CERTIFIED PUBLIC ACCOUNTANT

INTERMEDIATE LEVEL EXAMINATIONS

I1.4: AUDITING

DATE: FRIDAY, 03 DECEMBER 2021

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking guide

		Marks
a)	State four types of control activities	4
b)	Describe **Four** test of controls	4
	Explain recommendations	4
	Explain test of controls	4
c)	Explain performance audit	2
	Explain value for money audit	2
Total		**20**

Model answers

a) Four controls activities in a Company may include:

- Segregation of duties
- Information processing
- Authorization
- Physical controls
- Performance review

b) Control deficiencies, control recommendations and test of controls in respect of purchases and payables system of NVG Company

	Control deficiency	Control recommendation	Test of control
1	It is not possible for a store to order goods from other local stores for customers who request them. Instead, customers are told to contact the other stores. Customers are less likely to contact individual stores themselves and this could result in the company losing valuable sales. In addition, some goods which are slow-moving in one store may be out of stock at another, if goods could be transferred between stores, then overall sales may be maximized.	An inter branch transfer system should be established between stores, with inter branch. This should help stores whose inventory levels are low but are awaiting their deliveries from the suppliers.	During the interim audit, arrange to visit a number of the stores, discuss with the store manager the process for ordering of inventory items, in particular whether it is possible to order from other branches. At each store, inspect a sample of completed inter-branch inventory forms for confirmation if the control is operating.

.

	Control deficiency	Control recommendation	Test of control
2	Purchase orders below **FRW 150** Million is not authorized and are processed solely by the purchase order clerk – Peter, who is also responsible for processing invoices	All purchase orders should be authorized by a responsible official Authorized signatories should be established with varying levels of purchase order authorization.	Select a sample of purchase orders and review for evidence of authorization, agree this to the appropriate signature on the appropriate signature on the approved signatories list.
3	Goods received notes (GRN) are sent to accounts department every three weeks. This could result in suppliers being paid as the purchase invoices could not be agreed to a GRN and also recorded liabilities being understated.	A copy of the GRN should be sent to the accounts department on regular basis, such as daily. The accounts department should undertake a sequence check of the GRN to ensure none are missing for processing.	Enquire of the accounts clerk as to the frequency of when GRNs are received to assess if they are being sent promptly. Undertake a sequence check of GRNs held by the accounts department, discuss any missing items with the accounts clerk.
4	GRNs are only sent to the accounts department. Failing to send a copy to the ordering department could result in a significant level of unfulfilled orders leading to a loss of sales and stock outs.	The goods received notes should be created in three parts and copy the GRN should be sent to the purchase order clerk On regular basis purchase order clerk should review all unfulfilled orders and chase these with the relevant supplier.	Review the file of copy GRNs held by purchase ordering clerk and review for evidence that these are matched to orders for any overdue items and discuss their status accountant clerk.
5	The finance director authorizes the bank transfer payment list for suppliers; however, she only views the total amount of payments to be made. Without looking at the detail of the payments list, as well as supporting documentation, there is risk that suppliers could be being paid an incorrect amount, or that sums are being paid to fictitious suppliers.	The finance director should review the whole payments list prior to authorizing A part from this, she should agree the amounts to be paid to supporting documents, as well as reviewing the supplier names to identify any duplicates or any unfamiliar names. She	Review the payment list for evidence of review by the finance. Enquire of accounts staff what supporting documentation the finance director requests when undertaking this review.

	Control deficiency	Control recommendation	Test of control
		should evidence her review by signing the bank transfer.	
6	Supplier statement reconciliations are no longer performed. This may result in errors in the recording of the purchases and payables not being identified in a timely manner.	Supplier statement reconciliations should be performed on a monthly basis for all suppliers and these should be reviewed by a responsible official	Review of file of reconciliations to ensure that they are being performed on a regular basis and that they have been reviewed by a responsible official. Re-perform a sample of the reconciliations to ensure that they have been carried out appropriately.

c) Difference between performance audit and value for money audit.

Performance audit: is an independent assessment of an entity's operations to determine if specific programs or functions are working as intended to achieve stated goals.

Value for money audit: is an independent examination of an audit to assess whether the use of funds or resources is at the economy, efficiency, and effectiveness. Auditors will assess the use of resources and funds against the intended objective, **purpose**, **vision**, and **mission** of projects, entities, or organizations

QUESTION TWO

Marking guide

		Marks
a)	Identify and explain four sources of information	8
b)	Identify four audit risks	4
	Explain your response to each risk	4
c)	Describe auditor's responsibilities before issuing audit report	2
	Describe auditor's responsibilities after issuing audit report	2
Total		**20**

Model answers

a) Information sources to be used to gain understanding on CC & MIGAMBI Associates

S/N	**Source of information**	**Expected result**
1	Permanent audit file	Information on matters of continuing importance for the company and audit team, such as governing documents, share certificates and ongoing contracts
2	Prior year audit file	An awareness of issues arising in the prior year audit and the implications for the current year audit, especially the risk assessment where issues in the prior year suggest a particular area is more susceptible to misstatements.
3	Prior year financial statements	Information on the historic performance of the entity and its accounting policies. Last year's financial statements can help the auditor to form expectation for the purposes of performing analytical procedures.
4	Systems/internal control questionnaires	Information on how each of the key accounting system is designed, how it operates and how robust the internal control use.
5	Company website	Information on recent development or progress activity which could impact the risk assessment.
6	Financial statements or financial information relating to competitors	Information from which the auditor can develop expectations when undertaking preliminary analytical procedures and undertaking the risk assessment.
7	Company budgets	A reference point for expected performance which can be compared with actual performance
8	Prior year report to management	Information on deficiencies identified last year and auditor recommendations. If the deficiencies are unsolved this will impact on the risk assessment.
9	Discussion with management	Information in relation to any important issues arising or changes to the company during the period under review.

b) Audit risks identified and responses at CC & MIGAMBI Associates

S/N	Audit risk	Response
1	FRW 850 million spent on repairs may have been incorrectly analyzed between non-current assets and repairs. There is a risk that non-current asset and expenses are misstated.	Obtain and review an analysis of costs, tracing to invoices and other supporting documents to establish the nature of expenditure. Then accounting entries should be reviewed to ensure revenue and expenditures has been charged to the statement of profit and loss and capital expenditures is included in non-current assets.
2	CC & MIGAMBI Associates has borrowed FRW 780 million from Umutanguha Bank via 10 years loan. This loan has been incorrectly analyzed between current and non-current liabilities.	The allocation of the loan between current and non-current liabilities and other related disclosures for the loan should be reviewed to assess whether it is presented correctly.
3	Due to CC& MIGAMBI Associates conducting numerous inventory counts simultaneously on 31 December it may not be possible to attend all counts. As result there is a risk that sufficient appropriate audit evidence may not be gained over inventory in the financial statements.	A sample of sites should be visited, with those holding material inventory, including the warehouse a. Mini markets with history inventory count issues should be also visited.
4	Inventory valuation policy is selling price less average profit margin. Although IAS 2 inventories allows this as an inventory valuation method, it is only permitted if it proves a close approximation cost (IAS 2). There is risk that this is not the case, and that inventory is consequently be under or overvalued.	Valuation testing should include a comparison of the cost of inventory with the selling price less margin to assess if the method used does result in a close approximation to cost. The actual net realizable value (rather than anticipated selling price) for some items should be tested to ensure it does not fall below recorded values.
5	Opening balance to each Mini Markets have been transferred to head office. There is a risk that this transfer may not have been performed completely and accurately, which would mean that the opening balances would be misstated. If the opening balance are misstated, for some statement of financial position accounts (such as current assets) the closing balances may be also misstated.	Enquire of management how the data was transferred, what controls were in place and which procedures were performed to confirm the transfer was complete and accurate. Review of journal(s) made to transfer the opening balances and compare with the prior year financial statements to ensure they were as expected.

c) Auditor’s responsibilities before and after date of audit report

Responsibilities before audit report

Events occurring up to the date of the auditor’s report the auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence such that all events up to the date of the auditor’s report that may require adjustment, or disclosure, in the financial statements have been identified. When the auditor becomes aware of events that materially affect the financial statements, it is his responsibility to consider whether such events are properly accounted for and adequately disclosed.

These procedures are in addition to procedures that may be applied to specific transactions occurring after period end (normal year-end work) to obtain audit evidence as to account balances as at period end, for example, the testing of stock cut-off, receipts from debtors and payments to creditors.

Responsibilities after date of the auditor’s report

The auditor does not have any responsibility to perform audit procedures or make any inquiry regarding the financial statements after the date of the auditor’s report. During the period from the date of the auditor’s report to the date the financial statements are issued, the responsibility to inform the auditor of facts that may affect the financial statements rests with management.

Where the auditor becomes aware of a fact that may materially affect the financial statements, he should consider whether the financial statements need amendment. He should discuss the matter with management and should take the action appropriate in the circumstances

QUESTION THREE

Marking guide

		Marks
a)	Three reasons why an absolute level of assurance may not be given	6
b)	describe any Four audit procedures with use of examples	8
c)	Explain emphasis of the matter paragraph	2
	Explain matters that lead to modified auditor's opinion.	4
Total		**20**

Model answers

a) In an audit of financials statements, an absolute level of assurance may not be given because of following.

(i) The subject matter has been prepared by another party other than the auditor himself

(ii) Auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

(iii) There are inherent limitations of an audit which result in most of the audit evidence.

(iv) Exercise of judgement by the auditor in gathering of evidence and drawing of conclusion

b) The audit procedures the auditor should carry out in order to obtain sufficient audit evidence to be able to form an opinion on the going concern status of the BAZIRETE Company.

(i) Review events after the reporting period for the items affecting the entity's ability to continue as a going concern for example, the infringement lawsuit discussed in the case study.

(ii) Analyzing the company's cash flows, profits and other forecasts and hold discussions with management to determine how the future look like.

(iii) Review of terms of debenture and loan agreements and determine whether they have been breached.

(iv) Read minutes of the meetings of directors and shareholders for reference to factors that could lead to the collapse of the Company.

(v) Consider and discuss with management its plan for the future such as plans to liquidate the assets. Borrow money or restructure debt.

(vi) Inquire from the Company lawyers about possible litigation and claims against the Company and determine the reasonableness of the management assessment of the outcome of such litigation.

c)

Emphasis of matter' paragraph

In certain circumstances, an auditor's report may be modified by adding an emphasis of matter paragraph, to highlight a matter affecting the financial statements which is included in a note of financial statements that more extensively discusses the matter. The paragraph should be included after the opinion and should refer to the fact that the opinion is not qualified in that respect.

Examples could include questions over the recoverability of a debtor balance or a potential liability such as a fine.

The auditor may feel that there is sufficient disclosure in the accounts and as such there is no need to issue a qualified audit report. He may however, wish to draw the reader's attention to this matter and hence the emphasis of matter paragraph.

Matters that do affect auditor's opinion

(i) Limitations on scope of the audit

Has the auditor received all the information and explanations he deems necessary for the purposes of his audit. If not, then he needs to consider has there been a limitation imposed on the scope of his audit. This consideration will affect his opinion.

(ii) Disagreement with management

The auditor may disagree with management about matters such as the acceptability of accounting policies selected, the method of their application or their adequacy of disclosures in the financial statements.

It may even be a disagreement over an actual amount in the accounts or inadequate disclosure of an event or circumstance.

SECTION B

QUESTION FOUR

Marking guide

		Marks
a)	Three responsibilities of the Auditor General	6
b)	Describe four decisions in which to apply professional judgement	8
c)	Discuss **Three** conditions to hold an auditor liable for negligence	6
Total		**20**

Model answers

a) Responsibilities of the Auditor General include the following:

(i) Auditing objectively whether revenues and expenditures of the State as well as local government organs, public enterprises, privatized state enterprises, joint enterprises in which the State is participating and government projects were in accordance with the laws and regulations in force and in conformity with the prescribed justifications;

(ii) Auditing the finances of the institutions referred to above and particularly verifying whether the expenditures were in conformity with the law and sound management and whether they were necessary;

(iii) Carrying out all audits of accounts, management, portfolio and strategies which were applied in institutions mentioned above.

b) According to ISA 200, following are four decisions in which an independent auditor should apply professional judgement.

(i) Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the ISAs

(ii) The nature, timing and extent of the audit procedures used to meet the requirements of the ISAs and gather audit evidence.

(iii) The evaluation of management's judgements in applying the entity's applicable financial reporting framework.

(iv) Determining materiality and assessment of audit risk

c) Conditions that must be fulfilled for the auditor to be held liable for negligence

(a) Duty of care

There existed a duty of care enforceable at law. (This will always be the case if a contract is in place.)

(b) Negligence

In a situation where a duty of care existed, the auditors were negligent in the performance of that duty, judged by the accepted professional standards of the day.

(c) Damages

The client has suffered some monetary loss as a direct consequence of the negligence on the part of the auditors.

QUESTION FIVE

Marking guide

		Marks
a)	Define inherent risk	2
	Identify four factors that can affect inherent risk at entity level	4
b)	State two factors that can affect inherent risk at the account balance level	2
c)	Discuss the auditor overall responses	4
d)	Highlight Eight contents of a well-maintained audit workings paper files	8
Total		**20**

Model answers

a) Define and identify factors that can affect inherent risk at entity level.

Inherent risk: this is the risk that the account balances and transactions could be materially misstated assuming that there was no internal control system. Inherent risk could increase a result of an adverse attitude of managers on the internal control system.

(i) Adverse attitude of management on the internal control system
(ii) Policies and procedures as the regard control system instituted by the management
(iii) Complexity of the internal control system as regard detection and prevention of errors and frauds.
(iv) Integrity of the managers of entity

b) Factors that affect the inherent risk at the account balance and level of transaction.

(i) How duties are segregated amongst various department in the organization
(ii) Authorization and approval of transactions

c) The following are auditor overall responses to the risk of material misstatement at financial statement level that can result to the change of audit strategy

(i) Assigning additional staff or more experienced staff to the audit team (after assessing that the overall risk you can add the experienced staff in the team)
(ii) Incorporating more unpredictability into the audit procedures (after assessing the risk you add the specific procedures of the assessed risk)
(iii) Emphasizing to audit staff the need to maintain professional skepticism
(iv) Making general changes to nature, timing or extent of audit procedures

d) A good working paper file should include the following information

(i) Information of continuing importance to the audit
(ii) Extracts or copies of important legal documents. Agreement and minutes
(iii) Audit planning information and audit programs
(iv) The auditor's assessment of the entities systems and his review or evaluation of internal controls
(v) Record the nature, timing and extent of audit work carried out with notes of errors exceptions and the action taken thereon together with the conclusions drawn by the audit staff who performed the audit work.
(vi) An indication who performed the work and when it was performed and evidence that work has been properly reviewed.
(vii) Records of the relevant balances and other financial information supporting the financial statements.
(viii) Copies of communication with other auditors, third parties and specialists discussed with client
(ix) Letters of representation received from received from the client
(x) Summary of significant points affecting the financial statements and the audit report showing how these points were dealt with.
(xi) Copies of financials being reported on and related audit reports.

QUESTION SIX

Marking guide

		Marks
a)	State five factors that influence the selection of sample sizes	5
	Explain five factors that influence the selection of sample sizes	5
b)	Explain the difference between audit around and through computer	4
c)	Describe Four difficulties in testing computerized system data.	6
Total		**20**

Model answers

a) Factors to consider in determining sample size.

(i) **Auditor's assessment of control risk:** the higher the auditor's assessment of control risk, the larger the sample size. A higher control risk implies that little reliance can be placed on effective operation of internal controls. Reduce the audit risk the auditor will need to extend the level of testing; this is achieved by increasing the size of sample.

(ii) **Expected error:** This is referring to the total error that the auditor expects to find in the population. The greater the amount of error the auditor expects to find in the population, the larger the size of the sample needed in order to make a reasonable estimate of the actual amount of error in the population.

(iii) Auditor's required **confidence level**. The greater the degree of confidence that the auditor requires that the results of the sample are in fact representative of the actual amount of error in the population, the larger the sample needs to be.

(iv) Auditor's assessment of **inherent risk**. The higher the auditor's assessment of inherent risk, the larger sample size. Higher inherent risk implies that there is a greater risk that the financial balances will be misstated. To reduce this risk the auditor will need to extend the level of testing. This achieved by testing higher sample.

(v) The **tolerable error** or deviation rate**-** the larger the tolerable error or deviation rate, the smaller sample size.

b)

(i) Differentiation between audit through and around the computer.

Auditing through the computer: describes the various steps taken by auditors to evaluate client's software and hardware to determine the reliability of operations that is hard for human eyes to view and also test the operating effectiveness of related computer controls, e.g., access control.

Auditing through the computer is common in practice today as many companies/ businesses make use of computerized information systems and these in turn have significant controls embedded in them. Ignoring these computer controls will make auditors not to have the required insight into the effectiveness and reasonableness of the client's internal control. And will not be reporting in compliance with the relevant laws and regulations that govern auditing as a profession.

Though, external auditors most times uses this technique to test the controls in simple applications, but, internal auditors more frequently use auditing through the computer technique to ensure that errors that may not be easily detected from the output are discovered and corrected.

Auditing around the computer is one of the several methods that auditors can use to evaluate a client's computer controls. It involves picking source documents at random and verifying the corresponding outputs with the inputs. The client's computerized information system processes the 'test transaction'. For example, multiplying unit price with the number of products sold to ensure that the total revenue figure is correct.

Auditing around the computer is appropriate in situations where significant computer controls are not required. For example, auditing around the computer can be used when computers are only used for calculation purposes.

(ii) Difficulties you may encounter in the use of test computerized system data.

1. If the data is included with normal data. Separate test data totals cannot be obtained. This can sometimes be resolved by the use of dummy branches or separate codes to report the program's effects on the test data
2. Side effects can occur. It has been known for an auditor's dummy product to be included in a catalogue.
3. Client's files and totals are corrupted although this unlikely to be material
4. If the auditor is testing procedures such as debt follow up, then testing has to be over a fairly long period of time. This can difficult to organize.
5. Use test data can be expensive. The auditor needs to ensure that the benefit gained from the test outweighs the expense.
6. The technique uses a lot of computer time which any upset the client. Schedules.

END OF MARKING GUIDE AND MODEL ANSWERS