CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.2: AUDIT PRACTICE AND ASSURANCE SERVICES

DATE: FRIDAY, 03 DECEMBER 2021

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

a.

Marking guide

a) What to do to gain an understanding of the entity	**Marks**
• Inquiries of management, and of others within the entity	1
• Performing analytical procedures on the company's statement	1
• Schedule a meeting with outgoing auditor of TBR Ltd	1
• Review of previous year management letter	1
• Review of board audit committee packs/minutes	1
• Evaluation of ongoing, amended or newly signed significant contracts	1
• Analysis of the internal audits' reports of TBR	1
• Internet search and review of information on the company's website	1
• Any other valid point	1
Maximum	**5**

What to do to gain an Understanding of the environment

• The regulatory framework/guideline issued by the NBR, RRA, and ICPAR	1
• Read the World bank and IMF reports	1
• Competition. Analyzing competition that TBR Plc	1
• International Financial Reporting Standards and accounting policies	1
• Review of Government policies affecting the conduct of the entity's business	1
• Any other valid point	1
Maximum	**5**

b) Examples of line items that present such a risk as shown by extract	
• Legal claims	1
• Fees and commission income	1
• Interest income	1
• Inventories	1
• Property Plant and Equipment	1
• Any other valid point	1
Maximum	**5**

c) Examples, explanation/examples of such conditions/events.	
• Inquiries into the entity's operations or financial results	1
• Past misstatements, history of errors or a significant amount	1
• Significant amount of non-routine or non-systematic transactions	1
• Intercompany transactions and large revenue transactions at period end.	1
• Application of new accounting pronouncements.	1
• Any other valid point	1

Accounting measurements that involve complex processes.

• Events or transactions that involve significant measurement uncertainty,	1
• Pending litigation and contingent liabilities, for example, sales warranties,	1
• Operations in regions that are economically unstable,	1

- Operations exposed to volatile markets, for example, futures trading. 1
- Operations that are subject to a high degree of complex regulation. 1
- Going concern and liquidity issues including loss of significant customers. 1
- Constraints on the availability of capital and credit. 1
- Changes in the industry in which the entity operates. 1
- Changes in the supply chain. 1
- Developing or offering new products or services 1
- Expanding into new locations. 1
- Any other valid point 1

Maximum **5**

d) (i) "Audit Sampling" 1

(ii) ISA 530. "Audit Sampling" is application of audit procedures to less than 100% 1

(iii) Confirmations of 20 customers out of 100 draw a conclusion on population 2

(iv) Indicate 1 advantage of using the above technique in audit.

- It saves time. 1
- Reduce risk of 'over-auditing' and enables a much more efficient 1

Maximum **1**

(v) Sampling risk controls are operating effectively, when in fact they are not or controls are not operating effectively, when in fact they are 2

(vi) Example of a method used in Audit sampling includes:

- Random selection
- Systematic selection
- Monetary unit sampling
- Haphazard sampling
- Block selection

(1 Mark for one example given as per question) 1

e)

(i) ISA 550, "Related Party" 2

(ii) ISA 550, "Related Party" defines a related party as a person, or entity that has control or significant influence, directly or indirectly, over the reporting entity; 2

(iii)

- Many entities operate through a complex range of relationships and structures 1
- Management may be unaware of the existence of all related-party relationships 1
- The entity's information systems may not identify transactions 1
- Related-party transactions may not be conducted under normal terms and condition 1
- Related-party transactions may be deliberately concealed by management 1

Maximum **2**

(iv) Since the auditor is supposed to obtain representations from the management, and where applicable, those charged with governance on such transactions as highlighted under (i), (ii) and

- They have disclosed the identity of all related parties, 1
- They have appropriately accounted for and disclosed such relationships 1

f)

(i) **“Expert”** means a person or firm possessing special skill, knowledge, and experience in a particular field other than accounting and auditing. 2

(ii) As a responsibility of the auditor in regard to work of an expert, you should:

- Evaluate the competence, capabilities and objectivity of that expert 1
- Obtain an understanding of the work of that expert 1
- Evaluate the appropriateness of that expert’s work 1

(iii) Design and explain robust possible audit procedures that you would carry out on the work of experts to gain comfort over it.

- Inquiries of the auditor’s expert. 1
- Reviewing the auditor’s expert’s working papers and reports 1
- Observing the auditor’s expert’s work 1
- Examining reputable statistical reports and other authoritative published data 1
- Confirming relevant matters with third parties 1
- Performing detailed analytical procedures, and 1
- Reperforming calculations 1
- Discussion with another expert with relevant expertise 1
- Discussing the auditor’s expert’s report with management. 1

Maximum 3

h)

(i) IAS 38, Intangible assets 1

(ii)

- Only development costs can be capitalized, not research costs. 1
- The company must be able to complete the project and sell/use 1
- The expenditure must be clearly identified 1
- The development must be technically feasible 1
- The company must have the financial resources to complete development 1
- The project must result in a revenue stream and profit 1

Maximum 2

(iii)

- They may have incorrectly capitalized on research costs, or 1
- May not be able to complete all the projects or, 1
- Be able to sell/use the products. 1

Maximum 1

(iv)

- Intangible assets may be overstated, increasing profit. 1
- If the costs had been expensed, profit would be much lower. 1

Maximum 1

(v)

- We could look at a breakdown of the costs by project 1
- Applying detailed tests to understand what each of the costs related to. 1

Maximum 1

Total marks 50

Model answers

a)

The approach to answering the question is split into two main perspectives, what to do to gain an understanding of the entity (1) and the understanding of the environment (2)

1) Understanding of the entity

Inquiries of management, and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.

➢ **Performing analytical procedures on the company's statement of financial position and statement of comprehensive income.** This helps the auditor understand the causes in movement of numbers and what TBR Ltd dealt in which caused significant movements in numbers hence identifying risky financial statements line items to give much focus to.

➢ **Schedule a meeting with outgoing auditor of TBR** Ltd

It is vital for a new hired auditor to meet the auditor that he replaces with the client's permission to both auditors, this helps him to review their working papers and understand the reasonableness of opening balances that they (PFA Ltd) inherit. The discussion with the outgoing auditor gives you an advantage of understanding which issues they faced in the previous audits and how the management has been responding to them, this benefits the new auditor by planning accordingly.

➢ **Review of previous year management letter from the outgoing auditor and financial report of TBR** Ltd.

Management letter outlines the key audit issues that come to the attention of the auditor, how they approached them and the management's responses to them. This ensures that a follow up is made on the reported issues to make sure that they were subsequently resolved and if not, understand what the management plans for them. Additionally, it is important to understand how they impact the current year's audit.

- **Review of board audit committee packs/minutes, minutes of shareholders, directors and other oversight bodies**

The audit committee's role is one of oversight and monitoring of how the business is run., and in carrying out this responsibility, the committee may rely on management, the independent auditor, and any advisers the committee might engage, provided its reliance is reasonable. The review of its minutes will help the auditor identify potential matters of significance to the audit that might impose a risk on the presentation of financial statements, and it facilitates the auditor to design audit procedures to tackle them.

- **Evaluation of ongoing, amended or newly signed significant contracts**

This is important as it helps identify potential matters of significance to the audit in a sense that ensures that proper accruals arising from those contracts have been made, there are no potential covenants that the bank might be in breach of, that they have been signed in good faith and interests of

- **Analysis of the internal audits' reports of TBR** Ltd

The internal audit department is in charge of evaluating the company's compliance with internal and external rules/procedural manual and regulations. Evaluating how well risk management is being handled within a company etc. Reviewing their reports facilitates to identify which controls risks TBR Ltd faces. The reports cover all sections (operational, compliance, reporting etc) of TBR Ltd, hence it provides a quick understanding of the entity.

- **Internet search and review of information on the company's website**

With the current world turning into more of a digitalized World, it is easier than even to fetch more information about a person, an entity, a country, or any other thing it is paramount for an auditor to read TBR Ltd.'s website to understand the entity's business, governance, the entity's managerial structure, products etc. There are also other websites or internet platforms which might provide information about the audit client (TBR Ltd) and the internet search by the auditor can expose him to such information useful to his duties.

2) Understanding of the environment

Since TBR Plc is a financial institution operating in Rwandan, it is empirical that the auditor **reads about the regulatory framework/guideline issued by the National Bank of Rwanda and Rwanda Revenue Authority and Institute of Certified Public Accountants (ICPAR)**. Since the industry is highly regulated, this will enable the auditor to understand which regulatory requirements in as far tax and regulatory reporting bind his client (TBR Plc).

- **Read the World bank and IMF reports.** These reports will mainly provide insights on which economies are in recession, decline, depression or so and since these macro-economic factors have an indirect impact on the TBR Ltd, the auditor needs to understand these factors and how they are incorporated in the business performance review of the bank. E.g., The IFRS 9 model for loans and advances should incorporate macro-economic factors and the auditor should assess whether the ones used by the bank can be benchmarked with external sources.

- **Analyzing competition that TBR Plc faces by reading BNR reports**. In case the competition is stiff, and it is affecting the company's, the auditor should advise the management on the way forward. E.g. if the company's loan portfolio is shrinking which results in reducing interest income, the auditor will advise the management if there is a need to revise their interests rates not to be far higher than their competitors.

- **International Financial Reporting Standards and accounting policies**. TBR Ltd being a financial institution, a big bank in the country, it implies that it should IFRS compliant in its financial reporting. It is therefore mandatory that the auditor reads and internalize the financial reporting standards so as to know which ones are most relevant to his client. E.g., with the adoption of IFRS 16 and IFRS 9, you, as an auditor, would be required of its applicability to your client TBR Ltd and the impact of its adoption on the books of accounts.

- **Review of Government policies currently affecting the conduct of the entity's business**, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies.

b.

- **Legal claims:** Considering that the bank faces a potential legal claim of Frw 1billion relating to an issued performance guarantee and that there is an imminent possibility that the bank will be liable, there is a high risk of material misstatement at the FSLI level (legal claims payable).
- **Fees and commission income:** Fees and commission income charged in relation to the disbursements of loans should be deferred to the life of the loan, there is high risk of material misstatement in fees and commission income as there is a balance relating to fees and commission income reported under interest income and the non-deferring of fees on loans presents a potential risk of material misstatement.
- **Interest income:** Interest income balance includes fees and commission of Frw 1.7 billion which has not even been deferred. In addition to the above, interest income increases at a sizable rate of 164% compared to loans and advances and investments in EuroBonds which decreased significantly with an average of 48% decrease
- **Inventories:** The bank does not deal selling in selling commodities and it is strange to hold inventories of Frw 5 billion in their books hence there is high risk of material misstatement at the financial statement line item.
- **Property Plant and Equipment.** Despite the fact that there have not been any PPE additions during the year and that there was a depreciation charge of 6 billion, the PPE extract indicates an increase of 112% which would potentially indicate that there is a risk of material misstatement at the FSLI level.

c.

- Inquiries into the entity's operations or financial results by regulatory or government bodies.
- Past misstatements, history of errors or a significant amount of adjustments at period end.
- Significant amount of non-routine or non-systematic transactions including intercompany transactions and large revenue transactions at period end.
- Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold and classification of marketable securities.
- Application of new accounting pronouncements.
- Accounting measurements that involve complex processes.
- Events or transactions that involve significant measurement uncertainty, including accounting estimates.
- Pending litigation and contingent liabilities, for example, sales warranties,

financial guarantees and environmental remediation.

- Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies.
- Operations exposed to volatile markets, for example, futures trading.
- Operations that are subject to a high degree of complex regulation.
- Going concern and liquidity issues including loss of significant customers.
- Constraints on the availability of capital and credit.
- Changes in the industry in which the entity operates.
- Changes in the supply chain.
- Developing or offering new products or services or moving into new lines of business.
- Expanding into new locations.

N.B The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete. The marker should analyse the answer provided by a student and the relevance he gave to the question.

d.

(i) “Audit Sampling”

(ii) ISA 530 “Audit Sampling”

(iii) According to ISA 530. “Audit Sampling” is defined as the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population. E.g., While sending out confirmations to borrowers for loans and advances extended to them, I would send confirmations to 20 customers out of 100 customers it still helps me draw a conclusion on the entire population.

- It saves time. It offers the opportunity for the auditor to obtain the minimum amount of audit evidence, which is both sufficient and appropriate, in order to form valid conclusions on the population.
- Audit sampling is also widely known to reduce the risk of ‘over-auditing’ in certain areas and enables a much more efficient review of the working papers at the review stage of the audit.

(iv) Explain the risk associated with using the above audit technique highlighted

- Sampling risk is the risk that the auditor’s conclusions based on a sample may be different from the conclusion if the entire population were the subject of the same audit procedure.

ISA 530 recognizes that sampling risk can lead to two types of erroneous conclusion:
The auditor concludes that controls are operating effectively, when in fact they are not or when the auditor concludes that controls are not operating effectively, when in fact they are

(v) One example of a method used in applying the above technique is:

- Random selection
- Systematic selection
- Monetary unit sampling
- Haphazard sampling
- Block selection

e.

(i) ISA 550, "Related Party"

(ii) ISA 550, "Related Party" defines a related party as a person, or entity that has control or significant influence, directly or indirectly, over the reporting entity; another entity over which the reporting entity has control or significant influence, directly or indirectly, or another entity that is under common control of the reporting entity. TBR Plc and ZYC are related parties because they are under a common control

(iii)

- Many entities operate through a complex range of relationships and structures, increasing the complexity of related party transactions.
- Management may be unaware of the existence of all related-party relationships and transactions.
- The entity's information systems may not identify transactions or outstanding balances with related parties, especially for transactions conducted at nil value, or outside the normal course of business.
- Related-party transactions may not be conducted under normal terms and conditions; and
- Related-party transactions may be deliberately concealed by management, and their accounting treatments often carry a high risk of deliberate manipulation.

(iv)

- They have disclosed the identity of all related parties, related party relationships and transactions that they are aware; and
- They have appropriately accounted for and disclosed such relationships and transactions in accordance with the financial reporting framework.

f.

(i) An expert is an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.

(ii) As a responsibility of the auditor in regard to work of an expert, you should:

- Evaluate the competence, capabilities and objectivity of that expert
- Obtain an understanding of the work of that expert (reviewing the accuracy of inputs used in the model)
- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion

(iii) When evaluating the findings and conclusions of the auditor's expert for audit purposes, the auditor may carry out various procedures, including:

- Inquiries of the auditor's expert.
- Reviewing the auditor's expert's working papers and reports
- Observing the auditor's expert's work
- Examining reputable statistical reports and other authoritative published data
- Confirming relevant matters with third parties
- Performing detailed analytical procedures, and
- Reperforming calculations
- Discussion with another expert with relevant expertise
- Discussing the auditor's expert's report with management.

g.

(i) IAS 38, Intangible assets

(ii) There are certain criteria which must be met for a given cost to be capitalized.

- Only development costs can be capitalized, not research costs.
- The company must be able to complete the project and sell/use the new product being developed.

i.e.

- The expenditure must be clearly identified (trace to invoices and ensure the amounts have gone to specific projects)
- The development must be technically feasible (inspect reports and talk to developers; inspect prototypes; inspect board minutes.).
- The company must have the financial resources to complete development (inspect budgets and cash flows).
- The project must result in a revenue stream and profit (inspect budgets, talk to salespeople, inspect board minutes etc).

(iii) An auditor should have in mind that regarding capitalization of costs,

- They may have incorrectly capitalized on research costs, ormay not be able to complete all the projects or, be able to sell/use the products.

(iv)

- Intangible assets may be overstated, and this would have the effect of increasing profit.
- If the costs had been expensed, profit would be much lower.

(v)

- We could look at a breakdown of the costs by project….
- Applying detailed tests to understand what each of the costs related to.

SECTION B

QUESTION TWO

Making guide

a)

(i) Explanation to the board of governance what is required	**Marks**
• Directors are required to prepare financial statements	1
• Directors ensure that the Company keeps proper accounting records	1
• Directors responsible for safeguarding the assets of the Company.	1
• Directors accept responsibility for the annual financial statements,	1
• Directors accept responsibility for the maintenance of accounting records	1
• Any other valid point	1
Maximum	**4**

(ii) Provide well explained points validating the errands of auditors	
• Auditors are required to obtain reasonable assurance	1
• To issue an auditor's report that includes an audit opinion.	1
• Identify and assess the risks of material misstatement	1
• Obtain audit evidence that is sufficient and appropriate to provide a basis	1
• Obtain an understanding of internal control relevant to the audit procedures	1
• Evaluate the appropriateness of accounting policies.	1
• Any other valid point	1
Maximum	**6**

b)

i) Award 1 mark on each role of emphasis of matter paragraph on audit report	
Maximum	**3**
ii) Auditor may choose not to issue an unmodified opinion	
• When the financial statements are not free from material misstatement or	1
• When they have been unable to obtain sufficient appropriate evidence.	1
iii) Depending on how bad the results of their audit tests come out, auditors have dissimilar forms	
• Disclaimer opinion	2
• Adverse opinion	2
• Except for. /Qualified opinion	2
Maximum	**6**
iv) 2 marks for well provided definition of " **pervasiveness**"	2
v) 2 marks for well provided definition of "**other matter**"	2
Total Marks	**25**

Model answers

a. (i)

- Directors are required to prepare financial statements which give a true and fair view of the state of affairs of the company as at the end of the financial year and of its profit or loss.
- It also requires the directors to ensure that the Company keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the Company.
- They are also responsible for safeguarding the assets of the Company.
- The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable estimates, in conformity with International Financial Reporting Standards.
- The directors accept responsibility for the maintenance of accounting records that may be relied upon in the preparation of financial statements, as well as designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement.

(ii)

- The auditors are required to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. and
- To issue an auditor's report that includes an audit opinion.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and
- Obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If they conclude that a material uncertainty exists, they are required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure, and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Reasonable assurance.
- This is because reasonable assurance is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists (due to inherent limitations auditors may face such as management overriding controls or management concealing the fraud). Misstatements can arise from fraud or error and are considered material

if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

b. (i)

- An emphasis of matter paragraph is required to be included in the audit report
- Considering the company is in a net liability position and that they made huge losses during the year, the auditor should raise an emphasis matter on the doubt of the going concern of the business in the next 12 months. This should be indicating the existence of a material uncertainty which may cast significant doubt about the ability of the company to continue as a going concern.

(ii)

- When the financial statements are not free from material misstatement or
- When they have been unable to obtain sufficient appropriate evidence.

(iii)

- **Disclaimer opinion**, this is an opinion provided when the auditor cannot tell whether a true and fair view is given at all due to a limitation in scope of the audit.
- **Adverse opinion** provided when a true and fair view is not shown because disagreements are pervasive to the accounts; Accounts are meaningless.
- **Except for / Qualified opinion** provided when the auditor is unable to audit certain areas of the company's operations because of restrictions imposed by management or other conditions beyond the auditor's control.

(iv)

- Pervasiveness is a matter that requires professional judgment. In this case the judgment is whether the matter is isolated to specific components of the financial statements, or whether the matter pervades many elements of the financial statements, rendering them unreliable as a whole or is not confined, represent or could represent a substantial proportion of the financial statements; or in relation to disclosures, this disclosure is fundamental to the user’s understanding of the financial statements

- The bottom line is that if the auditor believes that the financial statements may be relied upon in some part for decision making then the matter is material and not pervasive. If, however, they believe the financial statements should not be relied upon at all for making decisions then the matter is pervasive.

(v)

- Other matter’ paragraphs are used to refer to matters that are not required to be disclosed in the financial statements that the auditor believes are significant to user understanding. One usage of these paragraphs is where the auditor concludes that there is a material inconsistency between the audited financial statements and the other (unaudited) information contained within the annual report and accounts, as required by ISA 720, The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements.

QUESTION THREE

Marking guide

a)

i) Differentiate a fraud from an error.

- The former is intentional while the latter is not. 2

ii) Two types of misstatements. Explain with examples those types.

- Fraudulent financial reporting 1
- Misappropriation of assets 1

iii)

- Assign and supervise personnel taking significant engagement responsibilities 1
- Evaluate accounting policies to be indicative of fraudulent financial reporting. 1
- Review the accounting policy in place and check if the finance manager complies 1
- Incorporate audit procedures to be executed to include an element of unpredictability.1
- Presume fraud risk in revenue recognition and management override of controls 1
- Any other valid point 1

Maximum 4

(iv) Is Auditor responsible for the Prevention and Detection of Fraud? Explain your answer.

- No, Management has the Primary responsibility for the prevention and detection 1
- However, the auditor's presence can act as a deterrent to fraud 1

b)

(i) Steps that an auditor should take to ensure that he/she avoids being held liable for a breach of negligence in arriving at audit conclusion

- Obtain reasonable assurance that the financial statements are not misstated 2
- The auditor can accept the records and documents as genuine 2
- Maintain professional skepticism throughout the audit 2
- Risk of non-detection of management fraud is greater than of employee fraud. 2
- Risk of non-detection of fraudulent material misstatement is higher than due to error. 2
- Any other valid point 2

Maximum 8

(ii) The procedures which you audit firm needs to adhere to gain information deemed reasonable to conclude on the assessment of risk of fraud are:

- To obtain information, which is used for risk identification, 1
- Assessment of risk to financials due to fraud, nature, extent and frequency 1
- Enquire the management on the process for identifying and responding 1
- Enquire the management on the communication to those charged with governance 1
- Enquire the management on the communication of employees 1
- Auditor to inquire the management, internal audit team 1
- Consider whether any other information obtained indicates the risk of fraud. 1
- Evaluate any fraud risk factors are present form the information 1

- Identify unusual or unexpected relationship while performing analytical procedure 1
- Presume that there will be risks in revenue recognition 1
- Any other valid point 1

Maximum **7**

Total marks **25**

Model answers

(a) (i)

- Financial statement misstatements arise from either fraud or error. The difference between fraud and error is that the underlying action in the former is intentional while the latter is not.

(ii)

- Fraudulent financial reporting: e.g., Fictitious journal entries which involved inflating the company's costs, system manipulation of production rates
- Misappropriation of assets: e.g., Embezzling of receipts/funds. This is best explained by recording manipulating numbers in the system to record high costs, yet they bought office supplies at low costs and the difference is confiscated.

(iii) Response to the Assessed Risk of Material Misstatement Due to Fraud Per SA 330, the auditor to determine overall responses to address the assessed risk through:

- Assign and supervise personnel taking significant engagement responsibilities

As the engagement manager and noted that costs present significant risk, the company's costs should be assigned to the most experienced person on the team and do regular catch ups with him/her to ensure that he is using the right approach of testing them.

- Evaluate accounting policies to be indicative of fraudulent financial reporting.

Review the accounting policy in place and check if the finance manager complies with it when it comes to recording the costs involved in the production process.

- Incorporate audit procedures to be executed to include an element of unpredictability.

Since most companies sometimes get used to the audit procedures, the engagement manager can unpredictably send out confirmations for costs incurred during the period to different suppliers for costs validation.

- Presume fraud risk in revenue recognition and management override of controls

This will give the audit engagement team a chance to design robust audit procedures to address such high risk. E.g, test of journals passed by senior management, test of manual journals passed in revenue, review of journals which are recorded in revenue without passing through receivables/cash accounts.

(iv)

- No, Management has the Primary responsibility for the prevention and detection of fraud and not the auditor. Management should take all necessary steps for fraud prevention and deterrence through implementing policies and controls
- However, the auditor's presence can act as a deterrent to fraud and in addition in accordance with ISA 240, the auditor is required to design audit procedures that should identify any

material misstatements arising from fraud or error in the financial statements" – this is also a valid explanation

(b)

(i)

- Obtain reasonable assurance that the financial statements are free from material misstatements:
- The auditor can accept the records and documents as genuine unless there is a reason:
- **Maintain professional skepticism throughout the audit:** The auditor should maintain professional skepticism while performing an audit and identify any possible material misstatement due to fraud that could exist despite the auditor's past experience of Management's honesty and integrity.
- Should know that Risk of non-detection of management fraud is greater than of employee fraud.
- Must be aware Risk of non-detection of fraudulent material misstatement is higher than the misstatement due to error.

(ii)

- To obtain information, which is used for risk identification, auditors shall:

- Enquire the management on the assessment of risk to financials due to fraud, nature, extent and frequency of such assessment
- Enquire the management on the process for identifying and responding to the risk of fraud including frauds already identified
- Enquire the management on the communication to those charged with governance for identifying and responding to the risk of fraud
- Enquire the management on the communication of employees regarding its view on business practice and ethical behavior.

- Auditor to inquire the management, internal audit team and those charged with governance whether any instance of actual or alleged fraud has occurred in the past and obtain their respective views on the risk of fraud.
- Consider whether any other information obtained indicates the risk of fraud.
- Evaluate any fraud risk factors are present form the information obtained from the assessment.
- Identify Unusual or unexpected relationship while performing analytical procedure and evaluate them to assess the risk of material misstatement due to fraud
- Presume that there will be risks in revenue recognition based on that evaluate transactions

QUESTION FOUR

Marking guide

a)

Oversight of financial reporting and related internal controls 1

- Review of filings and earnings releases 1
- Risk oversight 1
- Oversight of the independent auditor 1
- Ethics and compliance 1
- Oversight of internal audit 1
- Other interactions with management and the board 1
- Audit committee external communications 1
- Any other valid point 1

Maximum 6

b) Significant undertakings that the audit committee should prioritize work of internal audit.

- The audit committee reviews and approves internal audit's complementary roles 1
- It ensures that internal audit is free to work independently and objectively, 1
- It ensures that internal audit has the necessary resources and access 1
- The committee also approves appointment, termination of Head of Internal Audit, 1
- The audit committee reviews and approves internal audit charter. 1
- Internal audit is sufficiently resourced with competent, objective professionals 1
- Internal audit is empowered to be independent by its appropriate reporting 1
- Internal audit is quality-oriented and has a quality assurance. 1
- The audit committee regularly communicates about the performance and improvement 1
- Internal audit reports are actionable, and audit recommendations 1
- Any other valid point 1

Maximum 6

c)

(i) ISA 250 (Revised), consideration of laws and regulations 1

(ii) Provide the reflection of what the standard stated above,

Non-compliance is referred to as an Act of omission or commission intentional or unintentional, committed by the entity, or by those charged with governance, by management or by other individuals working for or under the direction of the entity which are contrary to the prevailing laws or regulations. 2

d)

- The auditor needs to consider laws and regulations pertinent to the client 1
- To obtain sufficient appropriate audit evidence regarding compliance 1
- To perform specified audit procedures to help identify instances of non-compliance 1
- To respond appropriately to identified or suspected non-compliance 1
- To obtain the management's representations that the company 1
- Any other valid point 1

Maximum 5

(e) (i)

- Understand that it is a role of the management of the Bank to ensure the operations 1
- Appreciate that an auditor is not responsible for prevention of non-compliance 1
- Auditor's responsibility to obtain reasonable assurance that the financial statements 1
- Make reference to the auditor's responsibility to consider those laws and regulations 1
- Any other valid point 1

Maximum **3**

(ii)

- Reading minutes of board meetings 1
- Enquiring of management and/or legal advisers concerning litigation 1
- Undertaking substantive tests on classes of transactions, account balances 1
- Reviewing communications with the regulator including review reports 1
- Any other valid point 1

Maximum **2**

Total Marks **25**

Model answers

a)

- Oversight of financial reporting and related internal controls: For any business to be run, there are internal controls set in place govern how things are done by who at which point in time. The audit committee is then charged with the responsibility of coordinating the financial reporting on time and to ensure that it is done in accordance with the prevailing financial reporting standards. Additionally, the internal controls put in place, should be vigorously enforced by that same board for an orderly running of the business.
- Review of filings and earnings releases. The audit committee generally reviews earnings releases, filings containing financial information, and other financial information and earnings guidance provided to analysts, ratings agencies, and others. The committee should consider how it will execute these responsibilities to satisfy itself that all information is presented fairly and in a transparent manner. This should include a focus on
consistency of information, tone, and messaging across all financial communications.

- Risk oversight: This is referred to as a board's supervision of the risk. Boards play a critical role in influencing management's processes for monitoring risks, and as such they should clearly define which risks the full board should discuss regularly, versus risks that can generally be delegated to a board committee. While many boards have a defined risk governance structure, it is important to continually assess the structure as companies face new risks. A leading practice is for management to maintain a list
of all enterprise-wide risks, which are then mapped to specific board committees with the expertise to oversee them. For example, human resource and compensation risks may be delegated to the compensation committee for oversight, and the audit committee should have a key role in overseeing financial risks. In many instances, the full board takes direct responsibility for and regularly discusses the company's most strategic risks, which include

risks that could disrupt and materially impact the company's business strategy. Committee charters should be updated to align with the defined risk governance structure.

- Oversight of the independent auditor: Audit committees of listed companies are directly responsible for the appointment, compensation, and oversight of the independent auditor, including the resolution of any disagreements with management. It is optimal for the audit committee, management, the internal auditors, and the independent auditor to work together in a spirit of mutual respect and cooperation. The audit committee and the independent auditor typically meet at least quarterly to thoroughly discuss a wide variety of matters, including the company's financial reporting, internal controls, and the audit, from planning to conclusion of the audit. These discussions should also include educational and evaluative topics.

- Ethics and compliance. The board should consider the audit committee's role in overseeing the company's ethics and compliance programs, noting listed companies are required to have the audit committee oversee legal and regulatory compliance.
- Oversight of internal audit: When the internal audit function reports to the audit committee directly, it allows the internal auditors to remain structurally separate from management and enhances objectivity. This also encourages the free flow of communication on issues and promotes direct
feedback from the audit committee on the performance of the chief Internal auditor.
Audit committees are required to oversee the internal audit function and to note this responsibility in their charters. Specific requirements include:
• The audit committee charter must include oversight of the internal audit function as one of its purposes.
• The audit committee's regular report to the board should include issues involving the performance of the internal audit function.
• The audit committee must meet separately with the internal auditors

- Other interactions with management and the board: As the audit committee seeks to align its structure with the company's strategic priorities, it should consider the coordination required among other board committees and the full board to facilitate the optimal allocation and coverage of topics that affect more than one group and to reduce the likelihood of something falling through the cracks. The audit committee should understand the roles and responsibilities of other board committees and consider whether they could benefit from periodic joint meetings to discuss areas of common interest and significant matters

- Audit committee external communications: Investors, policymakers, and regulators are continuing to show interest in more detailed disclosure about
audit committees, their activities, and their oversight of the relationship with independent auditors. As these external parties request additional clarification about the roles and responsibilities, audit committees should
consider whether they should enhance disclosures in the proxy statement.

b)

The audit committee's tasks include reviewing the company's internal controls and, unless expressly addressed by a separate board risk committee composed of independent directors or by the board itself, reviewing the company's governance and risk management systems. To do this, it utilizes the skills and expertise of the internal audit function, agreeing the scope of its work, its priorities and resources. There are several ways the audit committee can oversee the internal audit function.

- It must also monitor and review the effectiveness of the organization's internal audit function. Where there is no internal audit function, the audit committee should consider annually whether there is a need for it and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.

- The audit committee reviews and approves internal audit's remit, having regarded the complementary roles of the internal and external audit functions.

- It ensures that internal audit is free to work independently and objectively, i.e., free from the influence of those being audited.

- It ensures that internal audit has the necessary resources and access to information to enable it to fulfil its mandate and is equipped to perform in accordance with appropriate professional standards for internal auditors (IIA's Code of Ethics and the International Standards for the Professional Practice of Internal Auditing).

- The committee also approves the appointment or termination of appointment of the Head of Internal Audit, and its chair should play a direct role in decisions concerning the Head of Internal Audit's appraisal and remuneration.

The IIA provides the following checklist of considerations for audit committees in overseeing the internal auditors:

- The audit committee reviews and approves the internal audit charter and internal audit plan annually.
- Internal audit is sufficiently resourced with competent, objective professionals to carry out the internal audit plan, which has been reviewed and approved by the audit committee.
- Internal audit is empowered to be independent by its appropriate reporting relationships to executive management and the audit committee.
- Internal audit is quality-oriented and has a quality assurance and improvement program in place.
- The audit committee regularly communicates about the performance and improvement of the internal audit.
- Internal audit reports are actionable, and audit recommendations and other improvements are implemented by management satisfactorily.

c)

(i) ISA 250 (Revised), consideration of laws and regulations in an audit of financial statements
(ii) Non-compliance is referred to as an Act of omission or commission intentional or unintentional, committed by the entity, or by those charged with governance, by management

or by other individuals working for or under the direction of the entity which are contrary to the prevailing laws or regulations. Non-compliance does not include personal misconduct unrelated to the business activities of the entity.'

d)

- The auditor needs to consider laws and regulations pertinent to the client because a breach in such may result in fines or other consequences which may have a material effect on the financial statements.
- To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements
- To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements.
- To respond appropriately to identified or suspected non-compliance with laws and regulations identified during the audit.
- To obtain the management's representations that the company has been compliant with laws and regulations of the environment it operates in.

e)

(i) The student must explain clearly with due respect to the finance manager trying to make him:

- Understand that it is a role of the management of the Bank to ensure the operations of the entity are conducted in accordance with laws and regulations (this applies to accuracy of their reporting legislation also)
- Appreciate that an auditor is not responsible for prevention of non-compliance with laws and regulations, and it is not the responsibility of the auditor to detect instances of non-compliance.
- Acknowledge in the answer that it is the auditor's responsibility to obtain reasonable assurance that the financial statements are free from material misstatement. To that end the auditor will take into account the legal and regulatory framework within which the entity operates.
- Make reference to the auditor's responsibility to consider those laws and regulations that have both a direct and an indirect effect on the determination of material amounts and disclosures in the financial statements.

(ii)

- Reading minutes of board meetings
- Enquiring of management and/or legal advisers concerning litigation or claims brought against the entity, and
- Undertaking substantive tests on classes of transactions, account balances or disclosures.
- Reviewing communications with the regulator including review reports shared by the regulator over the period under audit and sending out confirmations to the regulator (if possible)

END OF MARKING GUIDE AND MODEL ANSWERS