CERTIFIED PUBLIC ACCOUNTANT

INTERMEDIATE LEVEL EXAMINATIONS

I1.4: AUDITING

DATE: FRIDAY 01, FEBRUARY 2024

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking guide **Maximum marks**

a) In accordance with ISA 520 Analytical Procedures, discuss at least Four practical techniques that can be used to perform analytical procedures. *(2 marks for each explained limitation technique).* (8 Marks)

b) Discuss the actions to be done by the auditors when the analytical procedures identify fluctuations or relationships that differ significantly with the expected results. *(2 marks for each action).* (4 Marks)

c) Enumerate Three factors to consider when evaluating whether the analytical procedures expectation can be developed sufficiently precisely to identify a material misstatement. *(1 mark for each factor).* (3 Marks)

d) In line with ISA 570 *Going concern*, discuss the audit procedures to be performed by the auditor when events and conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified *(1 marks for each stated valid procedure.)* (5 Marks)

Total marks **(20 Marks)**

Model answers

a) Four practical techniques that can be used to perform analytical procedures:

1. Ratio Analysis

This is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements such as the balance sheet and income statement. The auditor should calculate for previous periods and for comparable companies.

2. Examining related accounts

In conjunction with each other. Often revenue and expense accounts are related to accounts in the statement of financial position and comparisons should be made to ensure relationships are reasonable.

3. Trend analysis

Sophisticated statistical techniques can be used to compare a certain period with previous period.

4. Reasonableness test

This involves calculating the expected value of an item and comparing it with its actual value.

b) Actions to be done by the auditors when the analytical procedures identify fluctuations or relationships that differ significantly with the expected results:

- Enquire management and obtain appropriate audit evidence relevant to management's responses.
- Performing other audit procedures if necessary (eg, if management cannot provide an explanation or the explanation is not adequate).

c) Enumerate Three factors to consider when evaluating whether the analytical procedures expectation can be developed sufficiently precisely to identify a material misstatement.

1. The accuracy with which the expected results of analytical procedures can be predicted.
2. The degree to which information can be disaggregated.
3. The availability of the information

d) Audit procedures to be performed by the auditor when events and conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified.

1. Where management has not yet performed an assessment of the entity's ability to continue as a going concern, request management to make its assessment.

2. Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.

3. Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:

-Evaluate the reliability of the underlying data generated to prepare the forecast; and

-Determine whether there is adequate support for the assumptions underlying the forecast.

4. Consider whether any additional facts or information have become available since the date on which management made its assessment.

5. Request written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

QUESTION TWO
Marking guide

Question	Description	Total Marks
Qn 1 a)	Award 1 Mark per every limitation of an audit that makes it impossible to provide 'absolute' assurance **Note:** only five inherent limitations of an audit were required Maximum of 5 marks means (5 points* 1 Marks each limitation) **Other correct limitation provided by candidate not in the model answers are acceptable**.	**5**
Qn 1 b)	Award 1 Mark per every role of internal audit and award 1 mark per explanation provided by the candidate in total will be awarded 2 Marks per role provided and explain **Note:** only 5 roles of audit Internal audit were required Maximum of 10 marks means (5 roles with explanations* 2 Mark each) **Other correct roles of Internal audit provided by candidate not in the model answers are acceptable**.	**10**
Qn 1 c)	Award 1 Mark per every point of distinction between statutory audit and Non statutory provided by the candidate **Note:** only 5 distinctions were requested Maximum of 5 marks means (5 points* 1 Mark each) **Other correct distinctions provided by candidate not in the model answers are acceptable**	**5**
	Total Marks	**20**

Model answers

a) Five inherent limitations of an audit that makes it impossible to provide 'absolute' assurance

Limitations that restrict the auditor to gain absolute assurance are known as **Inherent limitations of an Audit.**

Inherent limitations of an audit arise due to the following reasons:

- Persuasive evidence instead of conclusive evidence.
- Use of judgement in establishing estimates for reporting purposes.
- Absence of clear instructions on accounting treatment.
- Degree of uncertainty and complexity of the transactions involved.
- Negative effects of subjective decisions or bias on part of the management or employee of the entity.
- Existence of fraud committed by entity's management or employees and thus concealing important financial information leading towards fraud.
- Use of sampling techniques by the auditor in conducting different audit procedures. In sampling auditor applies audit procedures only to a small portion of the whole population instead of checking each and every element of the population.
- Practical and/or legal limitations to obtain sufficient appropriate audit evidence.
- Limitations applied or forced by the management.
- Limitations as agreed upon in engagement letter.
- Auditor does not have investigative rights and cannot demand certain information or evidence from management if refused by the management.
- Existence of situations at present or in future that may cause an entity to stop being a going concern.
- Cost-benefit limitations i.e. conducting audit engagement requires resources which auditor might not have or in auditor's judgment cost of gaining additional assurance will be higher than the benefit gained and thus not obtain.

b) Describe Five roles you would expect the internal audit staff to perform in ZED Ltd

- **Offer Insight and Advice**: There are times when internal auditors' expertise, knowledge of controls, and broad perspective of the organization make them ideal candidates for consulting on a project to ensure that risks are considered and controls are built into a process on the front-end (e.g., mergers and acquisitions, new technology implementation). Internal auditors may offer insight regarding strategic risks and advice, though management must maintain ultimate responsibility for the processes in their area.

- **Evaluate Risks**: Risks are everywhere (natural disasters, loss of key suppliers, reputation damage, inefficient operations, fraud, lawsuits, policy violations, regulatory compliance, theft, etc.). It's the internal auditor's job to assess the significance of the organization's many risks and the effectiveness of risk management efforts, communicate these to management and the board, and develop recommendations to improve risk management.
- **Assess Controls:** Internal auditors evaluate control efficiency and effectiveness and provide management and the board assurance that the controls in place are adequate to respond to the risks that threaten the organization.
- **Ensure Accuracy**: Internal auditors ensure financial statement accuracy. They examine the reliability and integrity of financial and operational information.
- **Improve Operations**: With a solid understanding of the organization's objectives, internal auditors examine operations to determine whether they are efficient and effective.
- **Promote Ethics**: Professional internal auditors agree to abide by a Code of Ethics that upholds the principles of integrity, objectivity, confidentiality, and competency. They raise red flags when they discover improper conduct.

c) **Enumerate Five main points of distinction between statutory audit and Non statutory audit**

Statutory Audit:

- It is compulsory.
- The relevant statute or law determines the scope of work.
- The academic or professional qualification is prescribed for the auditor.
- The statute dictates the powers, rights and duties of an auditor.
- The auditor has independence in status and in mental attitude.
- The auditor is liable for negligence under the Common Law and for misfeasance under the relevant statute governing the audit.
- The audit report is published for the public.

Non-statutory Audit:

- It is voluntary.
- The employer or partners determine the scope of work.
- The auditor need not possess any academic or professional qualifications.
- The agreement between an auditor and firm decides these matters.
- The auditor does not enjoy such independence.
- The auditor is liable for negligence only under Common Law.
- The audit report is made known to the employers or partners

QUESTION THREE

Marking guide

Question	Description	Total Marks
Qn 2 a)	Award 1.5 Mark per every importance of the use of analytical review procedures at the review stage of the audit provided by the candidate **Note:** only four importance of the use of analytical review procedures at the review stage were required Maximum of 6 marks means (4 points* 1.5 Marks each purpose) **Other correct Importance provided by candidate not in the model answers are acceptable**.	**6**
Qn 2 b)	Award 1 Mark per every benefit of documenting audit work provided by the candidate **Note:** only 4 benefits of documenting audit work were required Maximum of 4 marks means (4 points* 1 Mark each) **Other correct benefit of documenting audit work provided by candidate not in the model answers are acceptable**.	**4**
Qn 2 c)	Award 1 Mark per every advantage for standardized working paper and Award 1 Mark per every disadvantage of audit firms using standardized working papers to documents their work **Note:** only 3 advantage and 3 Disadvantage of standardized working papers were required Maximum of 6 marks means (3 advantage + 3 Disadvantage) **Other correct advantage and disadvantage provided by candidate not in the model answers are acceptable**	**6**
Qn 2 d)	Award 2 Mark per every objective of an audit peer review provided and explained by the candidate **Note:** only 2 objectives of an audit peer review were required Maximum of 4 marks means (2 points* 2 Marks each) **Other objective of audit peer review provided by candidate not in the model answers are acceptable**	**4**
	Total Marks	**20**

Model answers

a. Importance of the use of analytical review procedures at the review stage of the audit

- ❖ Review ensures that the work performed supports the conclusions reached,
- ❖ Review ensures that evidence obtained is sufficient and appropriate to support the audit observations and conclusions, and
- ❖ Review ensures that the audit work is appropriately documented.
- ❖ Ability to detect discreet misstatements and identify potential problems in an audit.

b. Four (4) benefits of documenting audit work.

- ❖ Provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the audit.
- ❖ Provides evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.
- ❖ Assists the engagement team to plan and perform the audit.
- ❖ Assists members of the engagement team responsible for supervision to direct, supervise and review the audit work.
- ❖ Enables the engagement team to be accountable for its work
- ❖ Retains a record of matters of continuing significance to future audits.

c. List three advantages and three disadvantages of audit firms using standardized working papers to documents their work

Advantages

- This improves the efficiency the efficiency with which they are prepared.
- They act as guidelines or instructions to audit staff and facilitates delegation of work.
- They provide a means to control the quality of audit work by ensuring that minimum quality standards are maintained.
- Ensures that all relevant issues in the audit area are addressed.

Disadvantages

- It is not appropriate to follow mechanically a standardized approach to the conduct and documentation of the audit work without regard to the need to exercise judgment.
- Work becomes mechanical
- Client's staff may become familiar with the method.
- The initiative of the audit staff may be stifled.

c. Briefly explain two the objectives of an audit peer review

The objectives of a peer review are:

❖ To determine whether an audit organization's quality control system is suitably designed and is in place and operating effectively.

❖ A peer review also provides assurance that an audit organization is following its established policies and procedures and applicable auditing standards

SECTION B

QUESTION FOUR

Marking guide **Maximum marks**

a) In accordance with ISA 700, Explain at least Ten key elements of an audit report. *(1 mark per each valid stated and explained element, 0.5 Mark if not explained).* (10 marks)

b) (i) Explain Three types of modified opinions that can result from auditor's judgement on pervasiveness of the effect of uncorrected misstatement on financial statements. *(2 Marks per each stated and explained type).* (6 Marks)

(ii) Discuss the circumstances in which the auditor may need to modify the opinion. *(2 Marks per circumstance).* (4 Marks)

Total marks **(20 Marks)**

Model Answers

a) key elements of auditor's report

1. Title

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

2. Addressee

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

3. Opinion paragraph

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

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

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

4. Basis for audit opinion

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

5. Going concern

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

6. Key audit matters

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

7. Other information

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

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

8. Responsibilities for the financial statements

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

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

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

The report must state that:

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

10. Other reporting Responsibilities

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

11. Name of the engagement Partner

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

12. Auditor's signature

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

13. Auditor's address

The location where the auditor practices must be included.

14. Date of the report

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

b) i) Three types of modified opinions:

1. A qualified opinion: This must be expressed in the auditor's report if the auditor concludes that misstatements are material but not pervasive to the financial statements. And when he/she 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.

2. Adverse opinion: The auditor expresses such opinion when he/she has obtained sufficient appropriate audit evidence and concludes that misstatements are both material and pervasive to the financial statements.

3. **A disclaimer of opinion:** It is expressed 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.

ii) **Circumstances in which the auditor may need to modify the opinion:**

- The auditor concludes that the financial statements as a whole are not free from material misstatements, or
- The auditor cannot obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

QUESTION FIVE

Marking guide	**Maximum marks**
a) Define the term "Performance materiality".	(1 Marks)
b) Discuss the factors that may affect the identification of an appropriate benchmark by the auditor while determining materiality for the financial statements as a whole. *(1 Mark per factor).*	(5 Marks)
c) In line with the above case study, enumerate at least Four elements that you will document on materiality as requested by the audit manager. *(1 Mark per element).*	(4 Marks)
d) Differentiate risk-based audit from top-down audit approach and explain at least Three advantages on each once adopted by the auditor in the audit engagement. *(4 Marks per difference of the two approaches and 1 Mark per advantage).*	(10 Marks)
Total marks	**(20 Marks)**

Model Answers

a) Performance Materiality: Refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

b) Factors that may affect the identification of an appropriate benchmark by the auditor while determining materiality for the financial statements as a whole:

1. Elements of the financial statements. (e.g assets, liabilities, equity, revenue, expenses)
2. Whether there are items on which users tend to focus
3. Nature of the entity, industry, and economic environment
4. Entity's ownership structure and financing
5. Relative volatility of the benchmark

c) Four elements that you will document on materiality:

1. Materiality for the financial statements as a whole
2. Materiality level or levels for particular classes of transactions, account balances or disclosures if applicable.
3. Performance materiality
4. Any revision of the above as the audit progresses

d) Difference of risk-based audit from top-down audit approach and At least Three advantages on each:

Risk-based audit approach ensures that the greatest effort is directed at those areas of the financial statements that are most likely to be misstated. The chance of detecting errors is therefore improved, and time is not wasted on testing safe areas.

The business risk or Top-down approach was developed because it was believed that in some instances the risk of misstatement arises mainly from the business risks of the company. This business approach tries to mirror the risk management steps that have been taken by the directors.

Advantages of Risk-based audit approach:

- Risk-based audit approach helps the auditors to focus on areas with the most significant potential for financial and operational impact. It improves the efficiency of the auditing process and ensures that key risks are identified and managed appropriately.
- It allows effective allocation of audit resources by identifying and focusing on high-risk areas, auditors can concentrate their efforts where they matter the most.
- It enhances the credibility of the audit function and increases stakeholder confidence in the organization's risk management capabilities.
- It requires a deep understanding of the organization's business and its associated risks, can contribute to improved audit quality.
- The risk-based audit approach helps ensure that compliance risks are identified and addressed, reducing the potential for regulatory breaches, and the associated penalties and reputational damage.

Advantages of top-down audit approach:

- There is added value given to clients as the approach focuses on the business as a whole rather than just the financial statements.
- Where audit attention is focused on high levels of controls and use of analytical procedures, there is increased audit efficiency.
- There is no need to focus on routine processes where technological developments have rendered them less prone to error than in previous times.
- The approach responds to corporate governance issues in recent years.
- There is a lower engagement risk through a better understanding of the client’s business.

QUESTION SIX

Marking guide **Maximum marks**

(a) In In line with the above case study, design the audit program for the test of controls that you will carry out on the audit of sales of NMC group Ltd. *(1 Mark for valid and relevant assertion, 1 mark for a relevant control objective, 1 mark for a relevant control, and also 1 mark for a corresponding test of control).* (20 Marks)

Hint: Use a table to show the concerned assertion, control objective, a control, and a test of control to be performed. **(20 Marks)**

Model Answers

a)

Assertion	**Control objective**	**Control**	**Test of control**
Occurrence	*To ensure that goods are only supplied to clients with good credit rating.	*Review and confirm the credit limits and ranking of a client	*On sample basis, take the processed order and verify that they were processed in consideration the credit limits and ranking of clients
Existence	*To ensure that recorded sales transactions represent goods supplied	*The tasks of taking order, recording, and receiving payment are allocated to different staff *Sales are only recorded if there is an approved sales order form and good dispatch note.	*Check whether there has been the segregation of duties in the sales process. *On a sample basis, ensure there is a related sales order for that has been signed and authorized.
Completeness	*To ensure that all revenue relating to goods dispatched are recorded * To ensure that all goods are correctly invoiced,	*Accounting for numerical sequences of invoices. *Sales invoices are reconciled to the daily sales orders and sales report.	*Inspect the invoices and confirm that they were sequentially numbered. *Review a sample of reconciliation and reperform them on sample basis.

		*An open-order file is maintained and reviewed regularly.	*Inspect the open-order file for unfilled orders.
Accuracy and completeness	*To ensure all sales are correctly journalized and recorded to the correct accounts.	*Sales invoices and matching documents are referenced and properly recorded and dated in the accounting system.	*Review and ensure that the sales records are referenced and contain written details and dates.
Cut-off	*To ensure that transactions have been recorded in the correct period.	*Sales orders and goods dispatching notes are shared to finance on a daily basis.	*Compare dates on sales invoices with dates recorded in the sales ledger.
Classification	*To ensure that all transactions are properly classified in the accounts.	*Chart of accounts in place and is regularly reviewed for appropriateness and updated where necessary. *Codes in place for different types for goods.	*Inspect any documentary evidence of review and update done to the chart of accounts. *Test application for proper codes of the goods.

END OF MARKING GUIDE AND MODEL ANSWERS