



CERTIFIED ACCOUNTING TECHNICIAN
STAGE 3 EXAMINATION
S3.4 AUDIT AND ASSURANCE
DATE: TUESDAY, 26 JULY 2022
MARKING GUIDE AND MODEL ANSWERS

SECTION A

Marking guide

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

Section A-Marks allocation

2 marks for each collect answer

Total marks for this section

Marks

2

20

Model Answer

1. The Correct Answer is C

Control environment is the frame work in which controls operate, and the environment is very much determined by the management of a business (auditee). An Auditor should obtain an understanding of the control environment as per ISA 315 requirements. Thus, Clara should Seek agreement with the auditee as to the standards to be used to measure operating performance.

2. The Correct Answer is A

A control that might have prevented this situation would be to adequately check employment backgrounds for all new employees prior to onboarding, as this could have helped them identify that the accounts payable manager had been previously terminated from another company for alleged wrongdoing, hence question his/her integrity.

3. The Correct Answer is D

Statistical sampling involves the use of techniques from which mathematically constructed conclusion about the population can be drawn. For the case of Anita, she should consider using

statistical sampling because it is reliable and objective as the population is mathematically known.

4. The Correct Answer is A

Audit effectiveness refers to how well audit process accomplishes its objective. Focusing on substantive test and overlook test of controls while they might contain significant deficiencies would relatively impact the effectiveness of the audit.

5. The Correct Answer is B

Sampling from a population of policyholders would be very inefficient for the audit assertion, as many policyholders may not have any activity during the year, and a sample of claims filed does provide evidence on the overall processing of claims and thus provides some evidence related to the assertion. In addition, the claims denied filed provides evidence on the claims denied, but the auditor cannot conclude that all claims that were not denied should have been paid

As a conclusion, the auditor is interested in whether the actual claims paid are properly supported and the most appropriate population from which to sample is the claims-paid file.

6. The Correct Answer is D

Notes receivable are a balance sheet item that records the value of promissory notes that a business is owed and should receive payment for. The procedure of examination of cash receipts records to determine promptness of interest and principal payments is the best evidence of the collectability of notes receivable.

7. The Correct Answer is B

ISA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” describe that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. In this regard PAMOJA Consultancy is entitled to collect the audit fee as per engagement contract and is not liable for FRW 80 million.

8. The Correct Answer is C

Detection risks occurs when the auditor fails to detect the misstatements and errors in the company’s financial statement, and as a result, they issue a wrong opinion on those statements.

Below are the example sources of Detection risks:

- The auditors did not plan the audit well and have chosen inappropriate audit procedures
- The auditors did not choose the correct sample size
- The auditors did not understand the entity and its environment

9. The Correct Answer is B

Analytical procedures consist of comparison of financial data with other financial and non-financial data of the same or previous periods as well as comparison of financial data with expected data.

Considering the above definition, it is clear to note that Comparison of recorded amounts of major disbursements with appropriate invoices does not qualify as an analytical procedure.

10. The Correct Answer is D

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report. Thus, in our case the auditor may consider revising the audit report to include other matter paragraph describing the material inconsistency.

SECTION B

QUESTION 11

Marking guide	Marks
a. Definition of an accounting Estimate	1
b. Outline at least 3 examples of an accounting estimate	3
c. Give out at least 6 audit procedures to consider in the audit of accounting estimates	6
Total Marks	10

Model answer

- a) Accounting Estimates is a monetary amount in financial statements that are subject to measurement uncertainty. It is used in accrual basis accounting to make the financial statements more complete, usually to anticipate events that have not yet occurred, but which are considered to be probable. Estimates may be subsequently revised as more information becomes available.
- b) Examples of accounting estimates includes but not limited to the following:
- Provision for an environmental damage claim,
 - Allowance for loss from a lawsuit
 - Depreciation method or asset useful life
 - Allowance for doubtful accounts
 - Fair value of goodwill and other intangibles
 - Warranty obligations
- c) For the case of HIRWA Inc, Wishavura need to consider the following audit procedures in her audit of the FRW 70 million provision:
- Confirm whether the treatment complies with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”
 - There is a probability that HIRWA Inc will lose the case, thus Wishavura need to assess the assumption on which the provision was based.
 - Obtain advice from the company’s legal team on the appropriateness of the estimated amount in relation to the nature of the breach and the consequences and if necessary, consider adjusting the balance. (Provision amount)
 - Review other major customers’ contract to establish whether there is a possibility of another similar breach, hence additional provisions required.
 - Extend the review to cover events after the reporting period to ensure the claim has been settled subsequently.

QUESTION 12

Marking guide

Define Audit Planning in reference to ISA 300

Identify at least 5 objectives of the planning stage and

Identify 4 Knowledge of the business expected to be acquired during audit planning

Total Marks

Marks

1

5

4

10

Model Answer

ISA 300 planning an audit of financial statements establishes standards and guidance on the considerations and activities applicable to planning an audit. The nature and extent of planning activities will vary according to the size and complexity of the entity, the auditor's previous experience with the entity and changes in circumstances that occur during the audit engagement.

The following are objectives of the planning stage, with particular attention being paid to those areas that will assist the auditor in obtaining a sound knowledge of the business.

Objectives of audit planning

- Ensure that appropriate attention is devoted to the different areas of the audit.
- Ensure proper resource allocation (appropriate staff with suitable expertise)
- Timetable of planned audit work - Set out timetable (client and staff)
- Ensure there is a budget and the fee is realistic.
- Ensure staff are informed of the inventory count.

Knowledge of the business

- Enable the auditor to document the system and understand the transaction flows and balances to be reviewed.
- Enables the auditor to assess the risk of error in their client's systems.
- Identify unusual and significant issues.
- Helps identify the risk of fraud/material misstatements.
- Identify applicable laws and regulations.
- Identify the need for use of an expert.

SECTION C

QUESTION 13

Marking guide

Marks

- | | | |
|----|---|----------|
| a. | Explain the difference and similarities between Contract law and Third-parties negligence claims in relation to auditor's liabilities. | 3 |
| b. | Explain the three requirements condition for a third-party negligence claim in relation to the case study. | 6 |
| c. | No & Explain why Creative Auditors Ltd will not be liable to Secure Bank for negligence. | 2 |
| d. | Identification of the 3 criteria (Duty of care, negligence, and Damages) | 3 |
| e. | Explanation of Duty of care, negligence and Damages discuss the likelihood of Secure Bank winning a negligence claim against Creative Auditors. | 6 |

Total Marks

20

Model Answer

a) Contract Law exist when the company and the auditor agree on the express term of the contract set out in an engagement letter and the auditor is liable for the breach of their Contract.

Although for Third parties' negligence there is no binding contract between auditor and third parties, however if the auditor has been negligent, it is possible for a third party to have a claim against the auditor even though they do not have a contract with them.

The similarity between the two is that for a successful claim there must be three conditions such as Negligence, Duty of care, and monetary loss suffered (damage).

b) In order to establish a Course of action for negligence against Creative Auditors Ltd, Secure Bank should prove that the following requirements were met:

- **Duty of Care:** Secure Bank should be able to demonstrate that Creative Auditors Ltd owed them a duty of care enforceable by Law.
- **Negligence:** in a situation where duty of care existed, the auditor should be held liable when they were negligent in performance of that duty. (Judged by the accepted professional standards).
- **Damages:** Secure Bank should demonstrate how they has suffered a monetary loss as a result of the negligence of the auditor.

c) No, Creative Auditors Ltd will not be liable to Secure Bank for negligence because they owed no duty of care to it. Hence all the requirements for third party negligence claim were not met.

d) The auditor has knowledge that the financial statements will be used for the sole purpose of loan negotiation with the TDK Bank and most likely owes a duty of care to TDK Bank. For the other financial institutions such as Secure Bank which subsequently lent money to ItekaLtd, it is difficult to argue that auditor's duty of care should be extended to them. The auditor had no binding contract with Secure Bank and the financial statements were neither audited for the primary benefit of Secure Bank.

The audit was performed mainly for the benefit of TDK Bank rather than for any other financial institutions, in addition it is also important to examine the terms of the engagement to ascertain whether TDK Bank was named as the only bank in the negotiations. If this is the case, it will provide additional evidence to support that the auditor does not owe a duty of care to any other financial institution.

Best Practice requires auditors to exercise reasonable care and skill while performing their duties. In this case auditor's conduct is likely to be negligent as he failed to discover the overvaluation of inventory and had relied on management representation letter for valuation of inventory which is a significant balance sheet item for a manufacturing company like Iteka Ltd. To rely on the client's personnel and/or management is an aid, but not a substitute for auditor's procedures. Auditing standards also require that when inventory is material, the auditor should obtain sufficient appropriate audit evidence regarding its existence and condition.

It is clear in this case that Secure Bank suffered losses as ITEKA Ltd had defaulted its loan. It is also likely that Secure Bank's loss was a direct result of auditor's negligence because the negligently prepared financial reports formed the major basis for its decision making.

In conclusion only one criteria of Duty of care were not met since the auditor owed no duty of care to Secure Bank. Therefore, it is unlikely that Secure Bank will win the case against Creative Auditors Ltd.

QUESTION 14

Marking guide

Marking guide	Marks
a. Identify at least 5 weaknesses in the internal control in the revenue system (1 mark each) Provide one control to address each weakness (1 mark each)	5
b. Distinguish the 2 assertions Decide which one is more effective than the other in the audit of receivables	1
c. Explain the substantive procedure that would test suspicion	3
d. Discuss how receivables' circularization frequently doesn't produce the same quality of audit evidence as a supplier statement reconciliation	5
Total Marks	20

Model Answer

a) See below Table

Auditable Area	Internal control weakness	Proposed control
Revenue System	Sales orders being recorded on a note pad.	Sales orders should be recorded on a pre-numbered sequential order pad to avoid duplications.
	Lack of Customers identity check	Orders should only be processed for customers who have credit accounts.
	Customers' balances are not checked prior to processing of an order	Only customer's balances that are within their credit limits should have their orders processed to avoid increase in long outstanding receivables
	Sales orders are only one -part	Sales orders should be multi-part, so that the ordering department maintain a copy.
	If the goods are not in inventory, the customer is not notified	The customer should be notified immediately if he is only going to receive a part-delivery.
	The goods are not checked before dispatch.	If the company has over-delivered, the customer will not complain hence loss to the business. Goods must be checked prior to dispatch.
	Goods dispatch note is prepared before sales order is received	Sales order must be cross-referenced to goods dispatch note
	Driver does not get the customer to sign goods dispatch note.	This potentially may lead to many disputes. Driver must get the goods dispatch note signed off by the customer.

Invoices are prepared on a weekly basis.	This effectively gives the customer potentially an extra week's credit and may results in cut-off. Ensure invoices are prepared and recorded promptly.
The person opening the post should not be the person who goes to the bank.	Segregation of duties should be observed such that no individual performing 2 conflicting tasks.
There are no credit control letters sent out.	Statements, reminders and final demands should all be sent out as each month progresses.

b) The assertion that you would pay more attention to in the audit of receivables is “Existence” to ensure there are no Ghost receivables.

c) If Shadia and Amani were looking to manipulate the financial statements, they would either overstate revenue or understate purchases or both. However, since the question talks about Receivables it is more likely that they would look to overstate revenue, i.e., include some revenues that were not genuine or include some revenues that did not exist as receivables arises from credit revenue.

To look for the existence of receivable we need to go back in the audit trail, as genuine documentation would not be forthcoming. We need to ascertain that the preceding document in the revenue system is authentic. Hence, check a sample of sales invoices to signed goods dispatch notes would be an ideal substantive test.

d) Receivable circularization is a technique used by an auditor in which all debtors to a company are asked to confirm the amounts outstanding (positive circularization) or to reply if the amount stated is incorrect or in dispute.

In order for a receivables’ circularization to be a sufficient and appropriate source of audit evidence, we need the co-operation of the debtors. There is no obligation for them to reply, they are only acting out of their own goodwill should they choose to co-operate.

In addition, the test has an inherent bias in it which only the careless credit customers would choose to ignore. If the request indicates that the client has a greater balance than the balance on the customer’s own purchase ledger, the customer is likely to object and supply a reconciliation (ignoring any timing differences). Should it be the other way round and the client has a lower balance than the credit customer’s purchase ledger balance he may choose to ignore the request as the difference is in his favor.

Supplier statement reconciliations are much easier as the statements come to the client automatically. All the evidence is there (suppliers automatically send statements that come from their sales ledger monthly - just like MUGISHA Ltd should be doing and there will be no

bias built into the test. Hence the quality of audit evidence will be far greater for supplier statement reconciliations than a receivables circularization.

QUESTION 15

Marking guide	Marks
a. Answer presented in a form of a letter/report (With Title, date, to whom the letter is addressed to, and the background of the case study)	2
Being able to elaborate at least 3 errors in revenue recognition relevant to ONTIME Engineers Ltd	6
Any other indicated possible error in revenue recognition not relevant to the case study	1
Conclusion remark	1
b. 5 Recommendation provided is in relation to accounting policies and principles (1 mark each)	5
c. Correct order of how client’s affairs should not be disclosed	1
Explain to whom the auditor should disclose unlawful act by the client	4
Total Marks	20

Model Answer

a) To the Directors of ONTIME Engineers Ltd

Audit Observation on the financial statements for the period ended 30 September 2021
29th March 2022

Dear Directors;

This letter has been prepared for the Directors of ONTIME Engineers Ltd to bring attention to those charged with governance regarding various matters arising from the audit of the period ended 30 September 2021.

After reviewing the financial statements of ONTIME Engineers Ltd for the period ended 30 September 2021 we have noted the following:

- Financial statements were misstated as a result of wrong revenue recognition / inappropriate accounting policies.
- The accounting policy adopted was cash basis and does not consider the requirements of IFRS 15 “Revenue recognition”
- The proportion of direct cost (80%) recorded in current year does not qualify for the entire period since the contract is valid for 3 years, thus a cut off issue.

We wish to express our appreciation of the courtesy and co-operation extended to us by your team during the course of our work.

b) Ideally income from contractual arrangements should be recognized in the period in which entitlement has been earned through service delivery thus management of ONTIME Engineers

Ltd should consider adopting accrual basis of accounting with emphasis put on compliance with IFRS 15 “Revenue recognition” through the following steps:

- Identify the contract(s) with a customer.
 - Identify the performance obligations in the contract.
 - Determine the transaction price
 - Allocate the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract.
 - Recognize revenue when a performance obligation is satisfied by transferring a promised good or service to a customer.
- c) An auditor should disclose information in the following order:
- (1) Management
 - (2) Non-executive directors or audit committee
 - (3) 3rd parties (if required by law, or in the public interest)

Note that in the case of suspected or actual money laundering the auditor should NOT discuss this with the client as that would tip them off. The auditor would raise the issue directly with the relevant law enforcement authority (having first discussed the matter with the audit firm with the money laundering reporting officer.

END OF MARKING GUIDE AND MODEL ANSWERS