CERTIFIED ACCOUNTING TECHNICIAN

STAGE 3 EXAMINATION

S3.4: AUDIT AND ASSURANCE

DATE: TUESDAY 22, AUGUST 2023

MARKING GUIDE AND MODEL ANSWERS

SECTION A

Marking guide

Question	Answer
1	B
2	B
3	D
4	B
5	D
6	C
7	A
8	D
9	B
10	C

Section A-Marks allocation	Marks
2 marks for each collect answer	2
Total marks for this section	**20**

Model answers

1. The correct answer is B

In accordance with article 1 of the Ministerial Order Nº004/19/10/Tc Of 29/04/2019 determining the annual turnover required for certification of financial statements, any taxpayer with an annual turnover of or above six hundred million (600,000,000) Rwandan francs is obliged to have his or her financial statements certified by a qualified professional approved by the tax administration. A is not correct because it relates to the previous law's requirements which was effective prior to 2019. C is not correct as it is contrary to the current law's provisions.

2. The correct answer is B

A qualified opinion would be issued on the basis that there is a material misstatement.
An adverse opinion would be issued if the matter had been pervasive. A disclaimer is issued where the auditor has not been able to obtain sufficient evidence and the matter is pervasive.

3. The correct answer is D

Auditors cannot say that financial statements are absolutely correct because:

i. Financial statements are a combination of fact and judgement
ii. An audit also includes judgements made by the auditors
iii. Auditors do not test every transaction (or audits would be too expensive)
iv. Company management might tell lies/carry out hidden fraud which the auditors do not detect.

4. The correct answer is B

Integrity is one of the fundamental principles of professional ethics (IESBA Code of Ethics: para. 110.1 A1) – the other options are threats to the fundamental principles. There are five threats in total, the remaining ones being self-review and intimidation (IESBA Code of Ethics: para.120.6 A3). .

5. The correct answer is D

Materiality may be based on other criteria, not just revenue, such as net assets and profit before tax. Materiality should be revisited throughout the audit and revised if necessary. (i) and (ii) present correct statements about materiality.

6. The correct answer is C

Because the business is stable, auditors are likely to base overall materiality on a percentage of revenue or total assets, or possibly an average of both. Profit before tax is unlikely to be used overall as its fluctuation does not appear to be significant. However, a different materiality level may be set when considering the one-off expense, since it may be particularly significant to readers of the accounts.

7. The correct answer is A

Testing the revenue/sales account transactions for a month before the start and at the end of the financial statements period would be a reasonable test for cut off on revenues. Normally the risks of cut off arises on transactions that close to the start and closely after the end of the year i.e. December of previous year and January of the subsequent year for a financial year that ends in December. Enquiring from management and checking the minutes are not the ideal test for cut off.

8. The correct answer is D

While testing for controls on purchases accounting system, the auditor checks whether:

- All expenditure is authorised and is for goods that are received.
- All expenditure that is made is recorded correctly in the general (nominal) and payables (purchase) ledgers.
- All credit notes that are received are recorded in the general and payables ledgers.
- All entries in the payable's ledger are made to the correct payables ledger accounts.

All invoices that are canceled before the delivery of goods or services are not supposed to be recorded in the accounting system. In case they were recorded, they are expected to be reversed in the system.

9. The correct answer is B

The net realizable value for an inventory is an estimated or actual selling price (net of trade discounts but before settlement discounts) less all further costs to completion and less all costs to be incurred in marketing, selling and distribution. A is not correct because this nature of expense is transport or distribution expense. C is not correct because trade discounts have to be determined before settlement discounts, otherwise it would lead to a miscalculation. D is not correct as it is against the IAS 2 standard.

10. The correct answer is C

Request from management if they are any ghost workers and stop from there is not an ideal audit procedure, since some management team members may be involved in the ghost workers scheme. All the other audit procedures are appropriate to identifying ghost workers.

SECTION B

QUESTION 11

Marking guide	**Marks**
a. Explaining the difference between auditing around the computer and auditing through the computer	3
b. Describe at least 4 benefits that NMP Associates Ltd is likely to occur while implementing the adoption of the new audit software	4
Describe at least 3 challenges that NMP Associates Ltd is likely to Encounter while implementing the adoption of the new audit software	3
Total Marks	**10**

Model answers

a. Difference between auditing around the computer and auditing through the computer

Auditing around the computer

To audit around the computer, the auditor does not look at the specific workings of the system itself. A sample of inputs will be traced to outputs, and vice versa. If they prove to be accurate and valid, it is assumed that the system of controls is effective and that the system is operating properly.

The main advantage of this method of auditing is that it can be carried out with very little technical expertise. However, this method is only suitable if there is a clear audit trail within the system, the system is relatively simple, and up to date documentation exists about how the system works.

Auditing through the computer

Auditing through the computer requires more specific IT audit skills than those required to audit around the computer as this method directly tests the controls within the system itself.

Auditors customarily audit 'through the computer'. This involves an examination of the detailed processing routines of the computer to determine whether the controls in the system are adequate to ensure complete and correct processing of all data. In these situations, it will often be necessary to employ CAATs.

b. 4 benefits and 3 challenges that NPM Associates is likely to have while implementing the adoption of the new audit software are:

Benefits:

- Audit testing capability is increased – large volumes, up to 100%, of information can be tested, thereby reducing or even eliminating sampling risk.
- Enhanced compliance with regulator recommendation as pronounced by ICPAR.
- Tasks which are manually impossible can be carried out – using the computer to trace key controls and processes where there is no visible audit trail.
- Cost-effectiveness – although up-front costs may be considerable, an audit software can often be used again in subsequent audits.
- Repetitive work is eliminated – this can increase job satisfaction for auditors and frees them up to apply professional judgement to key areas.
- Audit software are regularly updated to reflect new changes in the regulation and standards.
- Knowledge of client systems is improved – this is an important by-product that enhances the auditor's knowledge of the client and aids future audit planning.

Challenges:

- Setting up the software needed can be time consuming and expensive.
- Audit staff will need to be trained so they have a sufficient level of IT knowledge to apply it.
- Not all client systems will be compatible with the software used with the new audit software.
- Information in real-time systems is constantly changing.
- Testing can be limited by the data held on the system.
- There is a risk of over-reliance on 'infallible' computerization of audit procedures.
- Auditor judgement must still be applied throughout the testing process.
- Limited resources for a small firm to acquire an expensive software (same as the first)

QUESTION 12

Marking guide	**Marks**
a. Describing any four assertions used by the auditor to design and perform audit procedures	**4**
Give an example of an account balance of the financial statements suitable for the assertion	**4**
b. Explain the term “Sufficiency' of audit evidence	**1**
Explain the term 'appropriateness' of audit evidence	**1**
Total Marks	**10**

Model answers

a. Describing assertions used by the auditor to design and perform audit procedures and give an example of an account balance of the financial statements suitable for the assertion.

- **Occurrence:** transactions and events that have been recorded or disclosed have occurred and such transactions and events pertain to the entity. For example, all sales for which revenue has been recorded have taken place.
- **Completeness:** all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included. For example, all material purchases made in the year have been recorded on the purchase ledger.
- **Accuracy:** amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described. For example, depreciation on non-current assets has been charged in accordance with applicable accounting standards and the company's depreciation policy.
- **Cut-off:** transactions and events have been recorded in the correct accounting period. For example, all sales revenue relating to the period under audit have been recorded in the period, and no sales revenue relating to other accounting periods has been recorded in this period.
- **Classification:** transactions and events have been recorded in the proper accounts. For example, direct corporation tax expenses are recorded in the tax account, not other expense accounts.
- **Presentation**: transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
- **Rights and obligations:** the entity holds or controls the rights to assets, and liabilities are the obligations of the entity. For example, the plant and machinery recorded really belong to the company.

b. Explaining the terms "Sufficiency' and 'appropriateness' of audit evidence in line with ISA 500.

- **Sufficiency** is the measure of the quantity of audit evidence. The quantity of evidence required will be affected by the level of risk in the area being audited, and the quality of evidence obtained. (ISA 500: para. 5(e)).
- **Appropriateness** is the measure of the quality or relevance and reliability of the audit evidence. (ISA 500: para. 5(b)).

SECTION C

QUESTION 13

Marking guide	**Marks**
(a)Discussion of team engagement letter allow 2 marks for discussion	2
Eight element as contents of the engagement letter (Allow 0.5 mark for each valid point provided	4
(b). Matters that should be considered (allow 0.5 Mark) for each valid matter mentioned (maximum marks is 3)	6
Procedures that should have been performed (allow 0.5 Marks for each valid point) (maximum marks is 3**)**	
(c)Key matters that should be taken note of during the planning section of the audit file . Allow 2 marks for 4 each valid point explained. (maximum marks is 8)	8
Total Marks for the question	**20**

Model answers

(a) Engagement letter and contents:

Once the audit firm has accepted the appointment the terms of the audit engagement must be agreed between the auditor and management (or those charged with governance as appropriate). These terms must be recorded, normally in an audit engagement letter.
The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit , the extent of the auditor's responsibilities to the client and the form of any report

The form and content of the engagement letter may vary but must include the following (ISA 210: para. 10):

- The objective and scope of the audit
- The responsibilities of the auditor
- The responsibilities of management
- Identification of the applicable reporting framework to be used in the preparation of the financial statements
- The expected form and content of any reports to be issued by the auditor
- A statement that there may be circumstances where the actual form and content may differ from what was expected

The audit engagement letter may also include the following (ISA 210: para. A23):

- Further details regarding the scope of the audit
- Form of any other communication of the results to management
- The fact that due to the inherent limitations of an audit and those of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs
- Arrangements regarding planning and performance, including audit team composition
- Expectation that management will provide written representations

- The expectation that management will provide access to all information to which management is aware that is relevant to the preparation of the financial statements
- Agreement of management to provide draft financial statements including all information relevant to their preparation in time to allow auditor to complete the audit in accordance with the proposed timetable
- Agreement of management to inform auditor of facts that may affect the financial statements, of which management may become aware from the date of the auditor's report to the date of issue of the financial statements
- Fees and billing arrangements
- Request for management to acknowledge receipt of the letter and agree to the terms outlined in it
- Involvement of other auditors and experts
- Involvement of internal auditors and other staff
- Arrangements to be made with predecessor auditor
- Any restriction of auditor's liability
- Reference to any further agreements between auditor and entity
- Any obligations to provide audit working papers to other parties

(b) Matters that should be considered are:

- Reasons for non-appointment of predecessor auditor;
- Review of predecessor auditor work;
- Level of expertise within RHL: there are some concerns over expertise of finance team;
- Resources availability: Does the firm have the expertise for this kind of treatment of complex areas such as asset revaluation and defined benefit pension schemes;
- Lack of review of work done by Finance reconciliation team;
- Turnover in Finance team;
- Sale of land to the Managing Director's brother.

Procedures:

- Enquire of management as to why previous auditors were not re-appointed, and get written authority to contact them. If permission refused, then should not accept the audit.
- Write to previous auditor seeking relevant information such as: are there any reasons why you should not accept the appointment
- Audited Trial Balance, audit journals required last year, weaknesses identified etc.
- Research company using databases and press reports.
- Perform preliminary risk assessment.
- Review previous financial statements and current management accounts.
- Company records search.
- Money laundering client identification procedures.
- Further discussion with Directors about controls and concerns.
- Review potential conflicts of interest

(c) key matters that should be taken note of during the planning section of the audit file are:

Internal controls

The controls over bank and cash are weak this year as bank reconciliations have not been prepared for the last 4 months and Anselme revealed that he has not reviewed any of her finance assistants' work. In addition, they are short staffed on the team with one assistant leaving during the year. Additional bank and cash substantive tests will need to be undertaken.

Preliminary analytical review

Refrigerated Haulage Limited (RHL) Management Account

Income statement	Actual	Budget	Movement
Revenue	21,000	20,000	1,000
Cost of sales	(10,000)	(9,500)	500
Operating loss/Profit	11,000	10,500	500
Profit on sale of land	500	-	500
Interest payable	(2,000)	(2,000)	-
(Loss)/Profit for the period	**9,500**	**8,500**	**1,000**

From the management accounts extracts, the actuals suggest a much stronger result than what has budgeted for during the year. There is a profit of FRW 9.5 m rather than the budgeted FRW 8.5m profit. Revenue is 5% better than expected but the profits are much more than expected by 12% it gives cause for concern over expenditure which are not booked or overstatement in revenue.

Revenue Recognition

There is a risk that revenue has been overstated and also expenditure understated (to get more from the pharmaceutical company agreement to cover costs).

Revenue Recognition RHL has some complex areas of revenue recognition, which may mean that revenue is recognized in advance of being earned and could lead to overstated revenue. Revenue recognition policies will need to be tested for compliance with IFRS15 Revenue from Contracts with Customers.

Sale of land

This generated profit figure and was not budgeted for. There is also speculation that it was sold to a related party. Under IAS 24 Related Party Disclosures. The disclosures should be tested for completeness. Further investigations into this sale are needed and tests on the assertions of valuation, rights and completeness are needed.

QUESTION 14

Marking guide	Marks
a. Identify any four overall responses to risks of material misstatements	4
b. Describe at least 4 audit procedures to be conducted while reviewing the work of junior audit team members	4
Identify any six factors that will affect the form and content of the working papers	6
c. Define permanent and current audit files	3
Give examples of which information they should contain (0.5 marks per e.g.)	3
Total Marks	**20**

Model Answers

a) Overall responses to risks of material misstatement will be changes to the general audit strategy are:

- Emphasising to audit staff the need to maintain professional skepticism
- Assigning additional or more experienced staff to the audit team
- Using work of experts
- Providing more supervision on the audit
- Incorporating more unpredictability into the audit procedures
- Making general changes to the nature, timing and extent of audit procedures

b) i) Audit work performed by each assistant should be reviewed by personnel of appropriate experience to consider whether:

- The work has been performed in accordance with the audit plan.
- The work performed and the results obtained have been adequately documented.
- Any significant matters have been resolved or are reflected in audit conclusions.
- The objectives of the audit procedures have been achieved.
- The conclusions expressed are consistent with the results of the work performed and support the audit opinion.

b) ii) the form and content of working papers for Karemera Ltd may be affected by factors such as (ISA 230: paras. 8 and A2):

- The nature of the procedures to be performed
- Size and complexity of Karemera ltd
- The identified risks of material misstatements during the audit
- The extent of judgement required in performing the work and evaluating the results
- The significance of the audit evidence obtained
- The nature and extent of exceptions identified
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained
- The audit methodology and tools used during the audit

c) Defining permanent and current audit files and giving examples of which information they should contain:

Permanent audit files contain information of continuing importance to the audit. They contain:

- Engagement letters
- New client questionnaire
- The memorandum and articles
- Other legal documents such as prospectuses, leases, sales agreement
- Details of the history of the client's business
- Board minutes of continuing relevance
- Previous years' signed accounts, analytical procedures and management letters
- Accounting systems notes, previous years' control questionnaires

Current audit files contain information which is relevant to the current year's audit. They should be compiled on a timely basis after the completion of the audit and should contain:

- Financial statements
- Accounts checklists
- Management accounts details
- Reconciliations of management and financial accounts
- A summary of unadjusted misstatements
- Report to partner including details of significant events and misstatements
- Review notes
- Audit planning memorandum
- Time budgets and summaries
- Representation letter
- Management letter
- Notes of board minutes
- Communications with third parties such as experts or other auditors

QUESTION 15

Marking guide	Marks
Award up to 2 marks for every point well explained supporting why tests of controls and substantive tests of transactions are performed simultaneously as a matter of audit convenience (maximum of 4 marks)	4
Award 1 mark for every valid audit procedure for: Depreciation of PPE (maximum of 6 marks) Bonus paid to the Directors (maximum of 6 marks)	12
Award marks as below: 1 mark for the effect of laws and regulations on the financial statements 1 mark for each correct procedure conducted by the auditor where there is a non-compliance to the laws and regulations.	2
Note: Award credit for any additional points throughout the answers to the entire Question 3 that are not within the model answer as long as these are appropriate for the requirement	2
Total Marks	**20**

Model Answers

a) The auditor resolves the problem by making assumptions about the results of the tests of controls and performing both the tests of controls and substantive tests of transactions based on these assumptions.

Ordinarily, the auditor assumes an effective system of internal control with few or no exceptions planned.

If the results of the tests of controls are as good as or better than the assumptions that were originally made, the auditor can be satisfied with the substantive tests of transactions, unless the substantive tests of transactions themselves indicate the existence of misstatements.

If the tests of controls results were not as good as the auditor assumed in designing the original tests, expanded substantive tests must be performed.

b) **Substantive procedures for depreciation:**

- Discuss with management the rationale for the changes to property, plant & equipment (PPE) depreciation rates, useful lives, residual values, and depreciation methods and ascertain how these changes were arrived at.
- Confirm the reasonableness of these changes, by comparing the revised depreciation rates, useful lives, and methods applied to PPE to industry averages and knowledge of the business.
- Review the capital expenditure budgets for the next few years to assess whether the revised asset lives correspond with the planned period until the replacement of the relevant asset categories.
- Review the non-current asset register to assess if the revised depreciation rates have been applied.

- Select a sample of PPE and recalculate the depreciation charge to ensure that the non-current assets register is correct and ensure that new depreciation rates have been appropriately applied.
- Obtain a breakdown of depreciation by asset categories compare to the prior period; where significant changes have occurred, discuss with management, and assess whether this change is reasonable.
- For asset categories where there have been a minimal number of additions and disposals, perform a proof in total calculate the depreciation charged on PPE, discuss with management if significant fluctuations arise.
- Obtain a copy of the minutes of the meeting of the Board of Directors and confirm the Board's rationale and approval of the review of the PPE

Substantive procedures for Directors' Bonus:
- Obtain a schedule of the directors' bonus paid in October 2022 and cast the schedule to ensure accuracy and agree on the amount disclosed in the financial statements.
- Review the schedule of current liabilities and confirm the bonus accrual is included as a year-end liability.
- Recalculate the bonus payments and agree the criteria, including the exclusion of intangible assets, to supporting documentation and the percentage rates to be paid to the directors' service contracts.
- Agree the individual bonus payments to the payroll records.
- Review the board minutes to identify whether any additional payments relating to this year have been agreed upon for any directors and approved in the Board meeting.
- Obtain a written representation from management confirming the completeness of directors' remuneration including the bonus
- Confirm the amount of each bonus paid post-year-end by agreeing to the cash book and bank statements.
- Review the disclosures made regarding the bonus paid to directors and assess whether these are in compliance with local legislation.

c) ISA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements" distinguishes the auditor's responsibilities in relation to compliance with laws and regulations.

The provisions of those laws and regulations are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations; and other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:

- An understanding of the nature of the act and the circumstances in which it has occurred
- Further information to evaluate the possible effect on the financial statements.
- Seek legal advice if sufficient information is not made available on material non-compliance, which the auditor suspects.
- If information cannot be obtained consider the impact on the auditor’s opinion
- Consider the impact of non-compliance on auditor’s risk assessment and the reliability of written representations, and take appropriate action

END OF MARKING GUIDE AND MODEL ANSWERS