



CERTIFIED ACCOUNTING TECHNICIAN
STAGE 3 EXAMINATION

S3.4 AUDIT AND ASSURANCE

DATE: TUESDAY, 27 FEBRUARY 2024

MARKING GUIDE

SECTION A

1. D
2. D
3. A
4. A
5. D
6. C
7. A
8. C
9. D
10. D

2 Marks for each correct answer

2

Total marks

20

DETAILED MODEL ANSWERS

1. The correct answer is D.

The degree of uncertainty about the events or conditions being assessed increases significantly, is among the key consideration when management is making an assessment on company's going concern (ISA 570).

When examining the accounting policies, auditors should consider (a) Policies commonly adopted in particular industries, (b) Policies for which there is substantial authoritative support, (c) Whether any departures from applicable accounting standards are necessary for the financial statements to give a true and fair view and (d) Whether the financial statements reflect the substance of the underlying transactions and not merely their form.

2. The correct answer is D.

With reference to ISA 315, the internal control has five elements (ISA 315: paras. 14–24) which are:

- (a) The control environment
- (b) The entity's risk assessment process
- (c) The information system (including related business processes/communication)

- (d) Control activities
- (e) Monitoring of controls

3. The correct answer is A.

When forming an opinion and reporting on financial statements as to whether the financial statements give a true and fair view, the auditor should consider the following:

- (i) The overall presentation, structure and content of the financial statements.
- (ii) Whether the financial statements, including disclosures in the notes, faithfully represent the underlying transactions and events.
- (iii) Whether the financial statements (after any adjustments as a result of the audit process) are consistent with the auditor's understanding of the entity and its environment.

While consideration of a likelihood of the risks causing a material misstatement is among the step in assessing the risk of material misstatement at the financial statement level and assertion level.

4. The correct answer is A.

The control environment is the framework within which controls operate. The control environment is very much determined by the management of a business.

Control activities are those policies and procedures in addition to the control environment which are established to achieve the entity's specific objectives.

The monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.

The information system relevant to financial reporting is a component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions and to maintain accountability for the related assets, liabilities and equity

5. The correct answer is D.

Auditors should apply analytical procedures as risk assessment procedures to obtain an understanding of the entity and its environment (ISA 315: para. 6(b)). Possible sources of information about the client during risk assessment include: *Interim financial information*,

Budgets, Management accounts, Non-financial information, Bank and cash records, Sales tax returns, Board minutes, Discussions or correspondence with the client at the year end.

Auditors may also use specific industry information or general knowledge of current industry conditions to assess the client's performance.

6. The correct answer is C.

ISA 315 states that the auditor shall obtain an understanding of control activities relevant to the audit and how the entity has responded to risks arising from IT. Control activities include those designed **to prevent** or **to detect** and **correct errors**.

Audit Opinion is provided by auditor based on documented audit work, ISA 230 Audit documentation provides guidance, and requires that audit documentation is prepared on a timely basis.

7. The correct answer is A.

The status of items involving subjective judgement/accounted for using preliminary data is among the key procedures in testing subsequent events not a key factor that should be taken into consideration by management in assessing going concern.

When management is making an assessment on going concern of a given company, **the following factors should be taken into considered as guided by ISA 570:**

- (a) The degree of uncertainty about the events or conditions being assessed increases significantly the further into the future the assessment is made.
- (b) Judgements are made on the basis of the information available at the time.
- (c) Judgements are affected by the size and complexity of the entity, the nature and condition of the business and the degree to which it is affected by external factors.

8. The correct answer is C.

The analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Analytical procedures typically involve comparing financial statement amounts with other data, such as non-financial data, budgeted amounts, or comparable prior year amounts.

Comparing financial statement amounts with source documents is more of testing accuracy and verification rather than an analytical procedure.

9. The correct answer is D.

ISA 570 provide many financial indicators of going concern problems in a company. Among other, these include: (i) The company needs borrowing facilities which have not been agreed; (ii) Relying too heavily on short-term borrowing; (iii) Major debt repayment falling due where the company will need to borrow again if it can and (iv) Indications that creditors want to call in loans

10. The correct answer is D.

During the review for consistency and reasonableness, the auditors should consider whether the financial statements are consistent with their knowledge of the entity's business and with the results of other audit procedures, and the manner of disclosure is fair.

The principal considerations are as follows:

- (a) Whether the financial statements adequately reflect the information and explanations previously obtained and conclusions previously reached during the course of the audit.
- (b) Whether it reveals any new factors which may affect the presentation of, or disclosure in, the financial statements.
- (c) Whether analytical procedures applied when completing the audit, such as comparing the information in the financial statements with other pertinent data, produce results which assist in arriving at the overall conclusion as to whether the financial statements as a whole are consistent with their knowledge of the entity's business (see Unit 10).
- (d) Whether the presentation adopted in the financial statements may have been unduly influenced by the directors' desire to present matters in a favourable or unfavourable light.
- (e) The potential impact on the financial statements of the aggregate of uncorrected misstatements (including those arising from bias in making accounting estimates) identified during the course of the audit and the preceding period's audit, if any.

SECTION B

QUESTION 11

Marking guide	Marks
a. Listing the key components of ISAs structure <i>(0.5 marks-each)</i> .	2.5
Valid explanation of the key components of ISAs structure <i>(0.5 marks-each)</i> .	2.5
b. Listing the 5 fundamental principles set out in IESBA Code of Ethics <i>(0.5 marks-each)</i> .	2.5
Clear and correct explanation per each fundamental principles <i>(0.5 marks-each)</i> .	2.5
Total marks	10 marks

Model answers

(a) Describe briefly the structure of International Standards on Auditing.

International Standards on Auditing (ISAs) are produced by the International Auditing and Assurance Standards Board (IAASB), a technical committee of the International Federation of Accountants (IFAC). IAASB also produces other items of international guidance, ISAs are to be applied in the audit of financial statements and have the following structure:

- (a) Introduction:** the purpose, scope and subject matter of the ISA plus the responsibility of the auditor.
- (b) Objective:** a clear statement of the ISA's objective in relation to the audit area that the ISA addresses.
- (c) Definitions:** of applicable terms used in the text.
- (d) Requirements:** clearly stated as “*the auditor shall do the following...*”.
- (e) Application and other explanatory material:** more precise explanations of what requirements mean or are meant to cover. Examples of appropriate procedures may also be included.

In exceptional circumstances, an auditor may judge it necessary to depart from an ISA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure. ISAs need only be applied to material matters.

(b) List and explain briefly describe the five fundamental principles set out in IESBA Code of Ethics.

The IESBA Code of Ethics provides ethical guidance for members in its five fundamental principles of *integrity, objectivity, professional competence and due care, confidentiality and professional behavior*.

Members and students must comply with the above five fundamental principles set out in IESBA Code of Ethics. Below are detailed explanations of five fundamental principles set out under code of ethics:

- (a) **Integrity:** To be straightforward and honest in all professional and business relationships.
- (b) **Objectivity:** Not to compromise professional or business judgements because of bias, conflict of interest or undue influence of others
- (c) **Professional competence and due care:** Attain and maintain professional knowledge or skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation. Act diligently and in accordance with applicable technical and professional standards.
- (d) **Confidentiality:** To respect the confidentiality of information acquired as a result of professional and business relationships
- (e) **Professional behavior:** To comply with relevant laws and regulations and avoid any action that the professional accountant knows or should know might discredit the profession.

QUESTION 12

Marking guide

Marks

- | | |
|--|-----------------|
| a. Explain clearly what is audit evidence. | 2 |
| b. Differentiate clearly, what is sufficient and appropriate audit evidence (<i>1 mark-each for clear explanation provided</i>). | 2 |
| c. Two types of audit approaches (<i>1 mark – each and 1 mark for clear explanation</i>). | 4 |
| d. Explain the terms “substantive tests and test of controls” (<i>1 mark – each</i>). | 2 |
| Total marks | 10 marks |

Model answers

(a) Explain to your neighbor – Mapindano, what is audit evidence?

Audit evidence is all of the information used by the auditor in arriving at the conclusion on which the auditor's opinion is based. Audit evidence includes the information contained in the accounting records underlying the financial statements and information obtained from other sources, such as confirmations from third parties.

(b) Differentiate clearly to your neighbor Mapindano, what is sufficient and appropriate audit evidence.

Auditors should evaluate all audit evidence in terms of its **sufficiency** and **appropriateness** “Sufficiency” and “appropriateness” are interrelated.

Sufficiency is the measure of the quantity of audit evidence. The quantity of evidence required will be affected by the level of risk in the area being audited, and the quality of evidence obtained.

Appropriateness is the measure of the quality or relevance and reliability of the audit evidence. Auditors are essentially looking for enough reliable audit evidence. Audit evidence usually indicates what is probable rather than what is definite (is usually persuasive rather than conclusive) so different sources are examined by the auditors. Not all sources of evidence will be examined because auditors can only give reasonable assurance that the financial statements are free from misstatement.

(c) Briefly explain two types of audit approaches. (4 marks)

The auditors determine an approach to the audit based on their risk assessment. In general terms, there are **two types of approach**:

- (i) A systems-based approach:** is an approach to audit which seeks to place reliance on the accounting systems of an entity. The systems-based approach is sometimes called a combined approach, because it will involve the auditor carrying out both tests of controls and substantive procedures.
- (ii) A direct verification approach:** is an approach which does not place reliance on systems, where the auditor only verifies individual transactions and balances in the financial statements.

The direct verification approach is sometimes called the **substantive procedures** approach as it involves the auditors substantiating the financial statements by carrying out only substantive procedures. The direct verification approach is sometimes also called the **vouching approach** because transactions and balances are agreed (vouched) back to source documents, such as invoices or bank statements.

(d) Explain the terms “substantive tests and test of controls”. 2 marks

Tests of controls are audit procedures designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. They are

performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in an assertion.

Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level. They comprise of **Analytical procedures** and **Tests of details** of classes of transactions, account balances and disclosures. They are designed to obtain evidence about the assertions made by management about what the financial statements say about the assets, liabilities and transactions of the client, and the events that affect the client's financial statements.

SECTION C

QUESTION 13

Marking guide

Marks

- | | |
|--|-----------------|
| a. Most important objectives of internal control relating to receivables and sales applicable to Kamaro's business. (<i>1 mark for a correct feature and 1 mark for a correct objective</i>) | 6 |
| b. Eight test of controls to be performed by auditor during review of purchases (<i>1 mark each</i>). | 8 |
| c. Explaining management letter | 2 |
| Four (4) importance of management letter (<i>1 mark – each</i>). | 4 |
| Total marks | 20 marks |

Model answers

- a) Briefly explain the most important objectives of internal control relating to receivables and sales applicable to Kamaro's business.**

The most important objectives of internal control relating to receivables and sales are as follows:

S/n	Features	Objectives
1	Ordering and granting of credit	To ensure that: <ul style="list-style-type: none"> ➤ Goods and services are only supplied to customers with good credit ratings ➤ Customers pay promptly ➤ Orders are recorded correctly

		➤ Orders are fulfilled
2	Dispatch and invoicing	To ensure that: <ul style="list-style-type: none"> ➤ All dispatches of goods are recorded ➤ All goods and services sold are correctly invoiced ➤ All invoices raised relate to goods and services that have been supplied by the business ➤ Credit notes are only given for valid reasons
3	Recording, accounting and credit control	To ensure that: <ul style="list-style-type: none"> ➤ All sales that have been invoiced are recorded in the general and sales ledgers ➤ All credit notes that have been issued are recorded in the general and sales ledgers ➤ All entries in the sales ledger are made to the correct sales ledger accounts ➤ Cut-off is applied correctly to the sales ledger ➤ Potentially irrecoverable debts are identified

b) Test of controls to be performed by auditor during review of purchases

A most important test of controls is for auditors to confirm that all purchases have been authorized. The person who approve the invoices should be operating within laid-down authority limits. The precise nature of the tests of controls performed by the auditor may vary from the scenario and depending on the way in which the control is being operated by the audit client. The following are general applicable procedures on purchases:

- Observe the processing of purchase orders throughout the purchasing cycle and evaluate whether proper segregation of duties is operating.
- Examine application controls for re-order levels.
- Verify that authorised supplier lists exist and have been communicated.
- Obtain evidence of regular management reviews of supplier terms.
- Examine a sample of purchase orders for evidence that they have been authorised.
- Observe procedures for receipt of goods to verify that the goods actually received are matched to the purchase order.
- Review entity's procedures for accounting for pre-numbered documents and inspect a sample of goods received notes for evidence of sequential numbering.
- Review a sample of goods received notes for evidence of matching to purchase orders.
- Examine supporting documentation for evidence that purchase invoices are matched to goods received notes and orders.

- Review a sample of purchase invoices for evidence that their accuracy has been verified (eg signature or initials) and reperform the procedures.
- Review evidence of approval of invoice coding to relevant expenditure account by responsible staff member.
- Test application controls relating to the input of purchase invoices and credit notes. For example, perform a batch reconciliation to determine whether purchase invoices have been entered accurately and a sequence check to determine whether all credit notes have been recorded.
- Review procedures for reconciling supplier statements to payables ledger accounts and reperform a sample of reconciliations.
- Reperform a sample of reconciliations of the payables' ledger accounts and the payables ledger to ensure that they have been performed accurately.

c) Management letter and four importance of management letter.

Management Letter means a letter prepared by the auditor which discusses findings and recommendations for improvements in internal control, that were identified during the audit and were not required to be included in the auditor's report on internal control, and other management issues.

1. Management letter provides a comprehensive assessment of the company's performance, allowing the management team to make informed decisions and take proactive measures to address any identified issues.
2. Management letter clearly identify inefficiencies and bottlenecks within the organization. By analyzing the company's financial statements, internal controls, and operational processes, the management letter helps pinpoint areas where improvements can be made.
3. Management letter in turn, leads to increased efficiency, improved productivity, and enhanced customer satisfaction.
4. Management letter provides valuable insights that can shape the company's future direction. It helps the management team identify new markets to explore, potential risks to mitigate, and innovative strategies to adopt.
5. A well-written management letter consists of several key components, each providing valuable information and recommendations for improvement.

QUESTION 14

Marking guide

Marks

- a. Explaining error and fraud (*2 marks each*).

4

- Clearly stating who is responsible for detection and prevention of fraud. 2
- b. Listing three things that must exist for the company to bring a successful claim. (2marks each) 6
 Explaining three things that must be exist for the company to bring a successful claim (2 marks each). 6
- c. Explaining the duty of reasonable care 2
- Total marks 20 marks**

Model answers

(a) Briefly explain what is error, fraud and who is responsible for detection and prevention of fraud.

Fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Error is an unintentional misstatement in the financial statements, including the omission of an amount or a disclosure.

The responsibility for the prevention and detection of fraud **lies with the directors of a company, not with the external auditors.**

(b) Briefly describe three things that must exist for the company to bring a successful claim.

If the auditors breach the terms of their contract the company will have a claim against them for damages. If the auditors breach their implied duty of care under the contract, the company may be able to sue them for negligence.

Three things must exist for the company to bring a successful claim:

- ✓ **Duty of care:** There existed a duty of care enforceable at law. (This will always be the case if a contract is in place.)
- ✓ **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.
- ✓ **Damages:** The client has suffered some monetary loss as a direct consequence of the negligence on the part of the auditors.

(c) What does a duty of reasonable care mean?

There is not a list of things that an auditor must do/not do to prove he has exercised a duty of reasonable care. However, there are several guidelines:

- Auditors should use generally accepted auditing techniques (that is, adhere to auditing

standards).

- If auditors' suspicions are aroused, they must carry out investigations until they are satisfied (this is called being 'put on enquiry').
- Auditors must act honestly and carefully when making judgements.

QUESTION 15

Marking guide

Marks

- | | |
|--|-----------------|
| a. Five (5) tests of controls to be performed by the auditor to ensure proper controls over movements (acquisitions and disposals) (<i>1 mark – each</i>). | 5 |
| b. Six factors that may affect inherent risk (<i>2marks each</i>). | 12 |
| c. Enumerate the three basic components of an audit risk model (<i>1 mark – each</i>). | 3 |
| Total marks | 20 marks |

Model answers

(A) Five (5) tests of controls to be performed by the auditor to ensure proper controls over movements (acquisitions and disposals)

The precise nature of the tests of controls performed by the auditor would depend on the way in which the control is being operated by the audit client.

A key concern of auditors to ensure proper controls over movements (acquisitions and disposals) during the year will be the following:

- ✓ Confirm maintenance of a non-current asset register.
- ✓ Review annual capital budgets produced by the board and confirm that they are authorised.
- ✓ For a sample of acquisitions and disposals recorded in the non-current asset register confirm authorisation (and board approval if necessary).
- ✓ Inspect invoices to confirm that they have been appropriately approved.
- ✓ Review reconciliations of the non-current assets register to the general ledger accounts and confirm that discrepancies are followed up.
- ✓ Reperform a sample of reconciliations.
- ✓ Verify that depreciation rates are authorised and are in line with company policy.
- ✓ Review evidence of arithmetical accuracy of depreciation and reperform a sample of calculations.
- ✓ Review evidence of calculations of profits or losses on disposal and reperform a sample of calculations.

- ✓ Review adequacy of physical security measures.

(B) Six (6) factors that may affect inherent risk.

Inherent risk is the risk that items will be misstated due to characteristics of those items, such as the fact they are estimates or that they are important items in the accounts. The auditors must use their professional judgement and all available knowledge to assess inherent risk.

Inherent risk is affected by many factors, including:

- ✓ The nature of the entity, for example, the industry it is in and the regulations it falls under.
- ✓ The attitudes and experience of management.
- ✓ The geographic spread of the operations.
- ✓ The future business strategy of the entity.
- ✓ The presence of complex wage structures, for example, a bonus- or commission-based salary structure.
- ✓ The information system, for example, computer-based accounting systems.

Inherent risk can also vary from account to account. Balances made up of complex items, such as inventory in a manufacturing company, portable assets in an engineering company and cash balances are generally more prone to high levels of inherent risk.

(C) Enumerate the three basic components of an audit risk model

An audit risk model is a conceptual tool applied by auditors to evaluate and manage the various risks arising from performing an audit engagement. The tool helps the auditor decide on the types of evidence and how much is needed for each relevant assertion.

The three basic components of an audit risk model are: **Control Risk**, **Detection Risk** and **Inherent Risk**.

Audit risk represented by the audit risk model as: **Audit risk** = Inherent risk*Control risk*
Detection risk

END OF MARKING GUIDE AND MODEL ANSWERS