must obtain a representation letter from the enterprise being audited; it does not replace any audit procedures.</p> <p>Statement 1/1977 Section IX</p> <p>The representation letter is a comprehensive assurance by the Board of Management concerning the completeness</p>

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<p>those affecting judgement and opinion or matters of fact where knowledge is confined to management. After written management representations have been obtained, the auditor must consider whether those representations together with such other audit evidence as he has obtained, are sufficient to enable him to form a conclusion on the matter in question.</p> <p>19. When, and only when, after performing further audit work and, if appropriate, obtaining the representations of management, the auditor is of the opinion that either sufficient evidence does not exist or is impractical to obtain regarding a material matter, then the auditor must qualify his opinion on the grounds of uncertainty in accordance with the reporting standard.</p>	<p>can be corroborated by checking with sources independent of the enterprise or by checking with evidence generated by the auditor. Where adequate corroboration is not and could not reasonably be expected to be available, the auditor should ensure that there is no other evidence which conflicts with the representations made by management and that the representations are confirmed in writing. Such written representations should be confined to matters which are material to the financial statements and which are mainly considerations affecting judgement and opinion. Matters of fact can also be included, however, where they are material and where knowledge of the fact is confirmed to management.</p> <p>ED para. 2</p> <p>Having obtained written representations, the auditor must still decide whether in the circumstances, these representations, together with such other audit evidence as he has obtained, are sufficient to enable him to form an unqualified opinion on the financial statements.</p> <p>ED para. 3</p>	<p>necessary to afford a reasonable basis for his opinion on the financial statements</p> <p>SAS 19 para. 2</p> <p>The auditor obtains written representations from management relating to its knowledge or intent when he believes they are necessary to complement his other auditing procedures</p> <p>SAS 19 para. 3</p>	<p>of information and documentation given to the auditor. It also represents whether all transactions have been recorded and whether the balance sheet reflects all the assets, commitments and risks which have to be accounted for.</p> <p>Statement 1/1977 Section IX Note 1</p>

7. STANDARD OF AUDIT REPORTS

7. STANDARD OF AUDIT REPORTS

7.1 EXPLANATORY FORWARD

← Forward

7.1.1 INTRODUCTION

The audit report is the visible and legible method available to the auditor to express his opinion on the quality of the financial statements in accordance with the terms of the audit engagement - usually by recording his opinion as to whether such statements give a fair view in accordance with generally accepted accounting standards appropriate to the circumstances of the business and comply with relevant legal requirements. The audit report should be explicit and should define the scope of audit engagement.

(para 3501)

7.1.2 OBJECTIVE

It should be the objective of the auditor for the meaning of the audit report to be fully understood by those concerned in its preparation, by those who are to read it and most importantly, by those who are likely to rely upon it. All audit reports must be sufficiently clear and comprehensive as to leave the reasonably competent reader of the report in no doubt as to the implications of the content of the report.

In order to achieve such an objective, it is important that all auditors attribute the same meanings to the words in the report, particularly in the case of the unqualified report. The auditor who expresses reservations arising from audit scope deficiencies, accounting deficiencies, uncertainties or non-compliance with

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relevant legal requirements or the enterprise articles of association is able to state his reasons and perhaps quantify the effects or possible effects on the financial statements. The reasonably competent reader of the financial statements should be able to recognize immediately whether the auditor wishes to bring the readers' notice any such reservations.

The auditor should not expect the reasonably competent reader of financial statements to be made aware of the essential features of the audit report by using 'reporting by exception', e.g., reporting only non-compliance with generally accepted accounting standards or relevant legal requirements. The auditor should instead make a positive statement about the essential features of his report such as:

- i) The scope of his audit
- ii) Any reservations which in his opinion have material effects or possible material effects on the financial statements.
- iii) The basis for the audit opinion being reasonable, not absolute, assurance.
- iv) The nature of the opinion, be it unqualified, qualified, adverse or a disclaimer of opinion.
- v) The subject matter of the opinion.
- vi) Any matters to which the auditor wishes to draw the particular attention to the reader.

By making positive statements on these matters using consistent language, the auditor should achieve the objective of audit reporting as expressed above. (para 3502)

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7.1.3 SCOPE AND NATURE OF THE AUDIT ENGAGEMENT

- 7.1.3.1 The readers of the financial statements and the audit report should be made aware of the nature and scope of the audit engagement. The reader should be informed whether the audit has been performed in accordance with the Auditing Standards or whether any restrictions have been applied to the scope of the audit.

Audit scope restrictions may be imposed by the enterprise or may arise from circumstances such as inadequacies in the accounting records, or the timing of the audit work.

Whenever such restrictions have a material effect on the auditor's ability to form an opinion, the auditor should inform the reader in the scope paragraph that the scope of the audit has been limited, express his reservations and amend his opinion as appropriate. The auditor should leave the reader in no doubt as to the financial statements upon which he is reporting. Unless the auditor identifies the financial statement, to which the audit relates, the reader may consider that the auditor is expressing an opinion on all the information presented.

(para 3503)

- 7.1.3.2 The Saudi Company Law states (article 123) that the responsibility for the preparation of the financial statements is that of the enterprise rather than the auditor. However, many of the readers of the financial statements do not appreciate this point unless it is made clear.

(para 3504)

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- 7.1.3.3 Under the requirements of the Saudi Company Law (Article 132) the auditor is required to make a positive statement to the effect that he has obtained all the particulars and explanations called for and accordingly, such a statement should be included in the scope paragraph of all audit reports.

7.1.4 EXPRESSION OF OPINION

The Saudi company law (article 132) states that the auditor must submit a report to the annual regular general meeting, setting forth the attitude of the company's management in enabling him to obtain the particulars and clarifications requested by him, any violations of the provision of these regulations or of the company's by-laws he may have discovered. The auditor is required in nearly all audit engagements to express his opinion as to whether the financial statements taken as a whole:

(para 3506)

- i) Give a fair view of the financial position at the period end, the results of the operations, changes in owners' equity and the sources and applications of funds for the accounting period, based upon the sufficient presentation and disclosure of information contained in the financial statements in accordance with generally accepted accounting standards, appropriate to the circumstances of the business.

(para 3507)

Normally, financial statements will almost always need to be prepared in accordance with generally accepted accounting standards in order to show a fair view. However, management when preparing the financial statements and the auditor when giving his opinion must always consider whether a fair view has been presented by the financial statements or whether an alternative accounting treatment or additional information

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is required. The auditor must be satisfied that the financial statements reflect the substance of transactions, events and circumstances affecting the financial position and changes in the financial position of the enterprise before he concludes that the financial statements give a fair view. He is also required to use his judgement in deciding whether the information disclosed in the financial statements is clear and comprehensible to the reasonably competent reader. (para 3508)

- ii) Comply with the relevant legal requirements. (para 3509)

7.1.4.1 UNQUALIFIED OPINION

When the auditor has no reservations, he should express an unqualified opinion. In this case, an unqualified audit report will normally consist of two paragraphs, as follows: (para 3510)

- i) Scope of the audit paragraph; and
- ii) Unqualified opinion paragraph

7.1.4.2 EMPHASIS OF MATTER

Sometimes, certain matters exist which have an impact on the understanding of the financial statements by competent readers, but they do not have a substantive effect on the presentation of such financial statements in a manner that would give a fair view of the financial position of the company or its legal commitments. The auditor would, therefore, add an "emphasis of matter" paragraph to draw the reader's attention to this fact. Following are some examples of such matters: (para 3511)

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i) CIRCUMSTANCES REQUIRING DEVIATION FROM GENERALLY ACCEPTED ACCOUNTING PRACTICES

The application of generally accepted accounting practices may, in scarce cases, render the financial statements as misleading to the readers. In such cases, the management of the enterprise must apply alternative standards which shall be acceptable to the auditor who shall be convinced that they are suitable to the circumstances of the enterprise. Sufficient disclosures should be stated to indicate that deviation and the reasons behind it. When the auditor is satisfied with that disclosure he must refer to the deviation in the "emphasis of matter" paragraph.

(para 3512)

ii) CHANGES IN ACCOUNTING POLICIES

When management changes an accounting policy, generally accepted accounting standards require that the new policy should be applied retroactively by restating the financial statements of all prior periods presented. In addition, generally accepted accounting standards require that certain information about the change should be disclosed in the financial statements. When management changes an accounting policy, the auditor should not modify his opinion because of the change as long as the change is accounted for and disclosed in accordance with the requirements of generally accepted accounting standards.

(para 3513)

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In certain cases, management of an enterprise might not be able to restate the financial statements of all or some of the prior periods presented because of the lack of the necessary data to effect the restatement. In those cases, generally accepted accounting standards require that an adjustment should be made to the opening balance of retained earnings of the current period, or such earlier period as appropriate, to reflect the cumulative effect of the change on prior periods. In addition, generally accepted accounting standards require that certain information about the change should be disclosed in the financial statements. In those cases, the auditor should not modify his opinion because of the change in the accounting policy so long as he is satisfied that the effect of the new policy is not reasonably determinable for individual prior periods. However, since in these cases prior period financial statements are not restated to conform with the new accounting policy, the auditor should call attention to this fact in a separate "emphasis of a matter" paragraph of his audit report. This emphasis of a matter is intended to alert the reader of the financial statements that the statements of the prior period(s) are not comparable with those of the current period due to the change in an accounting policy. Such emphasis of a matter is not a qualification of the auditor's opinion.

(para 3514)

7.1.4.3 RESERVATIONS

If the auditor cannot express an unqualified opinion on the financial statements taken as a whole, the reasonable

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reader of the audit report should be in no doubt about the nature of the auditor's reservations if he considers the effect to be material. It is important that the auditor should use both a consistent format and consistent language if this objective is to be achieved. The circumstances requiring the auditor to express less than an unqualified opinion or to disclaim an opinion arise from the following: (para 3515)

i) AUDIT SCOPE DEFICIENCIES

- 1) Audit scope deficiencies arise when the auditor is is not able to apply certain auditing procedures he considers necessary in the circumstances and is not able to satisfy himself by other means. Audit scope deficiencies may arise because of restrictions imposed by the client or because of circumstances such as, the timing of the audit, the inability to obtain sufficient, relevant and reliable evidential matter or an inadequacy in the accounting records. It should be emphasized that the inability of the auditor to perform some specific auditing procedures does not constitute an audit scope deficiency if he is able to obtain the necessary evidence by performing alternative procedures.

Audit scope deficiencies which cover material financial statement items affect the auditor's ability to establish a reasonable basis for the expression of an opinion on the financial statements. When audit scope deficiencies exist, the auditor would not be able to determine whether the financial statements should be adjusted or in what

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amount. In these cases, the auditor's reporting objective is to inform the reader that he has been unable to perform specific auditing procedures and obtain certain audit evidence; accordingly, there might be some adjustments that need to be made to the financial statements.

(para 3516)

- 2) When audit scope deficiencies cover material financial statement items the auditor should qualify his opinion or disclaim an opinion on the financial statements taken as a whole. In such instances, the reason (s) for the auditor's qualification of his opinion or disclaimer of an opinion should be clearly described in his report.

(para 3517)

The auditor's decision to qualify his opinion or to disclaim an opinion because of audit scope deficiencies should be based on his assessment of the impact of any possible adjustments on the view given by the financial statements taken as a whole. The auditor should qualify his opinion if he concludes that any possible adjustments would not impair the overall view given by the financial statements, and in turn, would not impair the overall usefulness of the financial statements to the reader. Usually, the auditor would reach this conclusion if:

- i) The effects of any possible adjustments, can be isolated, identified and described clearly so that the users of the financial

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statements can easily assess their impact;
and

- ii) The magnitude of any possible adjustments is not so material that it overshadows a clear description of how the financial statements might be affected.
(para 3518)

When expressing a qualified opinion because of audit scope deficiencies, the auditor is indicating to the reader that except for the effects of any adjustments that might be necessary to a portion of the financial statements as presented, he is expressing a positive opinion on the financial statements taken as a whole.

The auditor should disclaim an opinion on the financial statements taken as a whole if he concludes that the effects of any possible adjustments are so pervasive or their magnitude is so material that he has no basis to express an opinion on the financial statements taken as a whole.

(para 3519)

ii) ACCOUNTING DEFICIENCIES

- 1. Accounting deficiencies arise when there is an inappropriate accounting treatment; an inappropriate valuation of an item in the financial statements; a failure to disclose information necessary for a fair view or a failure to present information

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in an appropriate manner. Accounting deficiencies, therefore, refer to misstatements in the financial statements and/or omitted or erroneous disclosures. In any of these circumstances, the auditor's reporting objective is to clearly inform the reader of material accounting deficiencies that affect the financial statements.

(para 3520)

In determining whether a reservation is necessary because of an accounting deficiency, the auditor will consider the materiality of the effects of the deficiency on the financial statements. The auditor needs to judge the materiality of the matter in relation to the reasonable prospect of its significance in the making of decisions by the users of the financial statements.

(para 3521)

2. When, in the auditor's opinion, the financial statements are materially affected by an accounting deficiency, the auditor should clearly state to the competent reader the substantive reasons for such deficiency. This should be clearly described in his report in either one of the following two alternatives:

- a) Express a qualified opinion, or
- b) Express an adverse opinion

(para 3522)

The auditor's decision to qualify his opinion or to express an adverse opinion because of a material

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accounting deficiency depends on his assessment of its effects on the fair view given by the financial statements taken as a whole.

The auditor should express a qualified opinion, if based on his assessment of the effects of material accounting deficiencies on the financial statements, he concludes that:

- i) They can be clearly described so that the users are in a position to assess their effects on the statements when read in conjunction with the audit report; and
- ii) Their magnitude is not so material that it overshadows a clear description of how the statements are affected.

In so doing, the auditor is indicating to the users of the financial statements that except for the effects of the accounting deficiencies the financial statements taken as a whole give a fair view.

The auditor should express an adverse opinion, if based on his assessment of the effects of material accounting deficiencies on the financial statements, he concludes that their effects are such that the statements are misleading or virtually useless to the users even when read in conjunction with the audit report. The financial statements would normally be considered misleading or virtually useless to the users when:

(para 3523)

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- i) The effects of material accounting deficiencies are so pervasive that the auditor would not be able to describe clearly how the statements are affected; or
- ii) The magnitude of the accounting deficiencies is so material that it overshadows a clear description of how the statements are affected.

(para 3524)

iii) UNCERTAINTIES

- 1. Uncertainties relate to a condition or a set of conditions involving the future outcome of matters that may affect the financial statements which is not susceptible of reasonable estimation. When uncertainties exist, it can not be determined by either the management of the enterprise and/or its auditor whether the financial statements should be adjusted, or in what amounts. In order to achieve the objective of clear communication of the auditor's substantive reasons for his reservations, the auditor must differentiate between Uncertainties and his disagreements, if any, with management estimates of the future outcome of matters that are susceptible of reasonable estimation; and Uncertainties and audit scope deficiencies.

(para 3525)

a) UNCERTAINTIES AND REASONS OF RESERVATION

- 1. Uncertainties must be differentiated from auditor's disagreement with management

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estimates of the future outcome of matters which is susceptible of reasonable estimations. An enterprise is a continuous stream of activities. The process of breaking this stream of activities into periodic segments so that financial statements can be prepared at the end of each segment requires management to estimate the outcome of future events. Estimates by management of the future outcome of matters such as the useful lives of assets that are expected to benefit the current as well as future periods, the collectibility of accounts receivable and the probability that a contingent loss may be confirmed by one or more future event(s) are necessary. In most cases, the auditor should be able to satisfy himself regarding the reasonableness of management's estimates by considering various types of audit evidence. If the auditor, on the basis of evidence available to him, is in disagreement with management's estimates, and if the effects on the financial statements are material, the auditor is faced with accounting deficiencies not uncertainties.

(para 3526)

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b) AUDIT SCOPE DEFICIENCIES

2. Uncertainties should also be differentiated from audit scope deficiencies even though their effects on the auditor's report is substantially similar. In the case of audit scope deficiencies, the auditor is not able, to determine whether the financial statements should be adjusted or in what amount because he is not able to obtain audit evidence that exist or should have existed at the present time to substantiate the matters under consideration. In the case of uncertainties, the auditor is not able to determine whether the financial statements should be adjusted or in what amount because no evidence is available at the present time to substantiate the matters under consideration. The evidence necessary to substantiate the matters under consideration will be available at some point in the future.
(para 3527)

3. LOSS CONTINGENCIES:

Uncertainties should not be confused with loss contingencies that have been accrued by management because, based on information available at the date of the financial statements, they are considered probable and their

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amounts are susceptible of reasonable estimation. Uncertainties refer only to matters that may affect the financial statements which cannot be resolved until the outcome of some future events is known. Accordingly management can only explain the nature of the unresolved matters in the notes to the financial statements.

(para 3528)

B) UNCERTAINTIES VS THE GOING CONCERN

1. UNCERTAINTIES NOT RELATED TO THE GOING CONCERN:

- a) Some uncertainties relate to specific matters whose possible effects on the financial statements, although material, can be isolated and their magnitude is not such that it raises doubt about the ability of the enterprise to continue should an adverse outcome be confirmed in the future. Examples are the likelihood that a material amount will be payable or collectible by the enterprise because of litigation or the likelihood that a material amount will be collected because of disputed adjustments to the amount of the operating subsidy that the enterprise has applied for. These types of uncertainties are referred to as uncertainties not relating to a going concern.

(para 3529)

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b) EFFECT OF UNCERTAINTIES NOT RELATED TO THE GOING CONCERN ON THE AUDITOR'S OPINION

When an uncertainty not relating to a going concern which might have material effects on the financial statements exist, the auditor should qualify his opinion or disclaim an opinion on the financial statements taken as a whole. The auditor's report should clearly describe all the substantive reasons for his qualification or disclaimer of an opinion.

The auditor's decision to qualify or to disclaim an opinion because of a material uncertainty depends on his assessment of the effects of any possible adjustments that might have been determined had the ultimate outcome of the uncertainty been known.

The auditor should qualify his opinion if he concludes, based on his assessment that any possible adjustments to the financial statements, although material, would not impair the overall view given by the financial statements, and in turn, would not impair the overall usefulness of the financial statements. Usually the auditor would reach this conclusion if:

- i) The effects of any possible adjustments can be isolated, identified and described clearly so that the users of the financial statements can easily assess their impact; and

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- ii) The magnitude of any possible adjustments is not so material that it overshadows a clear description of how the financial statements might be affected.

The auditor should disclaim an opinion on the financial statements taken as a whole because of an uncertainty if he concludes, that the effects of any possible adjustments are so pervasive or their magnitude is so material that he has no basis to express an opinion on the financial statements taken as a whole.

(para 3530)

2. UNCERTAINTIES RELATING TO THE GOING CONCERN:

Other uncertainties relate to matters whose possible effects on the financial statements can not be isolated. Examples of uncertainties of this type are recurring operating losses; serious deficiencies in working capital; an inability to obtain financing sufficient for continued operations; an inability to comply with terms of existing loan agreements; insufficient funds to meet liabilities; and external factors which could force an otherwise solvent enterprise to cease operations. Such conditions individually or collectively may cast doubt about the ability of the enterprise to continue as a going concern.

(para 3531)

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An assumption underlying generally accepted accounting standards is that the enterprise will be able to realize the recorded amounts of its assets and discharge its liabilities in the normal course of business for the foreseeable future. This is referred to as the "going concern" assumption.

C) EFFECT OF UNCERTAINTIES RELATING TO THE GOING CONCERN ON THE AUDITOR'S OPINION

When uncertainties cast doubt about the ability of the enterprise to continue as a going concern, the auditor would be concerned with whether the accounting standards used to prepare the financial statements are appropriate in view of the possible invalidity of the going concern assumption. When the auditor has substantial doubts about the ability of the enterprise to continue as a going concern, he should disclaim an opinion on the financial statements taken as a whole. In this case, he should clearly describe in his report all of the substantive reasons for his disclaimer.

(para 3532)

D) COMPLIANCE DEFICIENCIES WITH REGARD TO RELEVANT LEGAL REQUIREMENTS AND/OR ARTICLES OF ASSOCIATION

The Audit Reports Standard requires the auditor to give, in addition to his fair view opinion, an opinion that the financial statements, taken as a whole, comply with the requirements of the Company Law and the Articles of Association of the company with regard to the preparation and presentation of financial statements.

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Noncompliance with the requirements of the Company Law and/or the Articles of Association of the Enterprise with regard to the preparation and presentation of the financial statements requires the auditor to qualify his opinion. In such instances, the reason(s) for the auditor's qualification of his opinion with regard to compliance with the requirements of the Company Law and/or the Articles of Association of the Enterprise that relate to the preparation and presentation of financial statements should be clearly described in his report.

(para 3533)

E) EXPRESSING RESERVATIONS IN THE AUDITOR'S REPORT

If the auditor can not express an unqualified opinion, the reasonable reader of the auditor's report should be in no doubt about the nature of and the reasons for the reservations that caused the auditor to express less than an unqualified opinion. Accordingly, the disclosure of the auditor's reservations in a separate reservation paragraph is required to achieve the objective of unambiguous communication with the reader of the auditor's report. The use of a separate reservation paragraph between the scope of auditor and opinion paragraphs is an effective way of alerting the reader to the fact that there is a reservation of opinion and focussing the reader's attention on the substance of the reservation(s). Changes to the opinion paragraph because of reservations can then be limited to appropriate wording to modify the opinion and to reference to the reservation paragraph. If the reservation results from audit scope deficiencies,

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the change in the scope paragraph can be limited to a reference to the reservation paragraph.

(para 3534)

The separate reservation paragraph should clearly describe all of the substantive reasons for the auditor's qualified opinion, disclaimer of an opinion or adverse opinion. Such description should include the following:

- i) All of the auditor's reservations;
- ii) An adequate explanation of the reasons for each reservation; and
- iii) A clear indication of how and, when reasonably determinable, to what extent the financial statements:
 - a) Are affected by accounting deficiencies; or
 - b) May be affected by possible adjustments that might have been determined had the auditor been able to perform all the procedures he considers necessary in the circumstances; or
 - c) May be affected by possible adjustments that might have been determined had the future outcome of uncertainties been known;or
 - d) May be affected by possible adjustments that might have been determined had the future

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outcome of uncertainties about the ability of the enterprise to continue been known;

or

- e) Are affected by noncompliance with the requirements of the Company Law or the Articles of Association of the company with regard to the preparation and presentation of financial statements.

(para 3535)

F) QUALIFYING LANGUAGE

1. QUALIFIED OPINION LANGUAGES

As explained (in paragraph 8-1-2, it is important that all auditors use consistent language to describe the same types of qualifications. Accordingly, a qualified opinion should include one of the two following qualifying phrases as appropriate:

Reason for Qualification	Appropriate Qualifying Phrase
Audit scope deficiencies	Except for
Accounting deficiencies	Except for
Noncompliance with Company Law or Articles of Association requirements	Except for
Uncertainties	Subject to

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It should be emphasized that the auditor qualifies his opinion because he believes that the financial statements are deficient or might be deficient in some material respects. Accordingly, the wording in the qualified opinion paragraph should always base the qualification on the deficiencies or possible deficiencies in the financial statements.

When an auditor qualifies his opinion because of an audit scope deficiency, the wording in the qualified opinion paragraph should indicate that the qualification pertains to the effects on the financial statements of any adjustments that the auditor might have determined to be necessary had there been no limitations on the scope of the audit. The auditor should not use wording which bases the qualification on his own uncertainty.

When an auditor qualifies his opinion because of an accounting deficiency, the wording in the opinion paragraph should indicate that the qualification pertains to the effects of the accounting deficiency, on the financial statements. The auditor should not use wording which bases the qualification on his disagreement with the accounting policy that caused the deficiency.

When an auditor qualifies his opinion because of uncertainties, the wording in the opinion paragraph should indicate that the qualification pertains to the possible effects on the financial statements of the ultimate resolution of the uncertainties. The auditor should not use wording which bases the qualification on his own uncertainty.

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When an auditor qualifies his opinion with regard to compliance with the Company Law and the Articles of Association of the Enterprise, the wording in the opinion paragraph should indicate that the qualification pertains to the noncompliance with the law and/or the enterprise's articles of association. (para 3536)

2. ADVERSE OPINION LANGUAGE

An auditor should express an adverse opinion when he has gathered sufficient evidence to give him reasonable assurance that because of the effects of material accounting deficiencies the financial statements, taken as a whole, do not give a fair view of the financial position, results of operations, changes in owners' equity and sources and applications of funds. When an auditor expresses an adverse opinion, the wording in the adverse opinion paragraph should indicate that the adverse opinion pertains to the material effects of the accounting deficiencies on the financial statements. (See discussion paragraph 113 with respect to qualifying language.) The auditor should not use wording which bases his adverse opinion on his own disagreement with the financial statements as presented.

It should be emphasized that the auditor's adverse opinion covers both the view given by the financial statements and compliance with the requirements of the Company Law and the Articles of Association of the Enterprise with respect to the preparation and presentation of financial statements. (para 3537)

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3. DISCLAIMER OF AN OPINION LANGUAGE

An auditor needs to disclaim an opinion when audit scope deficiencies or uncertainties, including those that raise substantial doubt about the ability of the enterprise to continue as a going concern, cause him to be unable to obtain reasonable assurance to express an opinion on the financial statements taken as a whole.

It should be emphasized that a disclaimer of an opinion is not appropriate when the auditor has reasonable assurance, based on an examination in accordance with auditing standards, that the financial statements taken as a whole do not give a fair view.

When an auditor is disclaiming an opinion on the financial statements the wording in the disclaimer of an opinion paragraph should indicate that the disclaimer pertains to the possible material effects which might have been determined had the auditor been able to perform all of the auditing procedures necessary in the circumstances or had the outcome of the uncertainties been known. The auditor should not use wording in the disclaimer of an opinion paragraph which bases the disclaimer on his own uncertainties. (See discussion in paragraph No. 113 with respect to qualifying language).

It should be emphasized that the auditor's disclaimer of an opinion covers both the view given by the financial statements and compliance with the

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requirements of the company law and the articles of association of the Enterprise with respect to the preparation and presentation of financial statements.

If the auditor concludes on the basis of facts known to him that the financial statements on which he is disclaiming an opinion are affected by accounting deficiencies, he should describe specifically the nature of the matter, and if practicable, state the effects on the financial statements or include the necessary information for adequate disclosure in his reservation paragraph.

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FRAMEWORK FOR EXPRESSING RESERVATIONS IN THE AUDITOR'S REPORT

FRAMEWORK FOR EXPRESSING FAIR VIEW RESERVATIONS IN THE AUDITOR'S REPORT

Cause of Reservation	Type of Reservation	Audit Report Paragraphs Affected	Degree of Reservation	Type of Audit opinion
Audit scope deficiencies	Possible adjustments to the financial statements	Scope + Reservation + Opinion	Material	Qualified "Except for"
			Pervasive or so material that there is no basis for an opinion	Disclaimer
Accounting deficiencies	Mis-statements; omitted or erroneous disclosures	Reservation + Opinion	Material	Qualified "Except for"
			Pervasive or so material that the financial statements taken as a whole are mis-leading.	Adverse
Uncertainties relating to a going concern	Possible adjustments to the financial statements	Reservation + Opinion	Material	Qualified "Subject to"
			Pervasive or so material that there is no basis for an opinion	Disclaimer
Uncertainties relating to a going concern	Possible adjustments to the financial statements	Reservation + Opinion	Substantial doubt about the enterprise to continue as a going concern.	Disclaimer
Compliance Deficiencies	Noncompliance with relevant requirements of the Company Law and/or Articles of Association	Reservation + Opinion	Not relevant	Qualified "Except for"

7.2 COMMENTARY

7.2.1 INTRODUCTION

The means by which the auditor communicates the nature of his opinion is the audit report. In addition to statutory requirements, most of the self-regulatory institutes controlling qualified auditors have now issued their own standards on audit reporting. In drafting the reporting standard for Saudi Arabia, we have considered the current provisions of the Kingdom's company law together with the Reporting Standards of North America, and Company Law of the United Kingdom and Germany.

Appendix to the Commentary sets out the audit reports as recommended in the U.S.A., Germany and the U.K. for those circumstances where the auditor is able to issue an "unqualified" report, i.e., state that in his opinion the requirements relating to the financial statements under audit have been met. It can be seen that much of the content of the report is standard to all countries even if the procedures for reporting do differ.

(para 3608)*

7.2.2 The common features can be classified as follows:

- i) Identification of addressee
- ii) Identification of financial statements to which audit report relates.
- iii) Identification of standards governing the audit and procedures adopted by auditor.
- iv) Statement that adequate information and explanations have been received. (para 3609)

*Missing paragraphs are those concerned with the text of the standard that have been stated in the introduction of the book.

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SUBJECT MATTER OF OPINION

- i) View presented by financial statements
- ii) Compliance with generally accepted accounting principles.
- iii) Consistency of application of generally accepted accounting principles.
- iv) Compliance with appropriate legislation and the rules of the enterprise.

(para 3610)

In Appendix 2 to this Commentary, the audit reporting standards of the U.S.A., U.K. and Germany and the existing company law of the Kingdom are compared with regard to these common features.

(Para 3611)

We also considered that we should review any suggestions that have been made for improving the audit report. Accordingly, Appendix 3 to this Commentary, summarizes proposals for modifications of the standard report made by the Accountants International Study Group in 1969 and the AICPA Auditing Standards Executive Committee (1965-1972). It is significant that the Chairman of latter group stated "there is sufficient evidence to indicate that the present form of report . . . is not really understandable" and suggested the need for clarification of the meaning of fairness, generally accepted accounting principles, financial statements, examination, etc.

In this commentary, we have attempted to cover many of the proposals identified by these two groups. Apart from the more detailed matters considered in the commentary, there are general features identified:

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- i) Reporting by exception
- ii) Disclosure of fundamental accounting concepts
- iii) The auditor's responsibility for fraud and irregularities

(para 3612)

The disclosure of the fundamental accounting concepts should be considered as part of the accounting standard relating to the requirements for presentation and disclosure in the same way as the disclosure of significant accounting policies.

(para 3613)

Although we are sympathetic with the attitude which argues that a statement should be included in the scope paragraph of the audit report as to the auditor's responsibility for fraud, but find it very difficult to express the approach in the audit report in natural language which can be understood by the reasonably competent reader without considerably enlarging the terms of the audit engagement.

(para 3614)

With regard to reporting by exception, company law often requires the auditor to report if there has not been compliance with certain requirements. For example, an unqualified report in the U.K. indicates to the reader that the auditor is of the opinion that proper accounting records have been kept and that the accounts as presented agree with the accounting records. Similarly Article 132 of the Saudi Company Law requires the auditor to submit to the ordinary general meeting a report on which he shall state any violations to the provisions hereof. The auditor is not required to make any positive statement. This lack of positive

assurance may cause the reader of the audit report to have doubts about what is omitted. Appendix 2 indicates how the various countries adopt 'reporting by exception' for different subjects. However, should the reader require knowledge of the provisions of the company law, articles of association etc. to understand the audit report, even the reasonably competent reader (as defined in the Glossary of terms) is almost certain to be aware that an unqualified report in the U.K. implies that proper returns have been received from branches, since there is no requirement to indicate that such branches exist.

(para 3615)

If the auditor is required to report any violations of the company law, it is logical that he should be able to make a positive statement that the financial statements comply with those provisions since he has to have obtained assurance that there have been no violations. It seems reasonable that such assurance be communicated to the reader.

(para 3616)

7.2.3.1 TITLE OF REPORT

From the comparative study in Appendix 2(part 1) it can be seen that there is no common approach to this problem. The U.K. is the only country which has expressly required the auditor to identify those to whom this report is addressed. The U.S.A. recognizes the need for the report to be addressed to someone. It is important to remember, that in both countries, the identification of the addressees of the report does not now limit the auditor's liability for negligent work in most cases. Since Saudi Company Law requires the auditor to submit his report to the annual general meeting, there seems to be no reason why the audit report should not acknowledge this. The rules of other

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enterprises not subject to company Law but subject to audit usually require the audit report to be delivered together with the financial statements prepared by "management". We believe that it is worthwhile for the auditor to identify those to whom his report is addressed and our survey of Saudi Audit Reports confirms that this is common practice already.
(para 3617)

7.2.3.2 SCOPE OF AUDIT

All countries are in agreement as to the necessity for the auditor to understand the scope of the audit engagement and to report if the scope of his engagement is limited in any material way. However, there are differences as to how the auditor is required to report on the scope of the audit. Currently, Saudi Company Law requires the auditor to make a positive statement with regard to the attitude of the management in placing at the auditor's disposal all the particulars and explanations called for. In accordance with the spirit of this translation and our approach to positive assurance for the reader, (discussed earlier in this commentary), we consider that the approach contained in the U.S. Fourth standard of Reporting should be adopted: "In all cases where an auditor's name is associated with financial statements, the report should contain a clearcut indication of the character of the auditor's examination". If such a clear-cut indication is to be made, the auditor should identify his scope paragraph clearly to the reader.
(para 3618)

7.2.4 ESSENTIAL FEATURES OF SCOPE OF AUDIT PARAGRAPH

7.2.4.1 Identification of the Financial Statements to which Audit Report relates:

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The U.K. standard is the only auditing standard which requires the auditor to expressly identify the financial statements to which his audit relates by use of the phrase "the financial statements set out on pages x to x". However, both the U.S. and Germany do so by implication by identifying that it is the financial statements (rather than any other information to which the audit report relates. The problem is that more and more financial reports contain information additional to the financial statements such as policy statements by the directors (or Chairman or Minister), statistical information relating to a number of years, value added reports, reports to employees, etc. Much of this information is expressed in financial terms. As a result, the reasonably competent reader may be doubtful as to which pieces of information have been subject to audit. We consider that the express identification by the auditor of the parts of the financial information to which his report relates considerably reduces the possibility of such doubt. (para 3619)

7.2.4.2 Identification of Those Responsible for the Preparation of the Financial Statements:

It is a fundamental auditing concept in all countries that the auditor is independent of the persons responsible for the preparation of financial statements. Saudi company law recognizes this by stating (Article 123) that at the end of every financial year the board of directors shall make an inventory of the value of the company assets and liabilities as of that date and shall prepare a balance sheet of the company, a profit and loss statement, and a report on its operations and financial position for the expired financial year, setting out the proposed method for the allocation of

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net profits. The board shall put the said documents at the disposal of the auditor.

Both the Accountants International Study Group and the AICPA Auditing Standards Executive Committee proposed that a statement to this effect should be included in the report.

It is is accepted that positive statements by the auditor lead to improved communication with the reasonably competent reader, we consider that there should be a statement to this effect. If there is such a statement in the financial statements, for example at the beginning of the disclosure of the accounting policies, it may be that such a statement is not required.

(para 3620)

7.2.4.3 Attitude of Management to Placing at the Auditor's Disposal all the particulars and Explanations Called For:

Article 132 of the Saudi Company Law states that "the auditor shall submit to the ordinary general meeting a report in which he shall state the attitude of the company management in placing at his disposal all the particulars and explanations "

We understand this provision in Saudi Company Law to require an express reference by the auditor to management's attitude towards this matter the German auditor has to make a similar comment in his full length audit report. The U.K. and U.S. require a statement if such particulars and explanations as are necessary for the purpose of the audit are not made available. We recommend that this provision of Saudi Law be maintained as again it leaves the reasonably competent reader in no doubt. (para 3621)

according

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7.2.4.4. Identification of standards to Which Audit Performed:

The only current Saudi requirement here, we understand, is in the Tax law according to which the auditor should prepare his report in accordance with generally accepted auditing standards.

Both the U.S. and U.K. standard reports (appendix 1) require a statement by the auditor to the effect that his audit has been performed in accordance with the appropriate auditing standards as does the German full length audit report. However, it is also necessary to consider if the auditor should include some other information additional to the source of the audit standards. In its Statement of Issues, the commission on Auditors' Responsibilities established by the AICPA in 1974 raised this problem as follows "Should the report explain more fully the nature of the auditor's examination including a fuller explanation of the limitations of an audit?" It can be seen that the current U.S. report goes further than most countries by stating "and accordingly, included such tests of accounting records and such other audit procedures as we considered necessary in the circumstances". However, we need to consider if this additional phase contributes any thing to the understanding of the reasonably competent reader of the audit report. The auditor has already stated that the audit has been performed in accordance with auditing standards. The reasonably competent reader may be expected to know that auditing standards exist even if he is not aware of the content of the standards in full. As the AICPA question implies, is it not more important that he should be more aware of the limitations of the audit? We believe he should. We consider

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that the proper approach is reflected by R.J. Anderson in his work "the External Auditor"

(Chapter 17.4.2).

(para 3622)

"In this writer's view, it would seem desirable for the auditor's report to make specific reference at least to the concepts of materiality, reasonable assurance and risk. Auditors tell each other that an audit report indicates that they have obtained reasonable, though not absolute, assurance that the financial statements are free of a material misstatement and further, that the level of reasonable assurance must depend on the perceived risk of the hypothetical misstatement in question. It would seem useful to inform the readers of this interpretation".

(para 3623)

We considered how such communication could be achieved without using technical terms which would decrease the reader's capacity to understand the audit report. We concluded that the auditor should state in his opinion paragraph that he has obtained "reasonable assurance" because we considered that these words used in a natural sense communicated that it was reasonable, not absolute, assurance that had been obtained. (para 3624)

7.2.5 EXPRESSION OF OPINION

As can be seen from Appendix 2, there is agreement in Saudi Arabia, the U.S.A. and the U.K. for the auditor to express an opinion on the financial statements. All these countries require the auditor to make it clear to the reader that it is his opinion that he is expressing. There is also agreement as to

the essential features of the subject matter of the opinion.
These are identified as:

- i) The view given by the financial statements
- ii) GAAP
- iii) Compliance with legal requirements

It is in the wording chosen for the opinion paragraph that the major differences occur. These are considered later.
(para 3625)

7.2.5.1 Financial statements taken as a whole:

Since the opinion paragraph relates to all the financial statements as identified in the scope paragraph, it follows that it should be interpreted as relating to the financial statements taken as a whole rather than individual items therein. It is for this reason that the U.S. fourth standard of reporting states "The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed". If a qualified audit opinion is permitted rather than an adverse opinion or a disclosure, the auditor's opinion on the view given by the financial statements and compliance with legal requirements has to be given on the financials tatements as a whole. Otherwise, logically, the auditor would only be able to issue an adverse opinion or disclaimer if he had reservations of a material nature. If this is the case, a positive statement as envisaged by the U.S. standard is seen as a necessary part of this paragraph. (para 3626)

7.2.5.2 FAIR VIEW

In 1900, the United Kingdom's Company Law required the auditor to give his opinion as the "true and correct view" of the state of the company's affairs. By 1948, the wording had evolved to "true and fair view". The 1981 Companies Act, which introduced the 7th Directive of the European Economic Community into U.K. Company Law, confirmed that the overriding requirement for financial statements is to give a "true and fair" view. Yet nowhere in English company law is there a definition of "true and fair". The section of the Explanatory Notes to the U.K. Auditing Standard on the Audit Report states, "The majority of audit reports are issued under the Companies Acts which normally require the use of the words "true and fair view" has been retained. When expressing an opinion that the financial statements give a true and fair view the auditor should be satisfied, inter alia, that:

- a) All relevant statements of Standard Accounting Practice have been complied with, except in situations in which for justifiable reasons they are not strictly applicable because they are impracticable or exceptionally, having regard to the circumstances, would be inappropriate or give a misleading view; and
- b) Any significant accounting policies which are not the subject of Statements of Standard Accounting Practice are appropriate to the circumstances of the business".

Thus, to the U.K. auditing Practices Committee in 1980, it appeared that generally accepted accounting principles (as defined) were an integral part of a "true and fair view". However, they were not necessarily the whole part since, a

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year later, the U.K. 1981 Companies Act for the first time set out major accounting principles in English statute law. The Act also provided that these principles could be overridden provided a "true and fair view" was obtained.
(para 3627)

In the United States, the relevant part of the standard report reads, "present fairly in conformity with generally accepted accounting principles". This has one great advantage over the U.K. in that there is express reference to generally accepted accounting principles. It also links the concept of "fairness" to the use of "generally accepted accounting principles in a similar way to the U.K. Standard (extract above). However, certain U.S. law cases support the U.K. Companies Act 1981 view that, while conformity with generally accepted accounting principles will normally ensure "a fair presentation in conformity with GAAP", there are some additional characteristics of fairness which also have to be satisfied. Thus, in the Continental Vending case, the judge stated "The first law for accountants was not compliance with generally accepted accounting principles but rather full and fair disclosure, fair presentation"
(para 3628)

The discussion as to the relationship between a "fair view" and "generally accepted accounting principles" has lasted many years. Generally, it is a discussion in the English speaking countries since in Europe there is rarely a similar requirement for an auditor to give an opinion on the view presented by the accounts.
(para 3629)

There has been an indication very recently from the German Institu de Wirtschaftspruffer that they may consider the inclusion of the fair view opinion in the audit report.(para 3630)

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In Canada, certain provinces still require an opinion a) as to fairness b) as to generally accepted accounting principles, but the Canadian Institute itself adopted the American style of report in 1976.

(para 3631)

Much of the discussion has been caused by the lack of a legal definition in countries with a long history of giving "fair view" opinions. It seems to us vital that there should be authoritative definitions of "fair view" and "generally accepted accounting standards". But, before defining such terms, one has to consider whether they are the appropriate words. The criteria for such decisions should be their effectiveness in communication to the reasonable reader of financial statements.

(para 3632)

Since the objective of an audit report is communication between the auditor and a reasonably competent reader, we have attempted to use words which do not fall into this category but rather have a natural meaning for the non-expert so that there is a common language between the auditor of the report and its reader. In this context, the phrase "fair view" means to use more appropriate than "true and fair view". Truth in accounting based upon a concept of materiality is very different to the non-expert but reasonably competent reader's concept of truth. We also found from our survey of the English versions of Saudi audit reports that the phrase "fair view" was used on a number of occasions particularly with regard to the financial statements of Saudi institutions. The phrase "generally accepted accounting standards" similarly has a natural meaning. Since the American form of

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report is often used in the Kingdom we expect that readers will already be familiar with these words.

(para 3633)

The definition of a "fair view" is perhaps best approached by examining the criteria therefor. The extract from the U.K. standard above refers to the need for the auditor to be satisfied, inter alia, that the financial statements comply with all existing Statements of Standard Accounting Practice unless the SSAP's are considered inappropriate or impracticable for justifiable reasons or lead to a misleading view and that any significant policies not the subject of existing SSAP's are appropriate to the circumstances of the business. This leads logically to the view expressed by Professor David Flint in his work "A true and fair view in company accounts" published for the Institute of Chartered Accountants of Scotland, in which he states:

"As far as the law is concerned, there is no universal set of detailed rules for the preparation of accounts which are required to give a true and fair view which are applicable to all circumstances. A choice must be made from the alternatives, according to which will satisfy the over-riding requirement".

(para 3634)

Professor Flint goes on to list the choices which may be summarized as:

- a) The preparation of historical cost accounts in accordance with normal accounting practice and the requirements of company law as to form and content and additional information by way of notes and with the provision of

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such further information, if any, as if necessary to give a true and fair view.

- b) Current value accounts as above.
- c) If special circumstances require it so that a true and fair view may be given to prepare accounts which depart from compliance with the requirements of company law as relevant.
- d) If it appears to the directors that there are special reasons for so doing, to prepare accounts on a basis which involves departure from the accounting principles laid down in company law.

The auditor must then consider if the choice made by the management is appropriate bearing in mind all the circumstances appropriate to the business.

(para 3635)

A definition in these terms relates accordingly to the knowledge of the management and judgement as to whether the financial statements as presented could mislead the reader. Accordingly, we define "fair view" as follows:

"Financial statements give a fair view if the reasonably competent reader of such statements with access to the knowledge relating to the financial affairs of the enterprise that management could reasonably be expected to possess would be able to conclude that there had been no material nondisclosure, misstatement or omission of information". financial statements give a fair view when the following conditions are met:

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- a) The accounting standards and methods selected and applied by management in the preparation of the financial statements are generally accepted.
- b) The financial statements and the related notes are sufficiently informative.
- c) The information presented in the financial statements and the related notes are placed properly and displayed in a reasonable manner, that is, neither too detailed nor too condensed; and
- d) The financial statements reflect the substance of the underlying transactions, events and circumstances.

(para 3636)

Given the above conditions, the relationship between "fair view" and "generally accepted accounting standards" becomes clearer. In most cases, all sets of financial statements which comply with generally accepted accounting standards as defined, will give a fair view. However, management when preparing the financial statements, and the auditor, when giving his opinion, must always consider whether a fair view has been presented or whether an alternative accounting treatment or additional information is required.

(para 3637)

Two examples are given in Appendix 4 of circumstances which we consider to be relevant - one from the past, the other more current. From the examples it can be seen that the auditor is having to judge whether the financial statements give a fair view despite his being fully satisfied that the financial statements have been prepared in accordance with

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generally accepted accounting standards. It seems reasonable that the auditor should be required to make this judgement available to the reader.

(para 3638)

An additional advantage may be achieved when the auditor establishes a consistent relationship between the concept of a fair view and generally accepted accounting practices in cases where more than one standard is applied. In light of this relationship between the concept of fair view and generally accepted accounting practices, the auditor must decide whether the financial statements give a fair view in line with the applicable standard which has been selected from available standards. The basis for the auditor's judgement in such cases is the suitability of the selected standard to the circumstances of the enterprise.

(para 3639)

In defining generally accepted accounting practices in Saudi Arabia, it was taken into consideration that there is not an official source at the present time to issue such standards, which means that the need is still there to define what is a generally accepted standard. However, the following measures have been established:

- A) If a given standard has been issued from the competent accounting standard committee of the Saudi Institute of Chartered Accountants, such a standard must be generally accepted and applied unless the company concerned has its reasons, which are deemed acceptable by the auditor, which justify the company's deviation from this standard in order for the financial statements to give a fair view.

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- B) In the absence of such a standard as referred to in "A" above, a suitable standard shall be selected from other sources, particularly those generally applied in Saudi Arabia. However, the selected standard must be consistent with the statement of objectives and concepts of financial accounting as issued by the Saudi Institute of Chartered Accountants. This is considered an essential condition for the proper application of consistent accounting standards in the preparation of financial statements.
- (para 3640)

7.2.5.3 COMPLIANCE WITH APPROPRIATE LEGAL REQUIREMENTS

As can be seen from Appendix 2, Saudi Arabia and the USA require reporting by exception whilst the U.K. and Germany require an express reference in the audit report. We believe a positive statement by the auditor leaves the reader in no doubt.

(para 3641)

7.2.6 CONCURRENCE WITH NON-COMPLIANCE WITH GENERALLY ACCEPTED ACCOUNTING STANDARDS

The various requirements in other countries with regard to this situation are even more varied than the attitudes to the "fair view" and conformity with generally accepted accounting principles or standards. The U.K. attitude is that the auditor can concur with a non-compliance with a relevant statement of standard accounting practice in appropriate circumstances but that in such cases the auditor does not have to indicate his agreement in his unqualified report. This is implicit from Paragraph 10 (a) (i) of the explanatory note on qualifications in audit reports and has been recent practice in the U.K.

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Whilst we agree whole-heartedly with the view that the auditor should issue an unqualified report in such circumstances, we believe also that the reasonably competent reader of the financial statements should be left in no doubt as to the auditor's attitude to the non-compliance. One must also remember that the unqualified audit report only give negative assurance to the reader with regard to compliance with generally accepted accounting standards.

The standard unqualified report in the United States requires a positive statement about 'conformity with generally accepted accounting principles'. The U.S. attitude towards concurrence with non-compliance with an official pronouncement on an accounting standard is to be found as follows:

Rule 203 of the AICPA Code of Professional Ethic states:

"A member shall not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if such statements contain any departure from an accounting principle promulgated by the body designated by Council to establish such principles which have a material effect on the statements taken as a whole, unless the member can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading. In such cases, the report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the principle would result in a misleading statement".

(para 3642)

In AU Section 509 "Reports on Audited Financial statements" (para 19), this statment is amplified. "When the circumstances contemplated by Rule 203 are present, the auditor's report should

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include, in a separate paragraph or paragraphs, the information required by the rule. In such a case, it is appropriate for him then to express an unqualified opinion with respect to the conformity of the financial statements with generally accepted accounting principles unless there are other reasons, not associated with the departure from a promulgated principle, to modify his report".

Thus, both the United Kingdom and the United States agree that the auditor can issue an unqualified report in the rare circumstances where he concurs with non-compliance; they disagree on how he should report.

The German auditing standards do not address this problem.
(para 3643)

7.2.7 EMPHASIS OF A MATTER-U.K. AUDIT REPORT STANDARD-EXPLANATORY NOTES PARAGRAPH 8 AND 9

"As a general principle, the auditor issuing an unqualified opinion should not make reference to specific aspects of the financial statements in the body of his report as such reference may be construed as being a qualification. In rare circumstances, however, the reader will obtain a better understanding of the financial statements if his attention is drawn to important matters. Examples might include an unusual event, accounting policy or condition, awareness of which is fundamental to an understanding of the financial statements.
(para 3644)

In order to avoid giving the impression that a qualification is intended, references which are intended as emphasis of matter should be contained in a separate paragraph and introduced with a

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phrase such as "We draw attention to" and should not be referred to in the opinion paragraph. Emphasis of matter should not be used to rectify a lack of appropriate disclosure in the financial statements, nor should it be regarded as a substitute for qualification".

(para 3645)

EMPHASIS OF A MATTER-USA AU 509-REPORTS ON AUDITED FINANCIAL STATEMENTS-PARAGRAPH 27

"In some circumstances, the auditor may wish to emphasize a matter regarding the financial statements but nevertheless intends to express an unqualified opinion. For example, he may wish to point out that the entity is a component of a larger business enterprise or that it has had significant transactions with related parties, or he may wish to call attention to an unusually important subsequent event or to an accounting matter affecting the comparability of the financial statements with those of the preceding paragraph of the auditor's report. Phrases such as 'with the foregoing explanation' should not be used in the opinion paragraph in situations of this type".

(para 3646)

EMPHASIS OF A MATTER-GERMANY-STATEMENT 3/1977 STANDARDS FOR THE ISSUE OF AUDIT OPINION E-ADDITIONS TO STANDARD OPINIONS

"Additions to standard opinions, although not stipulated by law, are desirable or required if, as a final result of his examination, the auditor has no exceptions arising from violations of legal requirements or the company's statutes and yet considers an additional statement necessary. Additions may result from reservations or represent additional remarks. The auditor should decide on additions to the standard opinion only after a thorough

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examination as to their necessity and should formulate them in such a way that the value and clarity of the opinion is not impaired. Qualifications of the opinion must be stated as such and should not give the impression to be additions to the standard opinion".

(para 3647)

CONCLUSION

Paragraphs 3644 - 3647 demonstrate that all three countries' auditing standards recognize circumstances where the auditor may have no reservation that the financial statements give a fair view and comply with legal requirement but an emphasis of a matter paragraph may be necessary. It is left to the auditor's judgement to decide when such an additional paragraph is necessary. Since the most essential feature of the audit report is the expression of the auditor's judgement, it is entirely consistent with this to be so. We believe that the approach adopted by the three countries towards an "emphasis of matter" statement is appropriate for inclusion in the Saudi standard.

(para 3648)

7.2.8 RESERVATIONS

The explanatory foreword and the auditing standard deal with how the auditor should express his reservations at some length. The material on which these requirements are based is to be found in the U.K., U.S.A. and Canadian standards, guidelines and statements respectively. Germany permits the use of a qualified audit opinion or a disclaimer of opinion but does not seem to make provision for the adverse opinion (see 3/1977 B Note 1).

(para 3649)

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Both the U.S.A. and U.K. adopt the framework with regard to opinions qualified due to audit scope deficiencies, accounting deficiencies or uncertainties and the use of similar language. Thus, AU 509.29 states, "A qualified opinion states that 'except for' or 'subject to' the effects of the matter to which the qualification relates, the financial statements" the U.K. Standard requires material reservations to be expressed as "except" with regard to disagreement and "subject to " in case of uncertainty.
(para 3650)

There is similar agreement with regard to the disclosure of the auditor's reasons for his reservations. Thus, AU 509 32/33, "When the auditor intends to express a qualified opinion, he should disclose all the substantive reasons in a separate explanatory paragraph(s) of his report and should include, in the opinion paragraph, the appropriate qualifying language and a reference as explanatory paragraph(s) should disclose the principal effects of the subject matter of the qualification on financial position, if reasonably determinable". The U.K. standard (paragraph 1) states, "All reasons for the qualification should be given, together with a quantification of its effect on the financial statements".
(para 3651)

Any limitations of the scope of the audit are treated similarly, i.e., by explanation in the explanatory paragraph and reference thereto in both the scope and opinion paragraph.

The only innovation introduced in this draft standard relates to the requirement to put a title to the reservation paragraph and the qualified, adverse or disclaimer opinion paragraphs. This is consistent with the objective of "leaving the reader in no doubt as to the meaning and implication" of an audit report. (para 3652)

7.2.9 SIGNING AND DATING THE AUDIT REPORT

The procedures relating to the signing of the audit report are as set out in current Saudi Law. The U.K. Auditing Standard and Guideline does not contain any reference to the requirements for signing and dating the report but AU 530 - Dating of the Independent Auditor's report - states, "Generally, the date of completion of the field work should be used as the date of the independent auditor's report". Paragraph 5 of the same statement deals with the circumstances when a subsequent event disclosed in the financial statements occur after completion of the field work but before the issue of this report. The later date or "dual dating" may be used. Dual dating may lead to the reasonably competent reader being confused as to the exact nature of the auditor's responsibility. Accordingly, we recommend the former treatment.

(para 3653)

7.2.10 OTHER AUDITORS

The requirement that there should be no references in the audit report to the work of other auditors reflects the view that it is the auditor's responsibility to obtain reasonable assurance from adequate audit evidence to support his opinion.

(para 3654)

7.2.11 ILLUSTRATIVE EXAMPLES

The inclusion of illustrative examples in the U.K. auditing guidelines was very successful in that the examples aroused far more comment than the content of the operational (fieldwork) standards. The guidelines states, "The examples are intended

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merely to illustrate possible forms of wording for use in different circumstances. Since qualifications must be expressed in terms chosen to fit the particular circumstances to which they relate, it is impracticable, and could be misleading, to suggest standard forms of qualifications". This statement seems to conflict with Paragraph 2 of the U.K. Auditing Standard. "A qualified audit report should leave the reader in no doubt as to its meaning and its implications for an understanding of the financial statements. To promote a more consistent understanding of qualified reports, the forms of qualification described in this standard should be used unless, in the auditor's opinion, to do so would fail to convey clearly the intended meaning".

The illustrative examples take this view by requiring mandatory events re the language used for the essential features of the scope, opinion and emphasis of matter paragraphs.

7.2.12 UNQUALIFIED REPORTS

1. U.S.A.

SCOPE PARAGRAPH

"We have examined the balance sheet of X company as at 31 December 19xx and the related statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

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OPINION PARAGRAPH

In our opinion, the financial statements referred to above present fairly the financial position of X company as at 31 December 19xx, and the results of its operations and the changes in financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year".

2. U. K.

SCOPE PARAGRAPH

"We have audited the financial statements on pages x to x in accordance with approved Auditing Standards.

OPINION PARAGRAPH

In our opinion, the financial statements, which have been prepared under the historical cost convention, give a true and fair view of the state of the company's affairs at 31 December 19xx and of its profit and source and application of funds for the year then ended and comply with the Companies Act 1948 and 1981.

3. GERMANY

a) ABBREVIATED REPORT-PUBLISHED WITH FINANCIAL STATEMENTS (ACCORDING TO SECTION 167 AG LAW)

"The bookkeeping, the annual financial statement and the report of the management accord with the law and

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the articles of association on the basis of our dutiful examination".

b) FULL REPORT TO THE BOARD OF EXECUTIVE MANAGERS
SUMMARY OF CONTENTS

MAIN SECTION

Engagement and performance

Legal situation of the company

Classification and valuation of assets and liabilities

Financial analysis

Major items of balance sheet

Earnings

Bookkeeping

Managerial report

Final conclusions and attestation

Recommended auditing standards

Comments on individual items in financial statements

Audit reports

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7.2.13 COMPARATIVE STUDY OF ESSENTIAL FEATURES OF THE AUDIT REPORT

(APPENDIX 2 TO COMMENTARY ON AUDIT REPORTS)

SCOPE PARAGRAPH	SAUDI EXISTING LAW	UNITED KINGDOM	UNITED STATES	GERMANY
1. Identification of addressee	Company law 'auditor to submit a report to the annual general meeting . . . (article 132)	The audit report should identify those to whom it is addressed (UK Standard Para 2)	The report may be addressed to the company whose financial statements are being examined or to its board of directors or stockholders. A report on the financial statements of an unincorporated entity should be addressed as circumstances dictate, for example to the partners (AU 509.08)	The opinion is the result of the audit and is directed not only to the client but also to a larger number of people, in many cases the general public (Statement 3/1977B).
2. Identification of financial statements to which report relates	No legal evidence other than company law requirement to submit a report to the AGM setting forth the extent to which the accounts (Article 132).	The audit report should identify the financial statements to which it relates (UK Standard para 2). 'We have audited the financial statements on pages x to x' (extract from illustrative audit report. (UK Para 12).	The report shall either contain an expression of opinion regarding the financial statements, taken as a whole or an assertion to the effect that an opinion cannot be expressed. (Fourth standard on reporting). 'We have examined the balance sheet, and the related statements of changes in financial position'. (Extract from standard audit report).	'The bookkeeping, the annual, financial statement Extract from abbreviated audit report.
3. Identification of auditing procedures performed.	Tax law. Chartered Accountant should prepare his audit report in accordance with generally accepted accounting and auditing principles. Article 131 states that the auditor shall at any time have access to the company's books, records and other documents. He shall be entitled to request such particulars and	The auditor should refer expressly in his report to the following: a) Whether the financial statements have been audited in accordance with approved Auditing Standards (UK Standard Para 3).	In all cases where an auditor's name is associated with financial statements, the report should contain a clearcut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking. (Fourth standard of reporting). The auditor can determine that he is able to express an	The audit report should describe the audit assignment and its performance. The audit report shall state that the auditor has conducted the audit according to the generally accepted standards for the audit of financial statements. (Statement 2/1977 C1 re long-form audit reports).

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7.2.13 COMPARATIVE STUDY OF ESSENTIAL FEATURES OF THE AUDIT REPORT

SCOPE PARAGRAPH	SAUDI EXISTING LAW	UNITED KINGDOM	UNITED STATES	GERMANY
4. Restrictions to the Scope of Audit	<p>clarifications as he may deem it necessary to obtain, and to verify the assets and liabilities of the company.</p> <p>The chairman of the board of directors must enable the auditor to perform his duty as specified in the preceding paragraph. If the auditor encounters any difficulty in this respect, he shall state that fact in a report to be submitted to the board of directors. If the board fails to facilitate his task, the auditor must call a regular general meeting to look into the matter.</p> <p>The auditor shall submit to the ordinary general meeting a report in which he shall state the attitude of the company management in placing at his disposal all the particulars and explanations called for</p>	<p>Nothing expressly stated in UK audit report. Under UK Company law, if auditors fail to obtain all the information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report - eg. reporting by exception.</p>	<p>unqualified opinion only if his examination has been conducted in accordance with generally accepted auditing standards (AU 509.10).</p> <p>Reporting by exception as UK.</p>	<p>According to S166 para 1 (AktG) it shall be expressly stated whether the board of management has given the explanations and presented the evidence requested. (Statement 2/1977 Cl re long-form audit reports).</p>

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7.2.13 COMPARATIVE STUDY OF ESSENTIAL FEATURES OF THE AUDIT REPORT

(APPENDIX 2 TO COMMENTARY ON AUDIT REPORTS)

OPINION PARAGRAPH	SAUDI EXISTING LAW	UNITED KINGDOM	UNITED STATES	GERMANY
1. Accounts conform with reality	The auditor shall submit to the ordinary general meeting a report in which he shall state his opinion as to the conformity of the company accounts with reality'. (Article 132).	The auditor should refer expressly in his report to the following b), whether in the auditor's opinion the financial statements give a true and fair view of the statement of affairs, profit or loss and, where applicable, sources and application of funds. (Standard Para 3(b)).	'Independent auditor's unqualified opinion usually reads: In our opinion, the financial statement referred to above present fairly the financial position (AU 411 - para 0.1 - The meaning of present fairly is discussed in this section).	Abbreviated form of audit report makes no express reference to opinion of financial statements other than compliance with law.
2. Violations of appropriate legal requirements	The auditor shall submit to the ordinary general meeting a report on which he shall state any violations to the provisions hereof'. (Article 132).	The auditor should refer expressly in his report to the following c) any matters prescribed by relevant legislation or other requirements.	No express reference is unqualified report. If opinion on fair presentation materially affected, auditor should qualify report.	Foremost objective of audit (Institute pronouncement) as to determine that the accounts have been prepared in accordance with the law and proper accounting principles. 'The audit report shall state specifically whether the accounting meets the legal requirements and whether the financial statements have been prepared in accordance with law' (Statement 2/1977 CIV).
3. Violation of articles of association	The auditor shall submit to the ordinary general meeting a report in which he shall state any violation to any of the articles of association (Article 132). No express reference - reporting by exception as above.	No express reference required - if violation had material effect, auditor should mention it. Otherwise compliance implied.	As UK - no express reference required. If opinion on fair presentation of financial statements materially affected, auditor should qualify report.	The audit report shall state specifically whether the accounting meets the legal requirements and whether the financial statements have been prepared in accordance with the Law and the company's statutes. (Statement 2/1977 CIV).

AUDITING STANDARDS7.2.13 COMPARATIVE STUDY OF ESSENTIAL FEATURES OF THE AUDIT REPORT

OPINION PARAGRAPH	SAUDI EXISTING LAW	UNITED KINGDOM	UNITED STATES	GERMANY
4. Compliance with accounting standards	Tax law - Chartered Accountant should prepare his audit report in accordance with generally accepted accounting and auditing principles. No express reference seems to be required.	No express reference required by UK standard-however, 'when expressing an opinion that financial statements give a true and fair view the auditor should be satisfied inter alia that: a) All relevant Statements of Standard Accounting Practice have been complied with, except in situations in which for justifiable reasons, they are not strictly applicable because they are impracticable. . . b) Any significant accounting policies which are not the subject of SSAP's are appropriate to the circumstances of the business. (UK Explanatory Guideline Para 6).	'The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles'.	Legal requirements referred to in Statement 2/1977 include accounting law.
5. Application of consistent accounting policies.	Company Law requires that classification in the balance sheet and the profit and loss account and the measurement bases for the assets and liabilities should be consistent (Article 124). No express reference seems to be required (as UK).	No express reference required - however, consistency is one of the fundamental accounting concepts. In order to express true and fair view, the auditor is required by company law to ensure consistency applied. Auditor will report by exception.	'The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period'. (Second standard of reporting - AU 420).	Consistent accounting policies - part of accounting law.

7.2.14 PROPOSALS FOR MODIFICATIONS OF THE STANDARD REPORT

A. Accounts International Study Group - 1969

Auditors in the United States who propose clarification of the auditor's responsibility by revision of his report suggest that an expanded opinion include:

- 1) Comment that the financial statements are those of management.
- 2) Explanation that amounts in the financial statements are reasonable approximations and are not precise calculations.
- 3) Reference to the fact that the audit was made in accordance with auditing standards established by the accounting profession.
- 4) Representation that selective tests were used and were based upon the auditor's evaluation of internal control.
- 5) Opinion that the financial statements conform with accounting principles determined by the accounting profession and that such principles were consistently applied.

B. Auditing Standards Executive Committee (AICPA) - Suggestions for possible expansion of the standard report.

- 1) To identify the financial statements as prepared by management.

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- 2) To discuss briefly the nature of financial statements including references to:
 - a) The 'going concern' concept;
 - b) The 'accruals' concept;
 - c) The 'historical cost' convention;
 - d) The necessity for approximations.
- 3) To identify the source of generally accepted auditing standards and accounting principles.
- 4) To include some comment with regard to fraud and irregularities.
- 5) To prescribe a mandatory title for the report (perhaps making reference to objectivity or independence).

7.2.15 FAIR VIEW

EXAMPLE A

Before accounting standards on post balance sheet events and contingencies became established, disclosure of such items were not required. Accordingly management could be aware of an event which materially or fundamentally affected the fair view presented by the accounts. Once the auditor was aware of the circumstances, he was in a position to state that the financial statements gave a fair view in conformity with generally accepted accounting principles since no breach had occurred. However, could he state that the financial statements gave a fair view?

EXAMPLE B

Related party transactions between two companies in a group are not yet the subject of a UK accounting standard. One problem that could occur is with regard to management charges. Say, a subsidiary company was engaged in Government contracting and a non-Company law regulation was introduced by a Government agency to the effect that:

- a) The maximum permitted net margin on such contracts was 10%.
- b) If that profit margin were exceeded, no more contracts would be awarded to the company concerned.
- c) The subsidiary company made more than the permissible margin, and
- d) In order to reduce the margin, a suitably authorized management charge was made by one company to the other on terms such

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as an employee being charged out at a rate of 1,000 an hour for services actually rendered.

In such circumstances, the financial statements of the contracting company after including the management charge comply with generally accepted accounting principles and with company law. Do they give a fair view to the reasonably competent reader?