



# **CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL**

## **11.4: AUDITING**

**DATE: FRIDAY 25, AUGUST 2023**

## **MARKING GUIDE AND MODEL ANSWERS**



## **SECTION A**

### **QUESTION ONE**

#### **Marking guide**

#### **Maximum marks**

- a) Define the term “Audit risk” and give an example of a risk that is attributed on NMB Group financial statements in accordance with the above case study. *(1 mark for definition and 1 Mark for valid example provided).* (3 Marks)
- b) i. In line with ISA 320 Materiality in Planning and Performing an Audit, elaborate at least five factors you will consider to identify NMB Group Ltd’s materiality benchmark. *(1 mark per each valid factor).* (5 Marks)
- ii. Briefly discuss why most auditors prefer to use risk-based audit approach to other audit approaches. *(2 marks per a valid reason, maximum 4)* (4 Marks)

(2) In accordance with ISA 200, Enumerate other matters that can be considered by an auditor to reduce the detection risk. *(2 marks per each valid matter).* (8 Marks)

**Total marks** (20 Marks)

#### **Model answers**

a) Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. In accordance with the scenario in the case study, there is a risk of misstatement on financial statements arising from migration transit accounts that still have uncleared balances.

b) i) Five factors you will consider to identify NMB Group Ltd’s materiality benchmark:

1. The elements of NMB Group Ltd’s financial statements
2. Whether there are items on which the attention of the users of the NMB Group Ltd financial statements tends to be focused.
3. The nature of NMB Group Ltd, life cycle, and the industry and economic environment in which it operates.
4. The entity’s ownership structure and the way it is financed and
5. The relative volatility of the benchmark.

ii. Reason why most auditors prefer to use risk-based audit approach to other audit approaches is because of two major facts such as:

Growing complexity of the business environment, such as advanced computer systems and the globalisation of business, increases the risk of fraud or misstatement as well as the evolving Pressure on auditors to keep fees down but improve the level of service.



**c) Other matters that can be considered by an auditor to reduce the detection risk:**

1. Adequate planning
2. Proper assignment of personnel to the engagement team
3. The application of professional skepticism; and
4. Supervision and review of the audit work performed.

**QUESTION TWO**

**Marking guide**

**Maximum marks**

- a) Describe the above four techniques for assessing and recording client's internal control system and enumerate at least two merits and demerits for the usage of each. *(1 mark for defining the technique, 0.5 mark for each merit and demerits and 2 marks maximum of all merits and demerits over a technique).* (12 Marks)
- b) Elaborate the control objectives, related risks and test of controls that are associated with ordering and receipts of company's purchases. *(0.5 mark for each control objective, related risks and test of control, 6 marks maximum for ordering as well as for receipts)* (6 Marks)
- c) Define a term "Walk-through test". (2 Marks)

**Total marks**

**(20 Marks)**

**Model Answers**

- a) Four techniques for assessing and recording client's internal control system and at least two merits and demerits for the usage

**1. Narrative notes**

They are used to describe and explain the system, at the same time as making any comments or criticisms which will help to demonstrate an intelligent understanding of the of the system

Merits	Demerits
They are relatively simple to record and can facilitate understanding by all audit team members	Describing something in narrative notes can be time consuming.
They can be used for any system due to the method's flexibility	They are awkward to update if written manually.
Editing in future years can be relatively easy if they are computerized.	It can be difficult to identify missing internal controls because notes record the detail of the systems but may not identify control exceptions clearly.



## 2. Flowcharts

These are graphic illustrations of the physical flow of information through the accounting systems.

Merits	Demerits
They can be prepared quickly after little experience	They are most suitable for describing standard systems. Procedures for dealing with unusual transactions will normally have to be recorded using narrative notes
As the information is presented in a standard form, they are fairly easy to follow and review.	Major amendment is difficult without redrawing.
They ensure that the system is recorded in its entirety as all document flows have to be traced from beginning to end	Time can sometimes be wasted by charting areas that are of no audit significance.

## 3. Questionnaires

Questionnaires are of two types:

**Internal control questionnaires (ICQs):** They comprise a list of questions designed to determine whether desirable controls are present within an entity. They are designed to ensure that each of the major transaction cycles is covered. Their primary purpose is to evaluate the system rather than describe it.

**Internal control evaluation questionnaires (ICEQs):** These are used to determine whether there are controls which prevent or detect specified errors or omissions. These are more concerned with assessing whether specific errors are possible rather than establishing whether certain desirable controls are present.

Merits	Demerits
If drafted thoroughly, they can ensure all controls are considered.	They can be drafted vaguely, hence misunderstood, and important controls not identified.
They are quick to prepare	They may contain many irrelevant controls
They are easy to use and control	They may not include unusual controls which are nevertheless effective in particular circumstances.



#### 4. Checklists

With this technique, instead of asking questions, statements are made to mark off and tick boxes are used to indicate where the statement holds true. They share many of advantages and disadvantages to the questionnaires.

Merits	Demerits
If drafted thoroughly, they can ensure all controls are considered.	The client may be able to overstate controls.
They are quick to prepare	They may provide less information to the auditor due to summarized information and no arrear for comments.
They are easy to use and control	They may not include unusual controls which are nevertheless effective in particular circumstances.
Checklists can highlight deficiencies where extensive substantive testing will be required.	They can impressions that are controls are of equal weight.

b) The control objectives, related risks and test of controls that are associated with ordering and receipts of company's purchases:

	Control objective	Risk	Test of control
Purchase ordering	All orders are authorized, received and are for the entity.	Purchase orders may not be authorized, received or not in for entity,	-Check whether the orders are authorized by competent staff in respect to segregation of duties.
			-Check whether the pressed orders were received and in the agreed time with the supplier.
			-Confirm whether the pressed orders are for the entity.
	Orders are done in respect to the approved re-order levels and pre-approved requisitions	-They may be excess store due to lack of re-order levels policy.	-Check whether purchase orders are done considering the entity's re-order level policy.
		-Orders may not done upon the approved requisitions from the user departments.	-Confirm whether the orders are processed with regards to the requisitions from user departments in the entity.
	Purchase receipts are received by authorized personnel in the entity	Supplied receipts may be diverted and used for personal benefits rather than for the entity.	-Crosscheck whether the supplied receipts are received by authorized staff.



Purchase receipts	All purchase receipts received are properly kept, recorded and defects in any are communicated, returned to the supplier and goods reception notes are countersigned.	-Received receipts may not be properly kept, not accounted for and returns may not be processed accordingly. -Goods reception notes may not be countersigned between entity's authorized staff and the supplier.	-Confirm whether the supplied receipts were kept and recorded in the books of accounts -Check whether the returns were communicated and returned to the supplier and return delivery note were signed. -Confirm that the GRNs are countersigned upon each receipt.
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c) **Walk-through test:** It is the test used to understand the entity's control system by picking up a transaction and follow it through the system to see whether all the controls they anticipate they should be in existence were in operation with regard to that transaction.

### QUESTION 3

#### Marking guide

#### Maximum marks

- In accordance with ISA 500, "Audit evidence", briefly comment on the argument between the audit manager and the audit partner in the above case study. (2 Marks)
- In accordance with ISA 500, "Audit evidence", Explain at least five audit procedures the auditor uses to obtain audit evidence. 1 Mark for outlined procedure and 1 Mark for explanation (10 Marks)
- In line with the above case study, enumerate at least 4 assertions that are applicable to the audit of NMB Group tangible assets and on each assertion, propose a relevant substantive audit procedure that you would perform to get audit evidence. 1 Mark for eliminated assertion and 1 Mark for explanation. (Maximum of 4 assertions) (8 Marks)

#### Total marks

(20 Marks)



## **Model Answers**

a) In Accordance with ISA 500 and the argument in the case study, the process of gathering the audit procedures involves the application of the audit procedures like inspection, observation. Etc. and any auditor whether experienced or new recruits will need to use any of that required procedures as per ISA 500. Also, it will be good to the new joiners to get exposed to the audit work for their development and future quality work as proposed by the audit partner.

b) **Audit procedures the auditor uses to obtain audit evidence in accordance with ISA 500**

### **1. Inspection**

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

### **2. Observation**

Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

### **3. External Confirmation**

An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements.

### **4. Recalculation**

It consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

### **5. Reperformance**

Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

### **6. Analytical Procedures**

Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

### **7. Inquiry**

Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries.



**c) Assertions that are applicable to the audit of tangible assets and relevant substantive audit procedure**

**Existence**

Carry out a physical verification and confirm that the recorded and reported NMB Group Ltd's assets do physically exist across the country.

**Completeness**

Cross check that all company's acquired and reported assets were all captured in the assets register for the noted difference may be due to unrecorded assets.

**Rights and obligations**

Confirm that all recorded tangible assets in the financial statements are owned by the company for there may be reported assets which are not owned by NMB Group Ltd.

**Classification**

Check whether the tangible assets were recorded in the right accounts by the asset's accountant.



## **SECTION B**

### **QUESTION 4**

#### **Marking guide**

#### **Maximum marks**

- a) - Define the term “Stratification” as far audit sampling is concerned. (2 Marks)
- In accordance with ISA 530 *Audit sampling*, discuss on the main methods of selecting audit samples (2 marks per each explained method). (6 Marks)
- b) - Define the term “Analytical procedures”. (2 Marks)
- List at least six factors that the auditor must consider when deciding to use the analytical procedures (1 mark per each factor). (6 Marks)
- c) In line with ISA 710 *Comparative Information Corresponding Figures and Comparative Financial Statements*, differentiate Corresponding Figures from Comparative Financial Statements. (4 Marks)
- Total marks (20 Marks)**

#### **Model Answers**

- a) **Stratification:** it is the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics.

#### **Main methods of selecting audit samples**

##### **1. Random selection**

Ensures that all items in the population have an equal chance of selection, e.g., by use of random number or random number generators.

##### **2. Systematic selection**

It involves selecting items using a constant interval between selections, the first interval having a random start. When using systematic selection auditors must ensure that the population is not structured in a such manner that the sampling interval corresponds with a particular pattern in the population.

##### **3. Haphazard selection**

With this method, the auditor is satisfied that the sample is representative of the entire population. It requires care to guard against making a selection which is biased. It should be used if auditors are carrying out statistical sampling.

- b) **Analytical procedures** mean evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

#### **Six factors that the auditor must consider when deciding to use the analytical procedures**

When deciding to use analytical procedures, the auditor must consider:

1. The plausibility and predictability of the relationships, such as the strong relationship between turnover and sales commission.
2. The objectives of the procedures and the extent to which their results are reliable.
3. The detail to which information can be analysed.



4. The availability of information both financial and non-financial.
5. The comparability of the information. Ratios, on their own, are of little use. They should be comparable to previous years and other similar companies.
6. The knowledge gained during previous audits such as effectiveness of controls.

**c) Corresponding figures:** Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as “current period figures”). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

**Comparative financial statements:** Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor’s opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

## QUESTION 5

### Marking guide

### Maximum marks

- a) In line with ISA 700, *Forming an opinion and reporting on financial statements*, Explain the basic elements to be included in the auditor’s report. (1 Mark per each explained element, and 0.5 Mark for listed element not explained) (14 Marks)
- b) List at least six factors to consider when determining Key Audit Matters. (6 Marks)

### Total marks

### (20 Marks)

## Model Answers

### a) Basic elements to be included in the auditor’s report

#### 1. Title

It should clearly indicate that the report is prepared by an independent auditor. This independence confirms that all the relevant ethical standards have been met.

#### 2. Addressee

The auditor needs to consider the circumstances of the engagement and the local regulations. Under company law the audit report should be addressed to the shareholders.

#### 3. Opinion paragraph

This paragraph will identify the entity been audited; state that the financial statements have been audited; identify each of the financial statements being audited; refer to the significant accounting policies and other notes contained within the financial statements; specify the date and period covered by the financial statements.

If the auditor expresses an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the opinion shall use one of the following equivalent phrases:



The financial statements present fairly, in all material respects, ...in accordance with the applicable financial reporting framework; or the financial statements give a true and fair view of ... in accordance with the applicable financial reporting framework.

#### **4. Basis for audit opinion**

The basis for opinion paragraph must state that the audit was conducted in accordance with the ISAs and refer to the 'Auditor's responsibilities for the audit of the financial statements' section which describes the auditor's responsibilities under the ISAs. The auditor must also state that they are independent of the audited entity, in accordance with the relevant ethical requirements relating to the audit. Finally, the auditor must state that they believe the audit evidence obtained is sufficient and appropriate to provide a basis for the audit opinion.

#### **5. Going concern**

Where the auditor considers a material uncertainty related to going concern exists, this should be described in a separate paragraph headed 'Material uncertainty related to going concern'.

#### **6. Key audit matters**

For the audit of listed entities, or where required by law or regulation, the auditor should include a 'Key audit matters' section. This section describes the matters that, in the auditor's professional judgement, are most significant to the audit.

#### **7. Other information**

For the audit of listed entities or any other entity where the auditor has obtained other information, an 'Other information' section should be included in the auditor's report. This section should include:

- A statement that management is responsible for the other Information
- An identification of the other information obtained before the date of the auditor's report (for listed entities, also the other information expected to be obtained after the date of the auditor's report)
- A statement that the auditor's opinion does not cover the other Information
- A description of the auditor's responsibilities for reading, considering, and reporting on other information, and
- Where other information has been obtained, either a statement that the auditor has nothing to report, or a description of any uncorrected material misstatement.

#### **8. Responsibilities for the financial statements**

This part of the report describes the responsibilities of those who are responsible for the preparation of the financial statements. This section should describe management's responsibility including the following:

- The preparation of the financial statements in accordance with the applicable financial reporting framework;
- The implementation of such internal control as are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to error or fraud.
- The assessment of the entity's ability to continue as a going concern, the appropriateness of the going concern basis of accounting and adequacy of related disclosures.
- Reference shall be made to 'the preparation and fair presentation of these financial statements.'



## **9. Auditor's responsibilities for the audit of the financial statements**

The report must state that:

- The auditor's objectives are to obtain reasonable assurance whether the financial statements are free from material misstatement, and to issue an auditor's report that includes the auditor's opinion;
- Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists.

## **10. Other reporting Responsibilities**

If the auditor is required by law to report on any other matters, this must be done in an additional paragraph titled 'Report on other legal and regulatory requirements' or otherwise as appropriate.

## **11. Name of the engagement Partner**

The name of the engagement partner should be identified, unless such a disclosure is reasonably expected to lead to a significant personal security threat.

## **12. Auditor's signature**

The report must contain the auditor's signature, whether this is the auditor's own name or the audit firm's name or both.

## **13. Auditor's address**

The location where the auditor practices must be included.

## **14. Date of the report**

The report must be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.

### **b) List at least six factors to consider when determining Key Audit Matters**

1. The importance of the matter to intended users' understanding, including materiality
2. The nature of the underlying accounting policy relating to the matter, or the complexity or subjectivity involved.
3. Any misstatements related to the matter
4. The nature and extent of audit effort needed to address the matter
5. The nature and severity of difficulties in applying audit procedures, obtaining evidence, or forming conclusions, including more subjective judgements.
6. The severity of any control deficiencies
7. Whether several separate issues interacted, eg. if a long-term contract had repercussions in several areas (revenue recognition, litigation, or contingencies).



## QUESTION 6

### Marking guide

### Maximum marks

- (a) Outline the key terms of reference as per Cadbury report *(1 Mark per each term)* (4 Marks)
- (b) In the context of the requirements of combined code, enumerate the principles which can be adopted globally for effective and sound corporate governance in a company. *(1 Mark per each principle)*. (14 Marks)
- (c) What is an audit committee in a company (2 Marks)

### Total marks

(20 Marks)

### Model Answers

#### a) Key terms of reference as per Cadbury report

1. The responsibilities of executive and non-executive directors and the frequency, clarity and form in which information should be provided to shareholders.
2. The case for audit committees, their composition and role.
3. The responsibilities of auditors and the extent and value of the audit.
4. The links between auditors, shareholders, and the directors.

#### b) The principles which can be adopted globally for effective and sound corporate governance in a company as per combined code

1. Every company should have an effective board.
2. There should be clear divisions of responsibilities at board level.
3. There should be an appropriate balance of executive and non-executive directors.
4. A formal procedure for appointments to the board should exist.
5. The board should receive timely information in order to discharge its duties.
6. All directors should maintain and upgrade their skills and knowledge.
7. There should be an annual evaluation of its own performance.
8. All directors should be submitted to re-election at appropriate time intervals.
9. There should be appropriate levels of remuneration that are sufficient to attract, retain and motivate individuals of the necessary quality required.
10. A significant portion of pay should be performance related.
11. A formal procedure for the fixing of pay levels should exist and no director should have a hand in fixing his/her own pay.
12. The board should present a balanced assessment of the company's performance.
13. The board should implement a good system of internal control.
14. The board should have meaningful communication with the shareholders and should use the annual meeting to communicate with investors.

- c) An audit committee is a sub-committee of the board of directors, usually containing a number of independent non-executive directors. Its main role is to provide oversight of the financial reporting process, the audit process, the company's system of internal controls and compliance with laws and regulations.

**END OF MARKING GUIDE AND MODEL ANSWERS**