CERTIFIED PUBLIC ACCOUNTANT

TECHNICAL LEVEL EXAMINATIONS

AA1.4: AUDIT AND ASSURANCE

MARKING GUIDE AND MODEL ANSWERS

SECTION A

Marking Guide

QN	Answer	QN	Answer
1	B	26	B
2	C	27	B
3	D	28	C
4	B	29	C
5	B	30	B
6	B	31	A
7	B	32	D
8	B	33	D
9	B	34	D
10	A	35	A
11	A	36	B
12	B	37	C
13	B	38	D
14	B	39	B
15	A	40	B
16	A	41	A
17	C	42	C
18	A	43	D
19	A	44	C
20	C	45	A
21	C	46	B
22	C	47	A
23	D	48	B
24	C	49	C
25	C	50	D

Model Answers

QUESTION ONE
Correct answer is B
Self-review threat arises because KJR audit firm is preparing the management accounts and assisting in drafting the very financial statements that the same firm will then audit. When the auditor comes to form an opinion on those statements, they would effectively be reviewing and passing judgement on their own work. This fundamentally compromises objectivity because auditors are psychologically and professionally unlikely to identify and report errors or weaknesses in work they themselves produced

Why other points are not correct

- A: Advocacy and intimidation are not engaged here. Advocacy arises when an auditor promotes a client's position (e.g., in litigation or fundraising). Intimidation arises when the auditor is pressured or threatened. Neither is present in this scenario.

- C: Familiarity and self-interest are not the primary threats. Familiarity develops over long association with a client. Self-interest typically involves a financial stake in the client. While prolonged engagement may eventually breed familiarity, the immediate and dominant threats created by this specific arrangement are self-review and management threat.
- D: Self-interest and advocacy do not directly describe the conflict of auditing your own work or assuming management responsibilities.

QUESTION TWO
Correct answer is C
Why the others are incorrect:
- A: Absolute confidentiality overrides all reporting obligations is fundamentally wrong. Confidentiality is a core ethical principle, but it is not absolute. The ICPAR Code of Ethics and ISA 250 both recognise that confidentiality yields where there is a legal or professional obligation to disclose, or where disclosure is in the public interest. Management's instruction does not create an absolute shield.
- B: Disclosure only with explicit written client consent misrepresents the framework. Waiting for client consent in cases of suspected intentional non-compliance would render the auditor complicit in concealment. ISA 250 specifically contemplates disclosure *without* client consent where appropriate authority requires it.
- D: No obligation because tax compliance is management's responsibility is incorrect on two levels. First, while management is responsible for compliance, auditors are required under ISA 250 to consider the effect of non-compliance on the financial statements. Second, systematic under-remittance of PAYE over three years at a material level is precisely the type of matter ISA 250 was designed to address — it cannot simply be disclaimed as outside audit scope.

QUESTION THREE
Correct answer is D
In *Bannerman*, the auditor knew financial statements would be relied on by lenders under a specific facility agreement and had not included a disclaimer disclaiming responsibility to third parties, the court held this could give rise to a duty of care based on the auditor's actual knowledge of reliance (a proximity-based extension of the *Caparo* framework, not a blanket duty to all foreseeable users).
Applying that here:
- **A is wrong**: absence of contractual privity does not automatically preclude a duty of care in tort; *Bannerman* itself involved no contract between auditor and bank.

- **B is wrong**: this overstates the law. *Caparo* rejected a duty owed to all foreseeable users; liability turns on proximity and specific knowledge of reliance, not mere foreseeability.
- **C is wrong:** fraud by management doesn't create automatic auditor liability; the auditor's own duty and breach must still be independently established.
- **D is correct:** the facts mirror *Bannerman* closely: RCB's reliance was a known, specific condition of the facility, the auditor was aware of this arrangement, and no disclaimer was issued to limit or exclude responsibility to RCB. This combination of factors (known identity of the reliant party, known purpose of reliance, absence of a disclaimer) is precisely what supports finding sufficient proximity for a duty of care

QUESTION FOUR
Correct answer is B
Why the others are incorrect:
- A: Board resolution with ten days' notice incorrectly attributes the removal power to the Board of Directors. While the ten-day notice element is correctly stated, the Act vests the removal decision exclusively in the shareholders, not the Board. The Board's dissatisfaction is irrelevant unless it is brought before a shareholders' meeting.
- C: Mutual written agreement between the Board and audit firm has no basis in the Rwanda Companies Act 2021. Removal is a statutory process requiring shareholder approval and cannot be reduced to a private bilateral agreement between management and the auditor, which would bypass the shareholders entirely.
- D: Registrar of Companies must approve removal misapplies the Registrar's role. As established earlier in your workbook, the Registrar's power relates to directing appointment where a company fails to appoint an auditor, it does not extend to approving or supervising removals.

QUESTION FIVE
B: 1, 3, and 4 only
Evaluating each statement:

Statement 1: TRUE
"The primary purpose of an engagement letter is to minimise the risk of misunderstanding between the auditor and the client regarding their respective responsibilities, and to confirm the formal acceptance of the engagement." This is correct and directly reflects the objective stated in ISA 210 (Agreeing the Terms of Audit Engagements). The engagement letter serves as the foundational document that establishes mutual understanding between auditor and client, clarifying what each party is responsible for, what the audit will cover, and on what basis it will be conducted. It also constitutes the auditor's formal acceptance of the appointment.

Statement 2: FALSE
"Under ISA 210, the engagement letter must be re-signed by both the auditor and the client at the commencement of every audit engagement without exception." This is incorrect. ISA 210 does not require automatic re-signing every year without exception. For recurring engagements, the auditor considers whether circumstances have changed sufficiently to warrant a new or revised letter. A new engagement letter is required when:

Circumstance	New Letter Required?
Change in senior management or ownership	Yes
Change in the nature or scope of the audit	Yes
Change in legal or regulatory requirements	Yes

Significant time has passed since the original letter	Advisable
No changes in any relevant circumstances	Not mandatory

Where terms remain unchanged, the existing letter may continue to govern the engagement, though many firms issue updated letters annually as best practice.

Statement 3: TRUE
"The engagement letter should state that management is responsible for the prevention and detection of fraud, and that the audit may not detect all material misstatements due to the inherent limitations of the audit." This is correct. ISA 210 requires the engagement letter to clearly establish management's responsibilities, which explicitly include the prevention and detection of fraud. The letter must also communicate the inherent limitations of an audit, that reasonable assurance is not absolute assurance, and that some misstatements, particularly those involving sophisticated fraud or collusion, may not be detected. This directly addresses the expectation gap by setting realistic parameters from the outset.

Statement 4: TRUE
"The engagement letter is a legally binding contract between the auditor and the client that can be used to define the scope of the audit and clarify the basis on which audit fees will be charged."
This is correct. The engagement letter constitutes a contract between the auditor and client, it creates enforceable obligations on both sides. Its contents typically include the scope of the audit, the applicable financial reporting framework, the basis of fee calculation, and billing arrangements. In the event of a dispute, the engagement letter is a primary reference document for determining what was agreed.
Summary table:

Statement	Verdict	Reason
1	✓ True	Reflects ISA 210's stated objective
2	✗ False	Annual re-signing is not mandatory where terms are unchanged
3	✓ True	Management fraud responsibility and audit limitations are required content
4	✓ True	Engagement letter is a legally binding contract covering scope and fees

QUESTION SIX
Correct answer is B
Why the others are incorrect:

- A High detection risk to compensate for high IR and CR inverts the model entirely. Setting detection risk high when IR and CR are already high would cause overall audit risk to exceed the 5% threshold, meaning the auditor accepts an unacceptably high risk of issuing an incorrect opinion. This is the most dangerous misconception about the audit risk model.
- C Only control risk affects detection risk is incorrect. Both inherent risk and control risk feed into the denominator of the model. Inherent risk — the susceptibility of an assertion to misstatement before considering controls — directly influences how low detection risk must be set. The fact that inherent risk is driven by the nature of the entity does not mean it is irrelevant to the detection risk calculation.
- D Substantive testing can be eliminated through tests of controls is categorically false under auditing standards. ISA 330 is explicit: regardless of the assessed level of control risk, the auditor must always perform some substantive procedures for material classes of transactions, account balances, and disclosures. Controls can never provide absolute assurance, and auditors can never rely on controls alone to reduce audit risk to an acceptable level.

QUESTION SEVEN
Why B is correct:
Item 1: Qualitatively material despite being below the quantitative threshold. The misclassification of FRW 35,000 of director remuneration represents only 25% of the FRW 140,000 materiality threshold, so it is quantitatively immaterial on its face. However, materiality is not determined by numbers alone. ISA 320 makes clear that an item can be material by its nature or qualitative characteristics even when the amount is small. Director remuneration is specifically required to be separately disclosed under the Rwanda Companies Act 2021, this is a statutory disclosure obligation, not merely a presentational preference. A misclassification that obscures director remuneration within operating expenses denies users information they are legally entitled to receive, potentially concealing related party transactions, governance concerns, or executive pay arrangements. The qualitative significance therefore renders this item material regardless of its monetary value.

Item 2: Not material on current assessment. The arithmetic error of FRW 28,000 in the depreciation calculation represents 20% of overall materiality. It is a straightforward quantitative error with no apparent qualitative dimension, it does not relate to a statutory requirement, a sensitive disclosure, or a matter where even small errors carry disproportionate significance. Applying the quantitative threshold, FRW 28,000 falls below FRW 140,000 and would not ordinarily require adjustment to avoid a modified opinion, though the auditor should still accumulate it with other misstatements when assessing aggregate uncorrected misstatements.

Why the others are incorrect:
- A Neither item is material fails entirely because it applies only a quantitative lens and ignores the qualitative dimension of Item 1 that ISA 320 expressly requires auditors to consider.
- C Both items are material because identified during fieldwork introduces a completely fictitious principle. The stage at which a misstatement is discovered has no bearing whatsoever on its materiality. Materiality is assessed by reference to the nature and amount of the item relative to the financial statements, not by the circumstances of its detection.
- D Depreciation errors are inherently more significant than misclassifications has no basis in auditing standards. There is no hierarchy of account types in materiality assessment. Depreciation errors are not automatically more significant, the framework assesses each item on its own quantitative and qualitative characteristics.

QUESTION EIGHT
The correct answer is B: statements 2 and 3 only.

Evaluating each statement:
Statement 1: FALSE. This overstates and mischaracterises professional scepticism. ISA 200 is explicit that professional scepticism does *not* mean assuming management is dishonest. It means neither assuming honesty nor dishonesty, the auditor maintains a neutral, questioning mind that recognises the *possibility* of misstatement without defaulting to suspicion. An auditor who assumed universal management dishonesty would be unable to function practically, as audits necessarily rely on some degree of management cooperation and representation. The standard requires alertness and critical assessment, not blanket distrust.

Statement 2: TRUE. This is a precise and accurate reflection of ISA 200's definition of professional scepticism. The three elements stated, a questioning mind, alertness to conditions indicating possible misstatement due to fraud or error, and critical assessment of audit evidence, map directly onto the standard's language. This is the correct and complete characterisation of what professional scepticism requires in practice.

Statement 3: TRUE. This accurately captures ISA 200's definition of professional judgement. The standard defines it as the application of relevant training, knowledge, and experience in making informed decisions about appropriate courses of action within the context of auditing standards, ethical requirements, and the specific circumstances of the engagement. Professional judgement is distinct from professional scepticism, scepticism governs the auditor's mindset toward evidence, while judgement governs the quality of decisions made throughout the audit.

Statement 4: FALSE. Written management representations do not suspend or extinguish the requirement for professional scepticism. ISA 580 confirms that written representations are audit evidence but are of limited reliability precisely because they come from the party whose assertions the auditor is testing. ISA 200 makes clear that professional scepticism must be maintained throughout the entire audit engagement. If anything, over-reliance on management representations without independent corroboration is itself a failure of professional scepticism.

QUESTION NINE

Why B is correct: The investor's statement contains two fundamental misconceptions that ISA 200 directly addresses, the nature of assurance provided and the concept of materiality.

An audit provides reasonable assurance, not absolute assurance. ISA 200 explicitly acknowledges that reasonable assurance is a high but not absolute level of assurance. This limitation arises from several inherent limitations of the audit process:

- Sampling: auditors test a representative sample of transactions and balances rather than every single item. Misstatements in untested items may go undetected.
- Judgement: many audit conclusions rely on professional judgement in areas such as estimates, provisioning, and going concern. Different auditors exercising reasonable judgement may reach different conclusions.
- Persuasive rather than conclusive evidence: most audit evidence is persuasive in nature. Unlike a mathematical proof, audit evidence supports conclusions without eliminating all doubt.
- Materiality: an unmodified opinion means the financial statements are free from material misstatement, not all misstatement. Immaterial errors may exist and the audit is not designed to detect them.

The investor's claim of a guarantee of complete accuracy with no errors whatsoever therefore misunderstands both the level of assurance (reasonable, not absolute) and its scope (material misstatements, not all misstatements).

Why the others are incorrect:

- A directly contradicts ISA 200 by claiming an audit does guarantee freedom from all misstatements. This compounds rather than corrects the investor's misconception. No such guarantee exists, the audit opinion addresses material misstatements only.
- C while technically accurate that the opinion is issued at a point in time and subsequent events are governed separately under ISA 560, this does not address the core error in the investor's statement, which concerns the nature and scope of assurance rather than its temporal limitations.
- D fundamentally misstates the auditor's responsibilities. Under ISA 700 and ISA 200, the auditor expressly evaluates whether accounting policies are appropriate and consistently applied. Limiting the auditor's role to numerical verification would describe a narrow agreed-upon procedures engagement, not an audit.

QUESTION 10

Correct answer is A: Closing inventory: FRW 18,000; Cost of goods sold: FRW 92,000

Working:

Total units available = 500 (opening) + 1,000 (Purchase 1) + 500 (Purchase 2) = 2,000 units

Total cost = (500×50) + (1,000×55) + (500×60) = 25,000 + 55,000 + 30,000 = FRW 110,000

Total units sold = 1,200 + 500 = 1,700 units

Units remaining (closing inventory) = 2,000 − 1,700 = 300 units

FIFO COGS (oldest costs used first, for 1,700 units sold):

Layer	Units used	Cost/unit	Total
Opening stock	500	50	25,000
Purchase 1	1,000	55	55,000
Purchase 2 (partial)	200	60	12,000
Total COGS	1,700		92,000

Closing inventory (remaining 300 units, from the last/most recent layer under FIFO): 300 units × FRW 60 (Purchase 2, since 200 of the 500 were used above) = FRW 18,000

Check: COGS + Closing Inventory = 92,000 + 18,000 = 110,000 = Total cost of goods available

Option B: Closing inventory FRW 18,000; COGS FRW 80,000

The closing inventory figure is correct (300 units × 60), but COGS is wrong.

Mistakenly using only opening stock + Purchase 1 costs: 25,000 + 55,000 = 80,000, and forgetting that 200 units of Sale 2 actually dip into Purchase 2 at FRW 60).

Option C: Closing inventory FRW 30,000; COGS FRW 75,000

30,000 = 500 × 60, assuming all of Purchase 2 (500 units) remained in closing stock, ignoring that only 300 units are actually left (mixing up total units sold vs. units remaining, or misreading "500 units" from Purchase 2 as the closing balance rather than tracing consumption).

Option D: Closing inventory FRW 25,000; COGS FRW 82,500

25,000 = 500 × 50, this suggests the student used opening inventory cost (FRW 50) for the closing stock instead of the most recent purchase cost. This is essentially applying LIFO logic by mistake (treating the oldest, cheapest layer as what remains) while labeling it FIFO, a very common conceptual mix-up between FIFO and LIFO.

QUESTION 11

The correct answer is A: statements 1, 2, and 3 only.

Evaluating each statement:

Statement 1: TRUE. This accurately describes the Control Environment, which is the foundation of the entire COSO framework. It encompasses the tone at the top, management's philosophy and operating style, integrity and ethical values, commitment to competence, and the overall governance structure. ISA 315 recognises the control environment as setting the foundation upon which all other components operate, a weak control environment undermines every other control regardless of how well designed it is.

Statement 2: TRUE. This correctly describes the Risk Assessment component. Under COSO and ISA 315, risk assessment refers to the entity's own process for identifying, analysing, and managing risks that could prevent it from achieving its objectives. From the auditor's perspective, understanding the entity's risk assessment process directly assists in identifying where risks of material misstatement are most likely to arise in the financial statements.

Statement 3: TRUE. This accurately describes Control Activities, the specific policies and procedures established to address identified risks and ensure management directives are executed. The examples given (authorisations, approvals, reconciliations, and segregation of duties) are precisely the categories ISA 315 and COSO identify as typical control activities. These operate across all levels and functions of the organisation.

Statement 4: FALSE. This description does not define the Monitoring component, it actually describes Information and Communication, which is the fourth component of the COSO framework. Information and communication refers to the systems and processes by which relevant control-related information is identified, captured, and communicated throughout the organisation, including through manuals, memoranda, and training. Monitoring, by contrast, is the fifth component and refers to the ongoing and periodic processes by which management assesses whether internal controls are present, functioning, and operating effectively over time, including internal audit activities, management reviews, and self-assessment procedures.

The five COSO components and their correct descriptions are:

Component	Core concept
Control environment	Tone at the top; integrity; governance foundation
Risk assessment	Identifying and analysing risks to objectives
Control activities	Policies and procedures to mitigate risks
Information and communication	Capturing and sharing control-relevant information
Monitoring	Ongoing evaluation that controls continue to operate effectively

Statement 4 deliberately swaps the descriptions of monitoring and information and communication, a classic exam technique designed to test whether candidates have genuinely learned all five components or are merely familiar with the labels.

QUESTION 12

The correct answer is B.

Why B is correct: The scenario describes a single individual controlling every stage of the entire purchase-to-payment cycle, from initiating a purchase all the way through to releasing the payment.

Why the others are incorrect:

- A Breach of authorisation principle is partially present since the clerk approves their own purchase orders, but authorisation is merely one element of the broader problem. Framing this solely as an authorisation issue understates the severity, the fundamental breach is that incompatible duties are wholly concentrated in one person across the entire cycle.
- C Breach of physical safeguarding is not directly engaged here. Physical safeguarding relates to restricting physical access to tangible assets such as inventory, cash, or equipment. While payments involve cash outflows, the primary concern in this scenario is the absence of segregation over the transaction processing cycle, not physical asset protection.
- D Breach of independent verification is a related but secondary concern. Independent verification is itself a *consequence* of poor segregation, when duties are properly segregated, different people

performing different functions naturally create verification checkpoints. The root cause, and therefore the most severely breached principle, remains segregation of duties.

QUESTION 13

The correct answer is B: Statements 1, 2, and 4 only.

Statement 1: Correct

General IT controls (GITCs) do indeed cover the four domains listed: IT operations, access to programs and data, programme change management, and systems acquisition and development. Critically, they provide the foundation upon which application controls rest. If GITCs are sound, the auditor gains confidence that application controls are operating consistently and reliably throughout the period.

Statement 2: Correct

Application controls operate at the business process or application level and are specifically designed to ensure the completeness, accuracy, authorisation, and validity of transactions as they are captured, processed, and reported. They are tailored to individual systems or processes, such as the payroll or sales ledger application.

Statement 3: Incorrect

This is the critical misconception to identify. Application controls are not independent of the general IT environment, they run on top of it. If GITCs are weak (for example, if unauthorised changes can be made to programs, or access to data is poorly controlled), the auditor cannot place reliance on application controls, because those controls themselves may have been compromised. Weak GITCs effectively undermine the integrity of any application control operating within that environment.

Statement 4: Correct

Input controls, processing controls, and output controls are all recognised categories of application controls, each addressing risks at a different stage of the data journey, from capturing data accurately, to processing it correctly, to ensuring outputs are complete and distributed appropriately.

Why the other options fail:

- A excludes Statement 4, which is correct
- C includes Statement 3, which is wrong, and excludes Statements 1 and 4
- D includes Statement 3, which is wrong

QUESTION 14

The correct answer is B: A flowchart and an organisation chart.

Here's why each element of the combination fits the scenario:

Flowchart is the natural complement to management's written description when there are multiple departments and complex document flows. It translates the narrative into a visual map, making it far easier to trace a transaction from origin to completion, spot gaps in controls, and identify where documents pass between departments. Written descriptions alone can obscure these flows, whereas a flowchart makes them immediately apparent.

Organisation chart is valuable because it identifies key personnel, their roles, and formal reporting lines. This is essential for understanding who is responsible for authorising, processing, and reviewing transactions, which is central to evaluating segregation of duties and accountability within the control system.

Why the other options fall short:

- Option A: A checklist confirms whether controls exist but doesn't map document flows. Combined with an org chart it still leaves the complex multi-department flow poorly documented. Checklists are better used after the auditor understands the system, not as a primary mapping tool.
- Option C: Narrative notes are the least efficient method for complex, multi-department processes. They can be verbose and make it harder, not easier, to spot control weaknesses or missing authorisation steps. They also duplicate what management has already provided.
- Option D: While a flowchart and checklist together are useful tools, dismissing the organisation chart is a mistake. The org chart directly supports the auditor's need to understand who performs controls and whether duties are properly segregated, a core objective in documenting an internal control system

QUESTION 15

The correct answer is A.

Why A is correct

ISA 610 (Using the Work of Internal Auditors) establishes a two-track framework for how external auditors may leverage internal audit:

Track 1: Using the work of internal audit. Where the internal audit function is assessed as sufficiently objective, competent, and applying a systematic methodology, the external auditor may use their completed work to reduce the nature, timing, or extent of external audit procedures. In Kicukiro's case, the fact that internal audit reports directly to the audit committee (supporting objectivity) and conducts control reviews and reconciliations makes it a strong candidate for reliance.

Track 2: Using internal auditors to perform procedures directly. The external auditor may also direct internal auditors to carry out specific procedures on their behalf — but this comes with an important constraint: the external auditor must provide appropriate oversight and direction, and must evaluate whether the work performed meets the required standards. The external auditor cannot simply hand over responsibility.

Crucially, under both tracks, the external auditor retains sole responsibility for the audit opinion. Internal audit can reduce the volume of work but never the accountability.

Why the other options are wrong:

- Option B: Control risk assessment is a non-delegable professional responsibility of the external auditor under ISA 315. A strong internal audit function informs that assessment but does not replace it. The external auditor must always form their own conclusions about the risk of material misstatement.
- Option C: ISA 610 explicitly prohibits the external auditor from basing the audit opinion primarily on internal audit findings. The external auditor must still perform sufficient independent procedures to support their own conclusion. Scope reduction is permitted; scope abdication is not.
- Option D: Use of internal audit work is never automatic or mandatory. ISA 610 requires the external auditor to first evaluate the function's objectivity, competence, and systematic approach. If the internal audit function is assessed as weak, lacks independence, or operates in a high-risk area, the external auditor may decide it is inappropriate to place any reliance on it at all.

QUESTION 16

The correct answer is A — 1 → 4 → 2 → 3

ISA 500 sets out a hierarchy of reliability principles that the auditor applies when evaluating audit evidence. The key determinants are: source (external vs internal), form (documentary vs oral), directness (obtained directly by the auditor vs via the client), and controls (whether internal controls over the document's preparation are strong).

Working through each item:
1st: Bank confirmation letter (most reliable)
This is the gold standard for bank balance evidence. It is external in origin, obtained directly by the auditor without passing through the client's hands, and is in written documentary form. ISA 500 is explicit that external evidence obtained directly by the auditor is the most reliable category. The bank, as an independent third party, has no interest in misrepresenting the balance.

2nd: Bank reconciliation prepared by management and reviewed by the Finance Director
Although this is an internally generated document, it carries meaningful weight because it has been subject to an internal control, specifically, independent review and sign-off by a senior officer. ISA 500 recognises that internally generated evidence is more reliable when it has been subjected to effective controls. The reconciliation also cross-references to external data (the bank statement), adding further credibility.

3rd: Photocopy of the bank statement
This originates from an external source (the bank), which ordinarily supports reliability. However, because it was provided by the client rather than obtained directly by the auditor, its reliability is reduced , the auditor cannot rule out the possibility that it has been altered or selectively presented. A photocopy also carries less assurance than an original. It ranks below the reconciliation despite being externally sourced, precisely because the chain of custody is broken.

4th: Oral assurance from the Finance Director (least reliable)
ISA 500 is clear that oral evidence is the least reliable form, regardless of who provides it. It is not independently verifiable, leaves no documentary trail, and comes from an internal party who may have an interest in presenting a favourable picture. While management representations have a role in the audit, they cannot substitute for documentary or external evidence.

Why the other options are not correct:
- Option B places the bank statement above the reconciliation, ignoring the effect of internal controls on the reconciliation's reliability
- Option C elevates the reconciliation above the bank confirmation, which contradicts ISA 500's clear preference for directly obtained external evidence
- Option D places the photocopy first, overlooking that client-provided documents are less reliable than directly obtained external confirmations

QUESTIO N 17
The correct answer is C: Random sampling.
Why C is correct
Random sampling is the only method that gives every individual item in the population an equal and independent probability of selection. This is achieved through a structured process, typically using random number tables or computer-generated random numbers, that removes all human discretion from the selection process. Because selection is driven purely by chance, the resulting sample is statistically representative of the population as a whole, and the auditor can draw valid statistical inferences from it.

Why the other options are wrong:
- Option A: Stratified sampling divides the population into distinct subgroups (strata) — for example, by transaction size — and samples separately from each stratum. While items within each stratum may be randomly selected, items across the whole population do *not* have an equal chance of

selection, since the auditor deliberately over-represents certain strata (such as high-value items). It improves efficiency and focus but sacrifices equal probability across the full population.

- Option B: Haphazard sampling attempts to approximate randomness by having the auditor select items without conscious bias, but it carries no mathematical guarantee of equal selection probability. It remains susceptible to unconscious human patterns — for instance, avoiding items that are difficult to locate or instinctively gravitating toward round numbers. ISA 530 permits it only where random sampling is impractical, and it cannot support statistical conclusions.
- Option D: Cluster sampling involves dividing the population into clusters (often by physical location or time period) and selecting entire clusters rather than individual items. Items within chosen clusters are all examined, while items in unchosen clusters have zero chance of selection — a direct violation of the equal probability principle.

QUESTION 18

The correct answer is A: The assurance that the auditor has in the sample results representing the entire population.

Why A is correct

The confidence level (sometimes called the reliability factor) expresses the degree of certainty the auditor requires that the sample results are representative of the true characteristics of the entire population. It is the statistical complement of sampling risk, if the auditor sets a confidence level of 95%, they are accepting a 5% risk that the sample conclusion does not reflect the true population position.

In practice, the confidence level directly drives sample size. A higher confidence level demands a larger sample, because the auditor needs more evidence to sustain a stronger assertion about the population. Conversely, where detection risk is higher (meaning the auditor is willing to accept more audit risk), a lower confidence level may be applied, permitting a smaller sample.

The confidence level is therefore a tool for calibrating the relationship between sampling risk and the sufficiency of audit evidence under ISA 530.

Why the other options are wrong:

- Option B describes tolerable error (or tolerable misstatement/deviation rate), the maximum error the auditor is willing to accept in the population while still concluding that the control or balance is acceptable. This is a separate input into sample design, not a definition of confidence level.
- Option C reflects a common misconception. There is no fixed percentage of a population that must be tested. Sample size is determined by risk, confidence level, tolerable error, and expected error, not by a prescribed coverage proportion. A small sample from a large population can be entirely valid if properly designed.
- Option D describes something closer to materiality, specifically performance materiality or a clearly trivial threshold. While materiality influences audit planning and the evaluation of misstatements, it is a distinct concept from the confidence level used in sampling methodology.

QUESTION 19

The correct answer is A.

Why A is correct

ISA 330 (*The Auditor's Responses to Assessed Risks*) contains an unambiguous requirement: substantive procedures must be performed for all material classes of transactions, account balances, and disclosures, regardless of the assessed effectiveness of internal controls. This is one of the most important mandatory principles in the standard, and it reflects a fundamental truth about the nature of audit assurance.

The reasoning behind this requirement is that controls testing alone can never provide complete comfort. Even perfectly designed and consistently operating controls carry inherent limitations, they can be

circumvented, they address process risk rather than balance risk, and they provide no direct evidence about whether the year-end figure is free from material misstatement. Substantive procedures, by contrast, address the financial statement assertions directly.
In Bugesera's case, the effective payroll controls allow the auditor to reduce the nature, timing, and extent of substantive procedures, for example, by performing analytical procedures rather than detailed transaction testing, or by testing a smaller sample. However, the auditor cannot eliminate them entirely. At minimum, some form of substantive work on the year-end payroll liability balance is required.

Why the other options are wrong:

- Option B directly contradicts ISA 330's mandatory requirement for substantive procedures on material balances. No matter how strong the controls, the auditor cannot rely on controls testing alone to support the audit opinion on a material balance.
- Option C mirrors the same fundamental error as Option B, framing the elimination of substantive procedures as an efficiency gain. ISA 330 does not permit this trade-off; efficiency cannot override the requirement for direct evidence on material balances.
- Option D is logically flawed. Effective controls reduce assessed risk, which in turn reduces the required extent of substantive procedures, not increases them. An increase in substantive work would be the appropriate response to *weak* controls or elevated risk, not to evidence of control effectiveness.

QUESTION 20

The correct answer is C: Existence.
Why C is correct
The defining characteristic of this procedure is its direction of testing. The auditor starts with balances already recorded in the receivables ledger and traces outward to an independent third party, the customer, asking them to confirm whether the balance exists from their perspective. This direction of testing, from the recorded population outward, is the hallmark of an existence test.
The existence assertion asks: do the assets recorded in the financial statements actually exist at the reporting date? By obtaining independent external confirmation that a customer acknowledges owing the recorded amount, the auditor gathers direct third-party evidence that the receivable is real and not fictitious. This is particularly powerful because the evidence comes from a party external to and independent of the client, satisfying ISA 500's preference for externally sourced evidence obtained directly by the auditor.
This procedure is therefore the primary tool for addressing the risk that management has recorded receivables that do not genuinely exist, a common risk in revenue and receivables, particularly where there is pressure to inflate reported balances.

Why the other options are wrong:

- Option A: Completeness is addressed by testing in the opposite direction, starting from external source documents (such as dispatch records, sales orders, or customer statements) and tracing inward to the ledger to confirm that all receivables that should have been recorded have been captured. The confirmation procedure starts from the ledger, so it cannot test for omissions.
- Option B: Valuation concerns whether receivables are carried at the correct recoverable amount, net of any allowance for doubtful debts. A customer confirming that a balance exists does not confirm that they will pay it. Valuation is better addressed through subsequent cash receipts testing, review of aged debt analyses, and assessment of the adequacy of bad debt provisions.
- Option D: Rights and obligations relates to whether the entity has the legal entitlement to the asset, for instance, whether receivables have been factored or assigned to a third party. While confirmation letters have some bearing on this, it is not their primary purpose, and rights and obligations is a

secondary assertion for assets such as receivables where existence and valuation carry the greater audit risk.

QUESTION 21
The correct answer is C.
Why C is correct
Completeness asks: *have all liabilities that should have been recorded actually been recorded?* To test this, the auditor must work in the opposite direction to the ledger, starting from outside the recorded population and tracing inward to check whether items have been captured.
Reviewing goods received notes (GRNs) and supplier invoices received in January 2026 does exactly this. These documents represent economic obligations that arose on or before 31 December 2025, goods or services received but potentially not yet recorded as payables. By tracing these source documents into the payables ledger, the auditor can identify cut-off failures and unrecorded liabilities, which are the precise risks that the completeness assertion is designed to address.
This procedure is especially powerful in the context of Musanze Supplies, where management has an incentive to understate liabilities. Unrecorded payables would not appear anywhere in the ledger, so any procedure that starts *from* the ledger can never detect what has been deliberately or accidentally omitted. Only by starting from an independent source, GRNs, subsequent invoices, or supplier statements, can the auditor identify what is missing.

Why the other options are wrong:
- Option A traces from the ledger outward to supporting invoices. This direction of testing addresses the existence assertion, confirming that recorded payables are genuine and supported. It cannot identify liabilities that have not been recorded at all, because unrecorded items simply do not appear in the starting population.
- Option B sends confirmations to suppliers already listed in the payables ledger. Again, this starts from the recorded population and primarily tests existence and valuation of known balances. It offers limited completeness assurance because suppliers with whom there are unrecorded balances would not be selected, they are absent from the ledger entirely. A more completeness-focused variant would involve requesting statements from suppliers not currently in the ledger, or reconciling supplier statements independently obtained.
- Option D is an analytical procedure, comparing the payables-to-purchases ratio against the prior year. While useful for highlighting unusual movements that might prompt further investigation, analytical procedures provide only indirect, corroborative evidence. They may indicate that a problem *could* exist but cannot confirm whether specific liabilities have been omitted. They are rarely sufficient on their own to address completeness for a balance where the risk of understatement is elevated.

QUESTION 22
The correct answer is C: Valuation.
Why C is correct
The critical distinguishing feature of this scenario is that the accruals are estimated figures, final invoices have not been received, so the amounts recorded represent management's judgement about the cost of work completed by subcontractors at year end. The accruals undeniably exist (they are in the ledger) and there is no particular reason to doubt they relate to the correct period. The fundamental question is: are they the right amount?
This makes valuation the primary assertion of concern. Under IAS 37 and general financial reporting principles, a liability must be measured at the best estimate of the expenditure required to settle the obligation at the reporting date. Where estimates are involved, particularly on long-term construction contracts with complex stage-of-completion assessments, the risk is that management's estimates are

too low (understating liabilities) or too high (creating provisions that could be released to flatter future profits).
The most direct response is to challenge and corroborate management's estimation methodology. This involves reviewing the underlying contract terms to understand the scope of subcontractor obligations, assessing the stage of completion using engineer or project manager reports, comparing estimates to agreed contract rates, and crucially, agreeing the estimated amounts to post-year-end invoices where these have since been received, because subsequent invoices provide the most direct and objective evidence of what the liability actually was at year end.

Why the other options are wrong:

- Option A: Existence is not the primary concern here. The accruals have been recorded in the ledger; there is no suggestion they are fictitious. Agreeing entries to the general ledger merely confirms recording, not whether the amounts are appropriate. Existence is typically tested by tracing from the ledger to supporting documentation, but supporting documentation here consists of estimates, not settled invoices, so existence testing adds limited value.
- Option B: Completeness would be the primary concern if the risk were that management had omitted accruals to understate liabilities. Reviewing post-year-end invoices for omitted items is a valid completeness procedure. However, the scenario describes a situation where accruals have already been recognised but are based on estimates, the question is whether those estimates are accurate, not whether items have been left out entirely. Completeness is a secondary rather than primary concern here.
- Option D: Cut-off addresses whether transactions have been recorded in the correct accounting period. While always relevant, there is no indication in the scenario that cut-off is the key risk. The accruals clearly relate to work in progress at year end on long-term contracts, the period attribution is not in dispute. The uncertainty lies in the quantum of the obligation, not its timing

QUESTION 23
The correct answer is D: Procedure 1: Test of controls; Procedure 2: Substantive test of details.
The classification of an audit procedure does not depend on the document being inspected but rather on the purpose and objective of the procedure and what the auditor is looking for.

Procedure 1: Test of controls
The auditor is inspecting purchase invoices specifically to find evidence that a control activity has occurred, in this case, managerial authorisation evidenced by a dated signature before payment was processed. The auditor is not interested in the monetary amount on the invoice; they are asking did the control operate as intended? This is the defining characteristic of a test of controls under ISA 330: it evaluates the design and operating effectiveness of a control within the internal control system. If the authorisation signature is present, the control operated; if absent, a deviation has occurred.

Procedure 2: Substantive test of details
Here the auditor is comparing the monetary amount on the invoice to the corresponding entry in the purchase ledger. The purpose is to detect financial misstatement, specifically whether liabilities and expenses have been recorded at the correct value. This directly addresses the valuation and accuracy assertions at the financial statement level. The auditor is gathering evidence about whether the numbers in the accounting records are right, which is the hallmark of a substantive procedure under ISA 330.

Why the other options are wrong:

- Option A reverses the two classifications entirely, misidentifying the purpose of each procedure
- Option B conflates the document inspected with the purpose of inspection. Both procedures happen to use purchase invoices, but this is irrelevant to classification, what matters is what the auditor is

testing for. Inspecting a document for a control signature is fundamentally different from inspecting it to verify a monetary amount
- Option C makes the same error in the opposite direction, assuming that because Procedure 1 involves invoices and a form of tracing, it must be substantive. In fact, tracing to find evidence of authorisation is a controls objective, not a financial statement one

QUESTION 24
The correct answer is C: Statements 1, 3, and 4 only.
Statement 1: Correct
Obtaining a direct bank confirmation and agreeing the confirmed balance through to the bank statement and then to the cash book is a fundamental and well-structured audit procedure. The direction of this work matters: starting from the independently confirmed bank balance and tracing through to the client's records provides assurance over the integrity of the reconciliation from an external anchor point. This procedure simultaneously addresses existence, rights, and the accuracy of the opening reconciliation figure.
Statement 2: Incorrect
This is the statement to reject. The auditor is never entitled to delegate their own procedures to the client's staff. Arithmetical checking of the bank reconciliation, while mechanical in nature — is an audit procedure that must be performed by the audit team, not the client. Allowing the client's finance team to perform it and merely reviewing the outcome would mean the auditor is relying entirely on internally prepared work without independent verification. This fundamentally compromises the sufficiency and appropriateness of audit evidence. Furthermore, the reconciliation itself is a client-prepared document, so its arithmetic cannot be taken as independently verified simply because it appears reasonable at a glance.
Statement 3: Correct
Reviewing post-year-end bank statements to confirm that reconciling items have subsequently cleared is a critical procedure for validating the legitimacy of those items. Unpresented cheques that never clear, or deposits in transit that cannot be traced to subsequent receipts, may indicate window dressing, fictitious entries, or cut-off manipulation. This procedure provides direct evidence that the reconciling items are genuine and properly described.
Statement 4: Correct
Inspecting the bank reconciliation for evidence of independent supervisory review, such as a senior manager's signature or initials, is a test of controls procedure. It confirms that the entity has an oversight control in place over the reconciliation process, which is a key element of a well-controlled cash management environment. The presence of such a review reduces the risk that errors or manipulations in the reconciliation would go undetected by management.

Why the other options fail:
- Option A correctly includes Statements 1 and 3 but wrongly excludes Statement 4, which describes a valid and important control-testing procedure
- Option B includes the incorrect Statement 2 and excludes Statements 1 and 3, which are both correct
- Option D includes all four statements, but Statement 2 is clearly inappropriate as it describes an improper delegation of audit work to the client

QUESTION 25
The correct answer is C.
Why C is correct
The rights and obligations assertion addresses a single focused question: does the entity actually own or control the assets it has recognised in its financial statements? It is not concerned with whether assets

physically exist, whether they are correctly valued, or whether additions have been properly authorised, those are separate assertions. Rights and obligations asks specifically about legal title and entitlement.
For Rubavu Hospitality's asset portfolio, the most direct evidence of ownership comes from legal documentation:

- Title deeds and land registration certificates for the hotel building and commercial properties provide formal legal evidence that the properties are registered in the entity's name, addressing the risk that properties are occupied but not owned, or have been sold and leased back without proper disclosure
- Vehicle registration documents confirm legal ownership of the motor vehicles, distinguishing owned assets from those that are leased or hired
- Lender confirmations are particularly important where assets are used as security — a lender confirmation acknowledges the entity's title while also revealing the existence of any charge or encumbrance over the asset, which has direct implications for financial statement disclosure

Together these procedures provide external, documentary, legally grounded evidence that directly responds to the rights and obligations assertion.

Why the other options are wrong:

- Option A: Recalculating depreciation and agreeing net book value to the asset register addresses valuation and accuracy. It provides no evidence whatsoever about who owns the assets — an asset can be correctly depreciated regardless of whether the entity holds legal title to it.
- Option B: Physical inspection of assets during a site visit addresses existence, confirming that assets the register says are there can actually be seen and touched. However, physical presence does not establish ownership. A hotel building that is physically inspected may be leased rather than owned; a vehicle on the premises may belong to an employee. Existence and rights are distinct assertions that require different procedures.
- Option D: Agreeing additions to supplier invoices and inspecting capital expenditure authorisation addresses occurrence, completeness, and accuracy of asset additions. Confirming that an asset was purchased at a given cost from a supplier is relevant to valuation, but a purchase invoice does not constitute proof of continuing legal ownership at the year end, assets may have subsequently been disposed of, encumbered, or transferred.

QUESTION 26

The correct answer is B: Scenario 1: Qualified; Scenario 2: Disclaimer; Scenario 3: Adverse; Scenario 4: Unmodified.
ISA 705 (*Modifications to the Opinion in the Independent Auditor's Report*) establishes a clear decision framework based on two dimensions: the nature of the issue (misstatement vs inability to obtain evidence) and the pervasiveness of its effect (material but contained vs material and pervasive).

Scenario 1: Qualified opinion ("except for")
The auditor has identified a material misstatement, a disagreement with management about the valuation of an intangible asset. However, the misstatement is explicitly described as isolated to a single item, meaning it is material but not pervasive. It does not undermine the financial statements as a whole. Under ISA 705, a material but non-pervasive misstatement warrants a qualified opinion, where the auditor expresses an opinion that the financial statements present fairly *except for* the effects of the identified misstatement.
Scenario 2: Disclaimer of opinion
Here the issue is not a misstatement but a limitation on scope, the auditor has been unable to obtain sufficient appropriate audit evidence because management denied access to sales records. Crucially, the auditor concludes that the possible effects are both material and pervasive. Under ISA 705, when a

scope limitation is so significant and pervasive that the auditor cannot form any opinion on the financial statements as a whole, a disclaimer of opinion is required. The auditor does not express an opinion at all.
Scenario 3: Adverse opinion
The auditor has identified a material misstatement that is also pervasive, it affects multiple line items and fundamentally undermines the reliability of the financial statements as a whole. Where a misstatement (as opposed to a scope limitation) is both material and pervasive, ISA 705 requires an adverse opinion: the auditor positively states that the financial statements do *not* present fairly in accordance with the applicable financial reporting framework.

Scenario 4: Unmodified opinion
The auditor has obtained sufficient appropriate audit evidence and concluded that the financial statements present fairly in all material respects with no material misstatements. This is the standard clean opinion under ISA 700, requiring no modification whatsoever.

The ISA 705 decision matrix in summary:

	Material but not pervasive	Material and pervasive
Misstatement	Qualified	Adverse
Inability to obtain evidence	Qualified	Disclaimer
	Material but not pervasive	Material and pervasive

Why the other options fail:
- Option A assigns a disclaimer to Scenario 1, which is wrong, a disclaimer arises from scope limitation, not an identified misstatement
- Option C assigns an adverse opinion to Scenario 1 and a qualified opinion to Scenario 3, reversing the pervasiveness distinction entirely
- Option D assigns an adverse opinion to Scenario 2, confusing a scope limitation with a misstatement, the critical distinction that separates a disclaimer from an adverse opinion

QUESTION 27
The correct answer is B: Performing regular reconciliations between sales records and bank deposits.
Why B is correct. The completeness assertion asks: have all transactions that should have been recorded actually been recorded? The risk is that revenue has been omitted from the financial statements, whether through error, system failure, or deliberate suppression.

Reconciling sales records to bank deposits directly addresses this risk by cross-referencing two independent data sources. If a sale has been made and cash received but not recorded in the sales ledger, the reconciliation will reveal an unexplained deposit. Conversely, if a sales entry exists with no corresponding receipt, this too is flagged. Because bank deposits are independently generated and difficult to manipulate without detection, this control provides strong assurance that the sales records capture the complete population of revenue transactions. Any gap between what was sold and what was banked becomes visible and requires explanation.

Why the other options are wrong:
- Option A: Independent review of sales invoices before recording is primarily a control over accuracy and authorisation. It ensures that invoices are correct and properly approved before entry, but it only operates on invoices that have already been raised. It cannot detect revenue that was never invoiced in the first place, which is precisely the completeness risk the question is asking about.

- Option C: Classifying sales by product category addresses presentation and disclosure, ensuring that revenue is appropriately disaggregated in the financial statements. It has no bearing on whether all sales have been captured. An entity could classify every recorded sale perfectly and still have significant unrecorded revenue.
- Option D: Verifying accurate pricing and quantities on invoices addresses valuation and accuracy, confirming that the amounts billed are correct. Like Option A, this control only operates on invoices that exist in the system. It provides no mechanism for identifying transactions that were completed but never invoiced or recorded, leaving the completeness risk entirely unaddressed.

QUESTION 28

The correct answer is C.

Why C is correct

Inherent risk is defined under ISA 315 as the susceptibility of an assertion to a misstatement that could be material, before consideration of any related controls. It is driven by the underlying nature of the business, its environment, and the complexity of its transactions and circumstances, not by the presence or absence of controls. The three factors described in the scenario are textbook drivers of elevated inherent risk at the financial statement level:

Geographic expansion into three new African countries introduces complexity across multiple dimensions simultaneously, unfamiliar regulatory and tax environments, foreign currency transactions and translation, new counterparties whose reliability is unproven, and potential challenges in obtaining sufficient appropriate audit evidence across dispersed locations. Each of these increases the likelihood that the financial statements contain misstatement.

A complex joint venture structure raises significant accounting judgement risks. Joint ventures require careful assessment of the nature of control or significant influence, appropriate consolidation or equity accounting treatment, intercompany eliminations, and allocation of profits and losses. Complex structures create more opportunities for misstatement, whether through misclassification, incorrect measurement, or inadequate disclosure.

The unexpected departure of the CEO amid board disputes is a significant indicator of management instability and potential governance breakdown. Senior management changes close to year end increase the risk of inconsistent application of accounting policies, disruption to the financial reporting process, and in more serious cases, the risk that transactions were entered into or recorded in ways that served the departing executive's interests. ISA 315 explicitly identifies management changes and disputes as risk factors warranting heightened professional scepticism.

Collectively, these factors mean that the financial statements are inherently more susceptible to material misstatement, before a single control is considered.

Why the other options are wrong:

- Option A reflects a fundamental misconception about the nature of inherent risk. It is not fixed by the type of account balance alone, ISA 315 is clear that inherent risk is assessed at both the financial statement level and the assertion level, and that entity-level factors such as the nature of the business, its operating environment, and management characteristics are directly relevant inputs. External circumstances absolutely affect inherent risk.
- Option B is implausible and inverts the correct logic. Complexity and instability do not inherently produce stronger governance, they typically strain existing governance structures and create conditions where controls are more likely to fail or be overridden. While a board might respond by strengthening oversight, that would affect control risk, not inherent risk, and cannot be assumed without evidence.
- Option D incorrectly conflates inherent risk with fraud risk. While ISA 240 addresses fraud specifically, ISA 315 requires the auditor to consider a broad range of business and environmental factors when assessing inherent risk, entirely independently of whether fraud is suspected.

Complexity, instability, and expansion are relevant to inherent risk assessment as a matter of standard audit planning, not only when fraud is in contemplation.

QUESTION 29

The correct answer is C: The engagement partner.

Why C is correct

ISA 220 (Quality Management for an Audit of Financial Statements) is unambiguous on this point. The engagement partner bears overall responsibility for the management and performance of the audit engagement, including the direction and supervision of the engagement team, the review of key audit judgements, and critically, ensuring that the audit report issued is appropriate in the circumstances.

This responsibility is both professional and personal. It is the engagement partner who signs the audit report, either in their own name or on behalf of the firm, and in doing so takes personal accountability for the conclusion expressed. This signature is not a formality; it reflects the partner's professional judgement that sufficient appropriate audit evidence has been obtained and that the opinion is supportable.

ISA 220 also requires the engagement partner to be actively involved throughout the engagement — not merely at the sign-off stage. This includes setting the tone for quality, directing the team's focus toward areas of significant risk, reviewing the work of the team on significant matters, and ensuring that consultations have been undertaken where required.

Why the other options are wrong:

- Option A: The audit manager plays an important operational role in coordinating fieldwork and reviewing working papers, but their responsibility is delegated and subordinate. They report upward to the engagement partner and do not bear ultimate responsibility for the engagement or the audit opinion. Reviewing working papers is a supervisory function, not an accountability for the overall quality of the engagement.
- Option B: The audit committee is an organ of the client entity, not the audit firm. Its role is to oversee the financial reporting process and the external audit on behalf of shareholders, for example, by approving the appointment of auditors, reviewing the audit plan, and discussing findings. It has governance responsibilities over the entity, but it bears absolutely no responsibility for the conduct, quality, or conclusions of the external audit itself. Confusing the audit committee's oversight role with the auditor's professional responsibility is a common misconception.
- Option D: The senior audit partner of the firm has firm-level responsibilities under ISQM 1 (International Standard on Quality Management) for establishing and maintaining the firm's system of quality management across all engagements. However, ISA 220 specifically locates engagement-level responsibility with the engagement partner assigned to that particular client. The senior partner of the firm does not personally bear responsibility for each individual engagement conducted by the firm.

QUESTION 30

Correct answer is B is correct.

The underlying logic: The audit risk model:

Audit Risk (AR) = Inherent Risk (IR) × Control Risk (CR) × Detection Risk (DR)

For a given, acceptable level of audit risk, IR and CR are inversely related to DR. If control risk is assessed as high (weak controls — here, lack of segregation of duties between raising and approving purchase orders, plus evidence of unauthorised invoices), the auditor cannot rely on controls to reduce the risk of material misstatement. To keep overall audit risk at an acceptable level, detection risk must be set low, which means substantive procedures must be more extensive, more reliable, and closer to year-end (e.g., larger sample sizes, more third-party confirmation, more detailed testing of purchase transactions and cut-off).

Why the distractors are wrong

A "Perform extensive tests of controls to identify and document all control deficiencies before deciding on substantive testing". This sounds procedurally careful, but it's backwards. Once the auditor has already concluded, via walkthroughs and pre-screening, that controls are weak (segregation of duties failure, unauthorised invoices), there is no benefit in testing those controls further. Tests of controls are performed *to justify reliance* on controls; if you already know reliance isn't appropriate, testing them more just wastes audit resources. The correct response to identified weak controls is to move to substantive testing, not double down on control testing. This distractor appeals to students who confuse "thorough documentation" with "correct risk response."

C "Increase the materiality threshold to reduce the number of transactions requiring substantive testing". This inverts cause and effect and conflates two unrelated concepts. Materiality is based on the needs of financial statement users and the size/nature of the balances, it is not a lever auditors adjust to manage workload or in response to control risk. Raising materiality to *reduce testing* would be manipulating the audit to fit convenience, which is an independence/professional scepticism red flag, not a valid technical response. This distractor tests whether students understand materiality is not an outcome of control risk assessment.

D "Expand tests of controls to a larger sample; this will automatically reduce substantive testing" This is doubly wrong. First, as in A, expanding control testing when you already have evidence controls are weak (unauthorised invoices, no segregation of duties) is not going to reverse that conclusion, a bigger sample of a broken control just gives you a more precise picture of how broken it is. Second, the claim that testing controls "automatically" reduces substantive testing misunderstands the *relationship* between CR and DR: substantive testing is reduced only when controls are tested and found to be operating effectively, not merely because more controls were tested. This distractor appeals to students who know the CR-DR relationship exists but haven't grasped that it depends on the *result* of testing controls, not the *volume* of testing.

QUESTION 31

The correct answer is A: Confirming bank balances with financial institutions.

Why A is correct

At first glance this may appear counterintuitive, bank confirmations are most commonly associated with testing the existence of recorded balances. However, when the confirmation request is designed and interpreted correctly, it also addresses the completeness of bank accounts themselves, meaning the risk that the entity has bank accounts that have not been disclosed or included in the financial statements.

A well-constructed bank confirmation letter requests the financial institution to confirm all accounts held in the entity's name, not merely the balances on accounts already known to the auditor. This means the bank is asked to disclose any current accounts, deposit accounts, loan accounts, or other facilities that exist, regardless of whether they appear in the client's records. If the bank's response reveals accounts that do not appear in the client's schedules, the completeness gap is immediately identified.

This makes bank confirmation the most direct procedure for addressing the risk that management has concealed or omitted bank accounts, whether to hide funds, suppress liabilities, or obscure related party transactions.

Why the other options are wrong:

- Option B: Reviewing cash flow forecasts provides forward-looking management estimates about expected cash movements. This is useful for going concern assessments and liquidity analysis, but it is entirely dependent on information management chooses to include. It cannot reveal the

existence of undisclosed accounts and therefore contributes nothing to completeness of bank accounts.
- Option C: Cut-off testing for cash receipts and payments addresses whether transactions have been recorded in the correct accounting period, specifically the cut-off assertion. It tests the timing of known transactions around the year end and has no capacity to identify bank accounts that have been omitted from the financial statements entirely.
- Option D: Checking calculations of bank reconciliations addresses the accuracy and arithmetical integrity of reconciliations that the client has already prepared for accounts already known to the auditor. Like cut-off testing, it operates entirely within the population of disclosed accounts. It cannot detect accounts that management has chosen not to reconcile or disclose in the first place.

QUESTION 32

The correct answer is D: Classification.

Why D is correct

The risk described is not about whether assets exist, whether they have been omitted, or whether they have been recorded in the wrong period. The risk is specifically that expenditure which meets the criteria for capitalisation has been incorrectly recorded as an expense in the income statement rather than as a non-current asset on the balance sheet. The asset may well exist, the transaction may well have been recorded in the right period, and nothing has been omitted, the problem is purely one of where it has been recorded.

This is the classification assertion: the risk that transactions and balances have been recorded in the wrong account or category, distorting both the income statement (overstated operating expenses) and the balance sheet (understated non-current assets) simultaneously.

The most direct response is to review expense postings, particularly repairs and maintenance, operating costs, or similar revenue expenditure accounts, and identify items that by their nature, value, or description suggest they may be capital in nature. By tracing these back to the underlying invoices and applying the entity's capitalisation policy, the auditor can determine whether items meeting the criteria for recognition as non-current assets have been incorrectly expensed. Reviewing the capitalisation policy itself and testing its consistent application is also central to this procedure.

Why the other options are wrong:

- Option A: Existence addresses whether assets recorded in the non-current asset register physically exist. Physical inspection confirms that an asset the register says is there can actually be found and verified. However, if a vehicle has been expensed rather than capitalised, it will not appear in the register at all, existence testing of register entries will never detect an asset that was never registered in the first place.
- Option B: Completeness is directionally closer but still misses the point. Tracing from the non-current asset register to purchase invoices confirms that registered assets are supported by documentation, but again starts from the register. The completeness risk would be addressed by going in the opposite direction, from invoices into the register, to find assets that should have been capitalised but were not. However, even this framing is incomplete, because the real issue is not just omission from the register but active misposting to the expense accounts. Completeness does not capture the full nature of the misstatement described.
- Option C: Cut-off is concerned with the timing of recognition, whether a transaction has been recorded in the correct accounting period. A cut-off error would mean, for example, that a vehicle purchased in January of the following year was capitalised in the current year. That is an entirely different risk from the one described, which has nothing to do with period allocation and everything to do with the nature of the account used to record the expenditure.

QUESTION 33

The correct answer is D: Accrued liabilities that are not linked to any contractual agreement.

Why D is correct

The rights and obligations assertion for liabilities asks: does the entity actually have a present obligation in respect of each recorded liability? For assets the assertion concerns ownership and entitlement; for liabilities it concerns whether the entity genuinely owes the amounts recorded, that is, whether a real, enforceable obligation exists at the reporting date.

An accrued liability that has no contractual or legal basis raises immediate doubt about whether a genuine obligation exists at all. If there is no underlying contract, agreement, purchase order, or other arrangement giving rise to an obligation, the accrual may represent a fictitious or unsupported liability, one that has been recorded without any corresponding duty to pay. This directly contradicts the rights and obligations assertion, which requires that liabilities recognised in the financial statements represent real obligations of the entity.

This risk is also closely connected to the occurrence assertion and has practical implications for manipulation — unsupported accruals can be used to shift profits between periods by creating provisions that are subsequently released.

Why the other options are wrong:

- Option A: Accruals recorded without supporting documentation is most closely related to the existence and valuation assertions. The absence of documentation raises doubt about whether the accrual is genuine and whether the amount is supportable, but the primary concern is whether the liability exists and is correctly measured, not whether a legal obligation underlies it. Documentation is an evidential issue rather than an obligations issue.
- Option B: Large year-end accruals missing from the financial statements is unambiguously a completeness risk. Completeness asks whether all liabilities that should have been recorded have in fact been recorded. Missing accruals mean the financial statements are incomplete, obligations exist but have been omitted, understating liabilities and overstating profit. This is the opposite problem to the one rights and obligations addresses.
- Option C: Accruals calculated using inconsistent methods relates to the valuation and accuracy assertion, specifically whether accruals are measured correctly and on a consistent basis in accordance with the applicable financial reporting framework. Inconsistent methodology may produce accruals that are materially misstated in amount, but the issue is one of measurement rather than whether the underlying obligation exists.

QUESTION 34

The correct answer is D.

Why D is correct

ISA 315 and ISA 330 together require that the auditor's risk assessment and audit plan remain dynamic throughout the engagement. When new information comes to light during fieldwork that was not identified at planning, particularly information as significant as an undisclosed legal claim, the auditor is required to reassess the identified risks and modify the audit plan accordingly. This is not optional; it is a professional obligation.

The discovery here is serious on multiple levels. The claim was filed before the year end, meaning it is a condition that existed at the reporting date. Under IAS 37, management is required to assess whether the claim represents a provision (probable and estimable) or a contingent liability requiring disclosure (possible but not probable, or probable but not reliably estimable). The complete absence of any recognition or disclosure, combined with the fact that management did not proactively inform the auditor, warrants both heightened professional scepticism and targeted additional procedures.

The appropriate response involves several coordinated steps. The auditor should obtain direct legal confirmation from the entity's external lawyers regarding the nature of the claim, the likelihood of an adverse outcome, and the range of potential financial exposure. The auditor should assess management's treatment against the requirements of IAS 37, determining whether a provision should have been recognised or whether disclosure is at minimum required. The auditor should also consider whether management's failure to disclose this matter during planning has implications for the reliability of other representations made by management. All changes to the audit plan and the reasoning behind them must be thoroughly documented in accordance with ISA 230.

Why the other options are wrong:

- Option A fundamentally misunderstands the auditor's responsibilities. The auditor is not a passive recipient of whatever management chooses to disclose, ISA 500 and ISA 501 require the auditor to actively seek evidence about contingent liabilities and legal claims. The fact that it is management's responsibility to disclose does not relieve the auditor of their responsibility to test and verify. Deferring the matter to the following year would leave a potentially material misstatement or omission entirely unaddressed in the current year's opinion.
- Option B contains a factual error and a professional error simultaneously. The legal claim was filed before the year end, making it a year-end condition, not a post-balance sheet event. Even if it had arisen after the year end, ISA 560 (*Subsequent Events*) requires the auditor to consider whether post-year-end events require adjustment or disclosure in the current year financial statements. It is not outside the scope of the audit on either analysis.
- Option C moves in entirely the wrong direction. Issuing a modified opinion without performing further procedures would be premature and professionally indefensible. The auditor does not yet know the financial exposure, the merits of the claim, or what treatment IAS 37 requires. An audit opinion must be supported by sufficient appropriate audit evidence, jumping to modification before gathering that evidence would violate ISA 700, ISA 705, and the fundamental principle that opinions must be evidence-based.

QUESTION 35

The correct answer is A: Reviewing the foreign exchange rates used in the conversion of cash balances.

Why A is correct

The risk specifically identified is incorrect translation of foreign currency cash balances into the presentation currency. Under IAS 21, foreign currency monetary items, including cash balances, must be translated at the closing rate at the reporting date. The risk of misstatement therefore lies directly in whether the correct exchange rates have been applied, making the rates themselves the primary object of audit scrutiny.

By reviewing the foreign exchange rates used by management and agreeing them to independent, reliable sources, such as central bank published rates, reputable financial data providers, or official closing rates for the reporting date, the auditor directly tests whether the translation has been performed correctly. The auditor can then reperform the translation calculation on a sample of balances to confirm arithmetic accuracy. This procedure goes to the heart of the identified risk and cannot be substituted by any of the alternatives below.

Why the other options are wrong:

- Option B: Confirming cash balances with foreign banks addresses the existence and rights assertions, it confirms that the balance held at the foreign bank is real and belongs to the entity. However, a bank confirmation is denominated in the foreign currency. It provides no evidence about whether that foreign currency balance has been translated at the correct rate into the presentation currency. The confirmation tells you the balance exists; it says nothing about whether it has been correctly converted.
- Option C: Observing the physical counting of foreign currency is relevant where the entity holds physical foreign cash, notes and coins, and addresses existence of that physical currency. Like bank confirmations, physical counts establish the quantity of foreign currency held but provide no

assurance about the exchange rate applied to translate it. Counting €10,000 in a cash drawer confirms it is there; it does not confirm whether it has been translated at the correct closing rate.
- Option D: Analysing cash flow forecasts is a forward-looking procedure concerned with liquidity and going concern assessment. Cash flow forecasts reflect management's expectations about future cash movements and are entirely irrelevant to the question of whether year-end balances have been translated at the correct exchange rate. This procedure addresses a different risk in a different time dimension.

QUESTION 36

Correct answer is B: To describe the scope, objectives, and intended outcomes of the audit
An audit plan sets out the overall strategy for the engagement. Its key objective is to define the scope of the audit, the objectives to be achieved, and the intended outcomes, essentially mapping out what the audit will cover and what it aims to accomplish.
Here's why the other options are incorrect:
- A Increasing the amount of audit evidence is not an objective of the audit plan itself; evidence collection is guided by the plan, but more evidence isn't inherently the goal.
- C Setting out the terms of the engagement for the client is the purpose of the engagement letter, not the audit plan.
- D Reporting weaknesses in internal control is the purpose of a management letter (or internal control report), which is a separate output produced after fieldwork.

QUESTION 37

Existence: Tracing from the ledger outward to supporting source documents confirms that recorded payable balances are supported by genuine underlying transactions and therefore actually exist
The direction of testing is the key to this question.
The auditor starts with entries already in the ledger and traces them outward to source documents (invoices and GRNs). This direction, from the records to the evidence, tests whether recorded balances are real and supported, which is the existence assertion.
Why the other options are wrong:
- A Completeness is tested in the *opposite* direction, starting from source documents (e.g., supplier statements or GRNs) and checking whether they have been captured in the ledger. This procedure starts from the ledger, so completeness is not primarily addressed.
- B Valuation would involve checking that amounts are calculated correctly, for example, agreeing to price lists, checking foreign currency translation, or reviewing aged payables for disputes. Simply matching a ledger figure to an invoice amount is a by-product here, not the primary focus.
- D Cut-off testing specifically focuses on transactions around the period-end, checking whether items recorded just before or after 31 December are in the right period. This procedure selects entries from across the ledger without a cut-off focus.

QUESTION 38

Correct answer is D: Comparing the actual financial results with auditor expectations
Substantive analytical procedures involve evaluating financial information by studying plausible relationships among data and comparing recorded amounts against independently developed expectations. The goal is to identify unusual fluctuations or unexpected results that may indicate a material misstatement. Comparing actual results with auditor expectations, such as comparing this year's gross margin to prior years, or comparing recorded interest expense to what the auditor calculates from known loan balances, is the classic example of this technique.

Why the other options are wrong:

- A Testing the physical existence of inventory is a substantive test of details (specifically, physical inspection/observation). It involves direct examination of an asset, not analysis of financial relationships.
- B Inspecting contracts for lease obligations is also a substantive test of details — the auditor is examining a specific document to verify a specific balance or transaction, rather than analysing patterns or relationships in financial data.
- C Reviewing the authorisation of journal entries is a test of controls — it evaluates whether a control (the authorisation process) is operating effectively, rather than directly testing whether financial statement figures are materially correct.

QUESTION 39
B – Procedure 1: Existence; Procedure 2: Completeness
Again, the direction of testing is the deciding factor here.
Procedure 1 – Confirmation of customer balances (Existence)
The auditor starts with balances already recorded in the receivables ledger and reaches out to customers to confirm they acknowledge owing those amounts. This is a classic test of existence — it challenges whether the recorded receivable balances are real and supported by genuine amounts owed by actual customers.

Procedure 2 – Tracing dispatch notes to invoices and ledger (Completeness)
The auditor starts with dispatch notes from the dispatch log, documents that exist outside the accounting records, and traces them inward to check whether a corresponding sales invoice and ledger entry exists. This tests whether all goods dispatched (and therefore all revenue earned and receivables created) have actually been captured in the records.

Why the other options are wrong:
- A reverses the logic, it assigns completeness to the confirmation procedure and existence to the tracing procedure, which contradicts the direction of testing in each case.
- C introduces valuation and cut-off, neither of which are primarily addressed by these specific procedures.
- D introduces rights and obligations and accuracy, which are also not the primary focus of either procedure as described.

QUESTION 40
Correct answer is B: To identify significant decisions, events, or transactions discussed at board level, such as major acquisitions, disposals, litigation, or related-party transactions that may affect the financial statements or require disclosure

Why this is correct:
Board minutes are a rich source of narrative evidence about what management and directors were aware of and decided during the year. When auditors review them, the primary objective is to identify matters that could have a material impact on the financial statements or require disclosure, things that might not be immediately visible in the numbers alone.

Why the other options are wrong:
- A Whether the minutes are signed by the Chairman is a governance/compliance formality, not the primary audit objective. Auditors are not Companies Act compliance officers.
- C Tracking board member attendance has no direct relevance to whether the financial statements are free from material misstatement. Corporate governance quality may be a contextual consideration, but this is not why auditors read minutes.

- D While board approval of financial statements is important, ISA 580 (Written Representations) deals with management representations as a separate, specific procedure. The review of minutes serves a much broader intelligence-gathering purpose beyond confirming approval.

QUESTION 41

Correct answer is A: 1 and 3 only

Statement-by-statement analysis:

1. "Sufficiency refers to the quantity of audit evidence collected to support the audit opinion." TRUE. This is the standard definition per ISA 500. Sufficiency is the measure of quantity of evidence, it's affected by the auditor's assessment of the risk of material misstatement (higher risk → more evidence needed) and by the quality of the evidence itself (higher quality evidence may reduce the quantity required).

2. "Appropriateness refers to the ease with which the audit evidence can be collected and documented." FALSE. This is a fabricated/incorrect definition designed to sound plausible. Appropriateness has nothing to do with how easy evidence is to obtain, that's a practical/logistical consideration, not a qualitative measure. Appropriateness is actually the measure of the quality of evidence, specifically its relevance and reliability (ISA 500). This distractor preys on students who vaguely recall "appropriateness = quality" but substitute an intuitive-sounding but wrong definition. In fact, some of the most appropriate evidence (e.g., external confirmations, physical inspection) is often the hardest to obtain, directly contradicting this statement.

3. "Audit evidence must be both relevant and reliable to be considered appropriate." TRUE This is the correct ISA 500 definition of appropriateness: Appropriateness = Relevance + Reliability. Both elements must be present, evidence can be reliable (e.g., an external bank confirmation) but irrelevant to the specific assertion being tested, or relevant but unreliable (e.g., an unsupported management representation), and in either case it fails to be "appropriate."

4. "Evidence that is appropriate but insufficient can still fully support the audit opinion." FALSE This directly contradicts the fundamental principle that both sufficiency and appropriateness are necessary, they are not substitutes for one another. High-quality (appropriate) evidence in too small a quantity cannot fully support an opinion; you cannot compensate for insufficient quantity purely through quality. This distractor tests whether students understand that sufficiency and appropriateness are independent, cumulative requirements, good quality evidence about only 2 transactions out of a population of 500 material transactions doesn't become "enough" just because those 2 were perfectly reliable and relevant.

QUESTION 42

Correct answer is C: Clearly identify the nature and scope of the error

Logic of the sequence:

When an error is identified during audit testing, there's a natural, necessary order of steps the auditor must follow, and each step depends on the one before it:

1. First: Identify the nature and scope of the error (C), What exactly is the error? Is it a one-off item or symptomatic of a wider issue? Does it affect one transaction, one account balance, or does it suggest a systemic control breakdown? You cannot properly evaluate anything else until you understand what the error actually is and how far it extends (e.g., is it isolated, or does it point to a pattern requiring extrapolation across the population?).
2. Then: Assess materiality (D), Only once you know the nature and scope of the error can you meaningfully judge whether it is material, either individually or in aggregate with other misstatements. Materiality assessment is downstream of understanding the error itself.

3. Then: Document management's response (B), After assessing the error and its materiality, the auditor typically raises it with management, and management's response (correct it, disagree, provide explanation) is documented as part of evaluating the audit implications.
4. Then: Report to the engagement partner (A), Escalation to the partner happens once the auditor has gathered enough information (nature, scope, materiality, management's response) to present a clear, informed picture, not as a reflexive first step before any analysis has been done.

Why each distractor is tempting but wrong
A Report directly to the engagement partner
This feels intuitively "safe" (when in doubt, escalate!), and in some firms there *are* policies requiring prompt communication of significant issues. But reporting before you've even identified what the error actually is and how extensive it is would mean escalating an unclear, unanalyzed problem, wasting the partner's time and providing no basis for a decision. Escalation should follow analysis, not precede it. This distractor tests whether students confuse "important issues get escalated" with "escalation is the first action."
B Document management's response to the error
This assumes the auditor has already gone to management and discussed the error — but you can't have a meaningful conversation with management about an error you haven't yet fully identified and scoped yourself. This distractor is attractive because documenting management's response *is* a real, necessary audit step, it's just out of sequence here.
D Assess the materiality of the error
This is the closest and most tempting distractor, because materiality assessment is indeed the *next* major step in the process, but it is impossible to assess materiality accurately without first clearly identifying the nature and scope of the error. Is it a cut-off error affecting one invoice, or a systemic issue affecting an entire class of transactions? The materiality conclusion (and whether to extrapolate/project the error across the population) entirely depends on first nailing down *what* the error is. This distractor tests whether students skip a foundational step because materiality feels like the "headline" audit concept.

QUESTION 43
Correct answer is C: The previous auditor is re-appointed
Why this is correct:
Under company law frameworks (including Rwanda's Companies Act), there is a default re-appointment mechanism designed to ensure audit continuity. If shareholders fail to appoint an auditor at the Annual General Meeting, whether due to procedural failure, deadlock, or oversight, the incumbent (previous) auditor is automatically deemed re-appointed, provided they are still eligible and have not indicated an intention to resign.
This prevents a dangerous gap in audit coverage that could arise simply because shareholders neglected or failed to make a formal appointment.

Why the other options are wrong:
- A The company becomes exempt from audit requirements This is incorrect. A failure to appoint does not extinguish the legal obligation to have an audit. Audit requirements are imposed by statute and cannot be accidentally waived through procedural inaction at a general meeting.
- B The Board of Directors must appoint the auditor Board appointment is a separate mechanism that typically applies in specific circumstances — such as filling a casual vacancy mid-year when an auditor resigns or is removed. It is not the default consequence of shareholders failing to appoint at the AGM.
- D The Registrar of Companies appoints the auditor Intervention by the Registrar is generally a last resort mechanism available in some jurisdictions when no auditor is in place and no other

appointment mechanism has functioned. It is not the immediate first consequence of a shareholder failure to appoint.

QUESTION 44

Correct answer is C: The risk that the auditor expresses an incorrect opinion because a material misstatement is not detected by audit procedures

Why this is correct:

Detection risk is specifically the risk that the auditor's own procedures fail to catch a material misstatement that exists in the financial statements. It is the component of audit risk that is directly within the auditor's control, the auditor manages detection risk by designing and performing appropriate substantive procedures and tests of controls.

Under ISA 200, detection risk has an inverse relationship with the other components of audit risk:

The higher the assessed risk of material misstatement, the lower detection risk must be driven, meaning more persuasive and extensive audit procedures are required.

Why the other options are wrong:

- A This describes inherent risk, the susceptibility of an assertion to misstatement due to the nature of the business, industry, or transaction, before considering any controls.
- B This describes control risk, the risk that the entity's internal control system fails to prevent, detect, or correct a material misstatement on a timely basis.
- D This describes audit risk itself (the overall risk of issuing an incorrect opinion on materially misstated financial statements), not detection risk specifically. Detection risk is one component of audit risk, not the whole concept.

QUESTION 45

Correct answer is A: The gap between auditors' legal duties and public expectations of the audit

Why this is correct:

The expectation gap refers to the difference between what auditors actually do (as defined by auditing standards, legislation, and professional obligations) and what the public, shareholders, and other stakeholders believe auditors do or should do.

It is one of the most significant and enduring challenges in the auditing profession, and it manifests in several ways:

Common misconceptions that drive the expectation gap:

- The public often believes auditors are responsible for detecting all fraud, when in reality auditors provide reasonable assurance, not absolute assurance
- Many assume a clean audit opinion means the company is financially healthy, when it only means the financial statements are free from material misstatement
- There is a widespread belief that auditors prepare the financial statements, when in fact management prepares them and auditors merely examine them
- Some expect auditors to predict business failure, when an audit is a historical review, not a forward-looking assessment

Why the other options are wrong:

- B The difference between audit fees and management's expectations is a commercial negotiation matter, not a recognised auditing concept.
- C The time between issuing the audit report and the shareholders' meeting is an administrative and procedural matter, not related to the expectation gap.
- D A gap between profits and tax obligations relates to tax planning or compliance, which is entirely unrelated to auditing theory.

QUESTION 46
Correct answer is B: To help management and those charged with governance focus their attention and resources on the most critical control weaknesses, and to guide the structure of the executive summary

Why this is correct:
The management letter (also known as a report to those charged with governance or internal control report) is a practical, action-oriented document. Its value lies not just in identifying weaknesses but in helping the recipient understand what matters most and act accordingly. Prioritisation serves two closely related purposes:
1. Directing attention and resources Management and the board have finite time, budget, and capacity. By assigning High, Medium, or Low ratings, the auditor signals where immediate remedial action is required versus where improvement is desirable but less urgent. A bank's board dealing with seventeen findings simultaneously would struggle to respond effectively without this guidance — prioritisation creates a clear hierarchy of urgency.
2. Structuring the communication In practice, management letters typically open with an executive summary that highlights the most significant findings. Prioritisation directly informs this structure, ensuring that High-rated findings receive prominent attention rather than being buried among lesser concerns.

Why the other options are wrong:
- A Excluding low-priority findings Prioritisation does not mean exclusion. All seventeen findings should be reported — the priority rating communicates their relative significance, not whether they are worth mentioning. Even a Low-rated finding may require a management response and a timeline for remediation.
- C Justifying a higher audit fee Audit fees are agreed based on the scope, complexity, and time required for the engagement — they are not determined by the number or severity of control weaknesses discovered. Linking fees to findings would create a serious independence and objectivity concern.
- D Determining inclusion in the audit opinion The audit opinion and the management letter are entirely separate documents serving different purposes. The audit opinion addresses whether the financial statements give a true and fair view. Control weaknesses — regardless of priority — do not automatically appear in or get excluded from the public audit report based on their management letter rating.

QUESTION 47
Correct answer is A: 1 and 3 are true
Evaluating each statement:
Statement 1: TRUE
"Payroll systems handle employee compensation, tax deductions, and benefit contributions to ensure accurate and timely wage payments." This is a accurate description of the core function of a payroll system. A properly designed payroll system integrates gross pay calculations, statutory deductions (income tax, social security contributions), voluntary deductions (pension, health insurance), and net pay disbursement, all within defined payroll cycles to ensure employees are paid correctly and on time.

Statement 2: FALSE
"Timekeeping systems are optional and not necessary for calculating employee compensation accurately." This is incorrect. Timekeeping systems are essential for most organisations, particularly where employees are paid on an hourly basis or where overtime, shift allowances, or attendance-based calculations apply. Without accurate timekeeping data, payroll calculations lack a reliable foundation,

creating significant risks of over or underpayment and potential fraud. Even for salaried employees, timekeeping records support absence management, leave deductions, and compliance with labour regulations.

Statement 3: TRUE
"Payroll systems are required to generate and submit tax forms and report payroll taxes to relevant authorities." This is correct. Payroll systems carry a statutory compliance function, they must produce tax declarations, remittance schedules, and regulatory reports for submission to tax authorities (such as the Rwanda Revenue Authority). Failure to accurately report and remit payroll taxes exposes the organisation to penalties, interest, and regulatory sanctions.

Statement 4: FALSE
"Employees have unrestricted access to modify their own tax withholdings and payroll deductions directly in the system."
This is incorrect and describes a serious internal control weakness. Allowing employees unrestricted access to modify their own payroll parameters would create significant opportunities for fraud and error.

QUESTION 48
Correct answer is B: The auditor should report the unresolved finding in the current year management letter, noting that it was raised in the prior year and remains outstanding; the continued absence of the control also represents an ongoing risk of material misstatement that should be reflected in the current year audit plan

Why this is correct:
When a prior year finding remains unresolved, the auditor has both a reporting obligation and an audit risk obligation to address it. These operate on two distinct but connected levels:

1. Reporting obligation, Current year management letter
The unresolved finding must be re-reported in the current year management letter with clear notation that:

- It was originally raised in the prior year
- Management committed to remediation by March 2025
- The agreed action has not been implemented
- The weakness therefore persists and may be escalating in significance

Re-reporting an unresolved finding serves several important purposes, it maintains accountability, demonstrates that the auditor follows up on prior recommendations, and signals to those charged with governance that management has failed to act on a commitment they made. In practice, a finding that was High priority in the prior year and remains unaddressed may warrant an upgraded priority rating or a separate escalation to the audit committee.

2. Audit risk implication, Current year audit plan
The absence of dual-approval for supplier payments is not merely a governance observation, it has direct audit risk consequences. Without this compensating control, the risk of unauthorised or fraudulent payments passing through accounts payable is elevated.

Why the other options are wrong:

- A Remove the finding as it is no longer the current auditor's responsibility This is fundamentally incorrect. An unresolved prior year finding does not expire or become someone else's responsibility. The auditor's duty is to follow up on prior recommendations and report on their status, particularly when management has failed to act on a commitment. Removing it would be a serious dereliction of professional responsibility.

- C Assume the control is now in place without further testing This contradicts a foundational principle of auditing, professional scepticism. Management's agreement to implement a control is not evidence that the control exists or operates effectively. ISA 315 requires the auditor to obtain evidence of control operation, not rely on management representations alone. The auditor has already discovered the control was not implemented, making this option not just wrong in principle but factually contradicted by the scenario.
- D Automatically issue a qualified opinion An unresolved internal control weakness does not automatically result in a qualified opinion. The audit opinion addresses whether the financial statements are free from material misstatement, it is not a direct report on the quality of internal controls. The appropriate response is to increase substantive testing to compensate for the absent control. A qualification would only follow if the auditor concluded that a material misstatement exists in the financial statements and sufficient appropriate evidence could not be obtained to resolve it.

QUESTION 49

Correct answer is C: To track amounts owed by customers and monitor collections

Why this is correct:

The accounts receivable (AR) module is the core component of a revenue accounting system that manages the period between a sale being made and cash being received. Its primary purpose is to maintain a complete and accurate record of all customer balances outstanding and to support the organisation's cash collection process.

Why the other options are wrong:

- A Managing product returns and refunds While the AR module may process credit notes arising from returns, the management of product returns as a process is primarily handled by the sales order or inventory module. Returns processing is a by-product function, not the primary purpose of AR.
- B Calculating monthly revenue projections Revenue projections and forecasting are functions of budgeting, planning, and financial modelling tools, not the AR module. The AR module records actual historical transactions, not forward-looking estimates.
- D Adjusting pricing strategies based on customer behaviour Pricing strategy is a commercial and management decision supported by sales analytics tools, CRM systems, or management information systems. The AR module has no pricing function, it records what customers owe based on prices already determined elsewhere in the system.

QUESTION 50

Correct answer is D: An unmodified opinion with a 'material uncertainty related to going concern' section, drawing attention to the note in the financial statements that discloses the uncertainty, while confirming that the audit opinion has not been modified in respect of this matter

Why this is correct:

Under ISA 570 (Going Concern), the type of audit report issued depends on two distinct judgements the auditor must make:

1. Is the going concern basis of accounting appropriate?
2. Is the disclosure of the uncertainty adequate?

In this scenario, the auditor has concluded yes to both questions, the going concern basis remains appropriate and the disclosure is comprehensive. Where these conditions are met, the correct response is an unmodified (clean) opinion, accompanied by a separate Material Uncertainty Related to Going Concern (MURGC) section.

The purpose of the MURGC section:
The MURGC section is not a modification — it is a transparency mechanism. It:

- Draws the reader's attention to the relevant note in the financial statements
- Describes the nature of the uncertainty
- Confirms explicitly that the audit opinion has not been modified in respect of this matter
- Ensures users are aware of the uncertainty without implying the financial statements are misstated

This approach reflects a careful balance; the auditor is neither concealing a significant risk nor overstating its implications.

Why the other options are wrong:

- A Qualified opinion: A qualified opinion arises when there is either a material misstatement or a limitation on scope that is material but not pervasive. The existence of a going concern uncertainty, when properly disclosed, does not constitute a misstatement. The financial statements can still present a true and fair view with adequate disclosure, a qualification is therefore not appropriate here.
- B Adverse opinion: An adverse opinion is issued when misstatements are material and pervasive, meaning they fundamentally undermine the financial statements as a whole. A going concern uncertainty that is properly disclosed and where the going concern basis remains appropriate does not meet this threshold. An adverse opinion would only apply if the going concern basis was being used inappropriately.
- C Disclaimer of opinion: A disclaimer is issued when the auditor is unable to obtain sufficient appropriate evidence and the possible effects are material and pervasive. Future uncertainty is not the same as an inability to obtain evidence, the auditor has formed a view and is satisfied with the disclosure. A disclaimer would be wholly inappropriate here and would significantly overstate the severity of the situation.

END OF MARKING GUIDE AND MODEL ANSWERS