

CERTIFIED ACCOUNTING TECHNICIAN (CAT)

STAGE 3 EXAMINATION

S3.4 AUDIT AND ASSURANCE

DATE: TUESDAY, 24 AUGUST 2021

MODEL ANSWERS AND MARKING GUIDE

SECTION A

Marking Guide

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

Question 1 to 10	2 marks for each correct answer	<i>Marks</i> 2
Total marks for the section		20

SECTION A – Detailed Answers

QUESTION ONE

The correct answer is D

Key functions that should be segregated from one another include: Authorizing and initiating transactions; physical custody and control of assets involved and recording of the transaction. This makes it more difficult for fraudulent transactions to be processed (since a number of people would have to collude in the fraud), and it is also more difficult for accidental errors to be processed (since the more people are involved, the more confirmation there can be). However, filing and archiving finance documents are not key functions that need to be segregated since this is related to keeping historical information.

QUESTION TWO

The correct answer is C

Control risk (together with inherent risk) are components of the risk of material misstatement, which is governed by the circumstances of the audit client and therefore is outside the control of the auditor. Sampling risk is a component of detection risk, which is controlled by the auditor. The correct answer is therefore Option C.

QUESTION THREE

The correct answer is B

Third party claim for auditor's negligence can only be valid if: Duty of care existed, negligence by the auditor occurred and damages in form of monetary loss was incurred by the client.

QUESTION FOUR

The correct answer is A

Reporting framework and scope of the audit, materiality levels and risk assessment are part of audit strategy. But sample sizes and management representations are not part of audit strategy since they are part of the audit execution or completion stages

QUESTION FIVE

The correct answer is D

Options (A), (B) and (C) pertain to documents that are unique to the current year's audit engagement; consequently, they should be filed on the current file. A copy of the company's legal constitution (Option D) would be of ongoing relevance to future audits and should therefore be retained on the permanent file.

QUESTION SIX

The correct answer is A

Changes in accounting policies, weak internal control systems and opening a new branch during the year if obtained during the audit should require the audit strategy to be updated. Departure of one of the key finances personnel however, should not render the audit strategy to be updated if there is no evidence of risk of material misstatements it poses to the financial statements.

QUESTION SEVEN

The correct answer is B

In accordance with ISA 220 Quality control for an audit of financial statements, the engagement Partner must take responsibility for the quality of the audit to be carried out, including managing the disagreements between the client and the audit team. A. is not correct because forcing the client can be considered unprofessional and C is not correct because accepting the client's interpretation on PPE which is not backed with evidence is against professional skepticism. D is also not correct since doing nothing would not resolve the situation.

QUESTION EIGHT

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.

QUESTION NINE

The correct answer is A

The valuation rules for inventory are laid down in IAS 2 which states that inventory should be valued at the lower of cost and net realizable value. (IAS 2: para. 9). Therefore, B. Selling price and D. Inventory cost plus inflation are not correct options.

QUESTION 10

The correct answer is A

The primary procedure for obtaining evidence for the existence of customers' balances is the accounts receivable confirmation, asking accounts receivable for confirmation of balances owed, though receivable confirmation, the auditor obtain the evidence on completeness of account balance recorded in the financial statement and the right and obligation as well. The Debtors Statement is used in the control of customers' accounts, and the collection of funds from credit account customer and this cannot confirm the existence of debtors. Analytical procedures and tests of controls would not provide the best evidence for these assertions.

SECTION B

QUESTION 11

Marking Guide

i) Identification and explanation of factors of analytical procedures	Marks
• Large volumes of transactions that tend to be predictable over time	1
• Reliability of the data where ratios are developed	1
• Expectation is sufficiently precise to identify a material misstatement	1
• Amount of any difference of recorded amounts from expected values	1
• Any other valid point	1
Maximum marks	4
ii) Accounts balances suitable for substantive analytical procedures	
• Revenue,	0.5
• Cost of sales,	0.5
• Payroll cost,	0.5
• Loans,	0.5
• Depreciation etc.	0.5
• Any other valid point (is 0.5 each)	0.5
Maximum marks	2
(b) Substantive analytical procedures on payroll costs for Mugisha & Sons Ltd.	
• Comparison of wages and salaries levels month-by-month with previous years	1
• Effect on wages and salaries of rate changes during the year	1
• Average wage per month over the year	1
• Sales/profits per employee	1
• Payroll proof in total (pay rise × staff changes × staff mix)	1
• Review monthly payroll charges, compare this to the prior year and budgets	1
• Compare overtime pay as a percentage of company normal hours pay	1
Maximum marks	4
Total marks	10

Detailed answer

(a) With reference to the above scenario,

- (i) Identify and explain factors you should consider as an auditor while conducting substantive analytical procedures?**

In accordance with ISA 520: Analytical procedures, Factors to should consider as an auditor while conducting substantive analytical procedures include:

- (1) The suitability of using substantive analytical procedures given the assertions:
Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
 - (2) The reliability of the data, whether internal or external, from which the expectation of recorded amounts or ratios is developed.
 - (3) Whether the expectation is sufficiently precise to identify a material misstatement at the desired level of assurance.
 - (4) The amount of any difference of recorded amounts from expected values that is acceptable.
- (ii) Examples of accounts balances for Mugisha & Sons Ltd financial statements that are suitable for substantive analytical procedures include:
- revenue,
 - cost of sales,
 - payroll cost,
 - loans,
 - depreciation etc.

(b) Discuss any 4 substantive analytical procedures you expect to conduct while reviewing payroll costs for Mugisha & Sons Ltd.

Substantive analytical procedures expected to be conducted while reviewing payroll costs for Mugisha & Sons Ltd should consider:

- Comparison of wages and salaries levels month-by-month with previous years
- Consider effect on wages and salaries of rate changes during the year
- Average wage per month over the year
- Sales/profits per employee
- Payroll proof in total (pay rise \times staff changes \times staff mix)
- – Review monthly payroll charges, compare this to the prior year and budgets and discuss with management any significant variances.
- Compare overtime pay as a percentage of company normal hours pay to investigate whether it is at a similar level to the prior year and within an acceptable range. Investigate any significant differences.

QUESTION 12

Marking guide

(a) Test of controls objectives for Gasongo Spare Parts Ltd

- All inventory movements are authorized and recorded 1
- Inventory records only include items that belong to the client. 1
- Inventory records include inventory that exists and is held by the client. 1
- Inventory quantities have been recorded correctly. 1
- Cut-off procedures are properly applied to inventory. 1

Maximum marks 4

(b) Identification of the loss incurred from the theft of inventory

- Reconciliation between purchases and sales of spare parts 1
- Physical count of all inventory items and reconciliation in the system 1
- Agreement of stock cards values to physical quantities of inventory items 1
- Identification of the missing inventory items and the quantities; 1

Maximum marks 3

(c) Identification of slow moving and obsolete inventory.

- Inventory valuation in accordance with IAS 2 1
- Inventory managers regularly review condition of inventory 1
- Slow moving and obsolete inventory items should be identified 1
- **Maximum marks 3**

Total marks 10

Detailed answer

(a) Clearly identify your test of controls objectives for Gasongo Spare Parts Ltd inventory.

When conducting the test of controls for Gasongo Spare Parts Ltd inventory, your objectives should be to ensure that:

- All inventory movements are authorised and recorded.
- Inventory records only include items that belong to the client.
- Inventory records include inventory that exists and is held by the client.
- Inventory quantities have been recorded correctly.
- Cut-off procedures are properly applied to inventory.

(b) Advise to the management of Gasongo Spare Parts Ltd on how to estimate the loss incurred from the theft and procedures to identify slow moving and obsolete inventory.

The management of Gasongo Spare Parts Ltd could use some of the techniques/procedures below to identify the loss incurred from the theft of inventory:

- Conduct a reconciliation between purchases and sales of spare parts to identify expected inventory quantities expected to be at Gasongo Spare Parts Ltd
- Conduct a physical count of all inventory items and reconcile the report to the logical values in the system.
- Agree stock cards values to physical quantities of inventory items.
- Identify the missing inventory items and the quantities; and multiply them with corresponding unit average cost to compute the value of missing inventory.

Gasongo Spare Parts Ltd should use the following procedures to identify slow moving and obsolete inventory.

- Ensure that inventory is valued in accordance with authorized IAS 2 (i.e. lower of cost and net realisable value)
- Inventory managers regularly review condition of inventory – Treatment of slow-moving, damaged and obsolete inventory – Authorization of write-offs
- slow moving and obsolete inventory items should be identified and marked during the annual physical count.

SECTION C

QUESTION 13

Marking guide

(a) Difference(s) between application controls and general IT controls

- **Application controls** typically operate at a business process level. 1
- Application controls are designed to ensure the integrity of the accounting records. 1
- **General IT controls** are 'policies and procedures that relate to many applications 1
- General IT controls commonly include controls over data centre; 1

Maximum marks 4

(b) Other challenges of new accounting system and their impact to the risks of material misstatements on Abahinzi Microfinance financial statements.

- Poor or lack of security: 2
- Inability to Access Accounting Software and Data Remotely 2
- Poor connectivity and poor internet 2
- lack of training, chart of accounts leading to mis-postings 2
- Data migration 2
- Resistance to change 2

Maximum marks 10

(C) General controls that Abahinzi Microfinance should use to address the challenges and risks identified above.

- Development of computer applications 1
- Prevention of unauthorized changes to programs 1
- Testing and documentation of program changes 1
- Prevention of use of wrong programs or files 1
- Prevention of unauthorized changes to data files 1
- Controls to ensure continuity of operation 1

Maximum marks 6

Total marks 20

Detailed answer

(a) Clearly show the difference(s) between application controls and general IT controls

Application controls are 'manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records.

General IT controls are 'policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operations of information systems. General IT controls commonly include controls over data

centre and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development and maintenance.'

(b) Discuss other challenges you anticipate in relation to the new accounting system and their impact to the risks of material misstatements on Abahinzi Microfinance financial statements.

Other challenges anticipated at Abahinzi Microfinance from the use of new accounting software include:

- Poor or lack of security: while implementing a new account software, people tend not to be up to speed with keeping the security of their accounts and the system in general. This can lead to unauthorized access to the system.
- Inability to Access Accounting software and data remotely
- Poor connectivity and poor internet – particularly for internet-based accounting software.
- As a result of lack of training, it is expected that Abahinzi Microfinance staff are not conversant with the chart of accounts in the new system and therefore leading to mis-postings
- Data migration- Data that's present in excel files, and pencil-and-paper systems may not be directly usable in the new system.
- Resistance to change whereby some staff prefer using the old ways of bookkeeping and preparation of financial statements

(c) Discuss various general controls that Abahinzi Microfinance should use to address the challenges and risks identified above.

Various general controls that Abahinzi Microfinance should use to address the challenges and risks include:

General IT Controls	Details
Development of computer applications	<ul style="list-style-type: none"> • Standards over systems design, programming and documentation • Full testing procedures using test data • Approval by computer users and management • Segregation of duties so that those responsible for design are not responsible for testing • Installation procedures so that data is not corrupted in transition • Training of staff in new procedures and availability of adequate documentation
Prevention of unauthorized changes to programs	<ul style="list-style-type: none"> • Segregation of duties • Full records of program changes • Password protection of programs so that access is limited to computer operations staff • Restricted access to central computer

General IT Controls	Details
	<ul style="list-style-type: none"> • Maintenance of programs logs Virus checks on software • Back-up copies of programs being taken and stored in other locations • Control copies of programs being preserved and regularly compared with actual programs • Stricter controls over certain programs (utility programs)
Testing and documentation of program changes	<ul style="list-style-type: none"> • Complete testing procedures • Documentation standards • Approval of changes by computer users and management • Training of staff using programs
Prevention of use of wrong programs or files	<ul style="list-style-type: none"> • Operation controls over programs • Libraries of programs • Proper job scheduling
Prevention of unauthorized changes to data files	<ul style="list-style-type: none"> • Password protection • Access restricted to authorised users only
Controls to ensure continuity of operation	<ul style="list-style-type: none"> • Storing extra copies of programs and data files off-site • Protection of equipment against fire and other hazards • Back-up power sources Emergency procedures • Disaster recovery procedures e.g., availability of back-up computer facilities • Maintenance agreements and insurance

Question 14

Marking Guide

(a) Describe the objective of ISA 500: Audit evidence in relation to the audit of MF Ltd

- To design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions. 2

(b) Factors that influence decision on what constitutes sufficient and appropriate audit evidence

- Risk assessment result on the account balance(s) 2
- The materiality of the account balance being examined 2
- The experience gained during previous audits 2
- The source and reliability of information available 2
- Auditor's professional judgement. 2

Maximum marks	8
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(c) Test of account balances for MF Ltd financial statements

• Existence	2
• Rights and obligations	2
• Completeness	2
• Accuracy, valuation and allocation	2
• Classification	2
• Presentation	2
Maximum marks	10

Total marks	20
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Detailed Answer

With reference to ISA 500: Audit evidence, advise Joel on the following:

(a) Describe the objective of ISA 500: Audit evidence in relation to the audit of MF Ltd financial statements.

Joel should be advised that the objective of the auditor in line with ISA 500: Audit evidence, is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion for MF Ltd financial statements.

(b) Clearly explain to Joel the factors that should influence his decision on what constitutes sufficient and appropriate audit evidence in regard to his assigned account balances.

Joel's judgement as to what is sufficient, appropriate audit evidence should be influenced by the following factors:

- Risk assessment result on the account balance(s)
- The materiality of the account balance being examined
- The experience gained during previous audits
- The source and reliability of information available
- Auditor's professional judgement.

(c) In accordance with ISA 315, the auditor must use assertions for classes of transactions, account balances, and related disclosures in sufficient detail to form the basis for the assessment of the risk of material misstatement and therefore the design and performance of further audit procedures. Explain this statement to Joel with the use of assertions used to test account balances for MF Ltd financial statements.

In accordance ISA 315: para. A129, the Assertions used the test the account balances and related disclosures (for MF Ltd) are the following:

- **Existence:** assets, liabilities and equity interests exist. For example, all MF Ltd plant and machinery recorded exist.

- **Rights and obligations:** MF Ltd holds or controls the rights to assets, and liabilities are the obligations of MF Ltd. For example, the plant and machinery recorded really belong to the MF Ltd.
- **Completeness:** all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the MF Ltd financial statements have been included. For example, all loan balances which MF Ltd is under obligation to repay have been recorded.
- **Accuracy, valuation and allocation:** assets, liabilities, and equity interests are included in the MF Ltd financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded, and related disclosures have been appropriately measured and described. For example, the trade receivables balance is a true reflection of the amount the MF Ltd expects to receive from its customers, and any irrecoverable balances have been provided against.
- **Classification:** assets, liabilities and equity interests have been recorded in the proper accounts.
- **Presentation:** assets, liabilities and equity interests 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.

Question 15

Marking guide

(a) Various audit opinions to the financial statements.

- | | |
|-------------------------------------|---|
| • An unmodified/Unqualified opinion | 1 |
| • Qualified opinion | 1 |
| • Adverse opinion | 1 |
| • Disclaimers of opinion | 1 |

Maximum marks **4**

(b) Clearly explain the factors that you need to consider to conclude whether reasonable assurance has been obtained

- | | |
|-----------------------------------------------------------------------------------------|---|
| • Whether sufficient appropriate audit evidence has been obtained (ISA 330) | 1 |
| • Whether uncorrected misstatements are material (ISA 450) | 1 |
| • Qualitative aspects of the entity's accounting practice, | 1 |
| • Disclosure of the significant accounting policies selected and applied | 1 |
| • Accounting policies are consistent with financial reporting framework | 1 |
| • Whether accounting estimates made by management are reasonable | 1 |
| • Whether information is relevant, reliable, comparable and understandable | 1 |
| • Adequate disclosures to allow users to understand the effect of material transactions | 1 |
| • Whether the terminology used in the financial statements is appropriate | 1 |
| • The overall presentation, structure and content of the financial statements | 1 |

• Whether the financial statements achieve fair presentation	1
• Whether the financial statements describe applicable financial reporting framework	1
Maximum marks	10

(c) Basics elements of Auditors report

Title	1
Addressee	1
Opinion paragraph	1
Basis for opinion	1
Going concern	1
Key audit matters	1
Other information	1
Responsibilities for the financial statements	1
Auditor's responsibilities for the audit of the financial statements	1
Other reporting responsibilities	1
Name of the engagement partner	1
Auditor's signature	1
Auditor's address	1
Date of the report	1
Maximum marks	6
Total marks	20

Detailed answer

(a) In line with ISA 700, discuss various audit opinions to the financial statements.

In line with ISA 700, the following are possible audit opinions to the financial statements;

- **An unmodified/Unqualified opinion:** is the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. (ISA 700: para. 16)
- **Qualified opinion:** issued when the auditor concludes that misstatements are material, but not pervasive, to the financial statements; or when the auditor cannot obtain sufficient appropriate audit evidence on which to base the opinion but concludes that the possible effects of undetected misstatements, if any, could be material but not pervasive.
- **Adverse opinion:** An adverse opinion is expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are both material and pervasive to the financial statements (ISA 705: para. 8).
- **Disclaimers of opinion:** An opinion must be disclaimed when the auditor cannot obtain sufficient appropriate audit evidence on which to base the opinion and concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. (ISA 705: para. 10)

(b) Cleary explain the factors that you need to consider to conclude whether reasonable assurance has been obtained that Nyaruguru District financial statements are free from material misstatement.

The auditor's conclusion needs to consider the following factors to conclude whether reasonable assurance has been obtained that [Nyaruguru District] financial statements are free from material misstatement in line with ISA 700:

- Whether sufficient appropriate audit evidence has been obtained (ISA 330)
- Whether uncorrected misstatements are material (ISA 450)
- Qualitative aspects of the entity's accounting practice, including indicators of possible bias in management's judgements – this includes considering whether the accounting policies disclosed are relevant to the entity, and whether they have been presented in an understandable manner
- Whether the financial statements adequately disclose the significant accounting policies selected and applied
- Whether the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate
- Whether accounting estimates made by management are reasonable
- Whether the information in the financial statements is relevant, reliable, comparable and understandable
- Whether the financial statements provide adequate disclosures to allow users to understand the effect of material transactions and events on the information presented in the financial statements
- Whether the terminology used in the financial statements is appropriate
- The overall presentation, structure and content of the financial statements
- Whether the financial statements represent the underlying transactions and events so as to achieve fair presentation
- Whether the financial statements adequately refer to or describe the applicable financial reporting framework

(c) Clearly demonstrate basics elements that should be contained in the audited financial statements for Nyaruguru District Hospital.

The auditor's report must be in writing and includes the following basic elements, usually in the following layout (ISA 700: paras. 21–49).

Basic elements of Explanation auditor's report	
Title	The auditor's report must have a title that clearly indicates that it is the report of the independent auditor. This signifies that the auditor has met all the ethical requirements concerning independence and therefore distinguishes the auditor's report from other reports.
Addressee	The addressee will be determined by law or regulation, but is likely to be the shareholders or those charged with governance.
Opinion paragraph	The opinion paragraph must identify the entity being audited, state that the financial statements have been audited, identify the title of each statement that comprises the financial

Basic elements of Explanation auditor's report	
	statements being audited, refer to the summary of significant accounting policies and other explanatory notes, and specify the date or period covered by each statement comprising the financial statements.
Basis for 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.
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'.
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.
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.
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.
Auditor's responsibilities for the audit of the financial statements	<p>The report must state that:</p> <ul style="list-style-type: none"> • The auditor's objectives are to obtain reasonable assurance whether the financial statements as a whole are free from material misstatement, and to issue an auditor's report that includes the auditor's opinion; and • 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.
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.

Basic elements of auditor's report Explanation	
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.
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.
Auditor's address	The location where the auditor practices must be included.
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.

End of model answers and marking guide