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

Model Answers

QUESTION ONE

D

Providing non-audit services such as tax consultancy creates a potential self-review threat, impairing the auditor's objectivity (actual or perceived).

QUESTION TWO

C

The auditor's report must state the scope and limitations to clarify to users what the audit covered (or did not cover). The auditor's opinion of company management may influence the risk assessment. A list of all transactions reviewed during the audit should be maintained in the audit working papers and recommendations for improvement should be included in the audit management letter.

QUESTION THREE

A
The *Caparo* case limited the scope of auditor liability to intended users of the financial statements, such as shareholders.

QUESTION FOUR
B
Statement 1: False – Auditors are not required to detect all fraud but must design procedures to provide reasonable assurance of detecting material misstatements, whether due to fraud or error.
Statement 2: True – Negligence arises when auditors fail to exercise reasonable care and skill, leading to financial loss.
Statement 3: True – Auditors may owe a duty of care to third parties if they know their report will be relied upon for specific purposes (as seen in the *Bank of Scotland v. Bannerman* case).
Statement 4: False – If management withholds key information, auditors may protect themselves by disclaiming (or qualifying) the opinion, thus reducing their liability.

QUESTION FIVE
B
Article 140 of the Companies Act requires that the auditor receive a ten-day notice period and is given the opportunity to make representations to shareholders before removal.

QUESTION SIX
A
ISA 200 emphasises the need for auditors to maintain professional scepticism throughout the audit process to detect potential misstatements.

QUESTION SEVEN
C
ISA 200 defines audit risk as the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated.

QUESTION EIGHT
C
1 -True – Detection risk refers to the risk that the auditor’s procedures will not detect a material misstatement. Increasing the amount of audit evidence reduces this risk.
2-False – If control risk is high, auditors must increase substantive testing, not reduce it, to gather sufficient evidence.
3-True – A risk-based audit approach helps auditors focus on areas with a higher risk of material misstatement, ensuring that their resources are used efficiently.
4-True – Inherent risk arises from the nature of the business or transactions, and managing it is primarily the responsibility of the company's management, not the auditor. The auditor's role is to assess inherent risk and design appropriate procedures.

QUESTION NINE
A
Even though the monetary amount of the error is small, it has a qualitative impact because it changes the company’s reported performance from a loss to a profit. This could mislead shareholders and investors who rely on the financial statements for decision-making. Qualitative materiality considers the context and impact of the misstatement, not just the amount involved.

QUESTION TEN

B

Under the Companies Act 2021, shareholders appoint the external auditor through an ordinary resolution during a general meeting.

QUESTION 11

A

Remaining Inventory: 300 units from Purchase 2 @ FRW 60 = 18,000

QUESTION 12

B

The statement of profit and loss (also known as the income statement) reports the company's revenues, expenses, and net profit or loss for a specific period, reflecting the financial performance of the business. Liabilities, non-current assets, and cash flows are reported in other financial statements, such as the balance sheet and cash flow statement.

QUESTION 13

B

Segregation of duties reduces the risk of fraud by ensuring that no single person has control over multiple stages of a transaction.

QUESTION 14

B

1 - True – The control environment establishes the foundation for internal controls by setting the tone at the top, emphasising management's integrity and commitment to governance and ethical behaviour.
2 - False – Risk assessment involves identifying and analysing risks that may impact the achievement of objectives, not transaction monitoring, which is part of monitoring activities or control activities.
3 - True – Control activities are specific actions (e.g., approvals, authorisations, reconciliations) that mitigate identified risks and ensure proper processes.
4- True – Information and communication ensure that relevant information flows within the organisation and to external stakeholders, supporting decision-making and control functions.

QUESTION 15

D

Sufficiency is concerned with the amount of evidence collected. For an audit to be effective, sufficient evidence must be gathered to form a reliable basis for the auditor's conclusions on the financial statements.

QUESTION 16

C

Recalculation involves verifying mathematical accuracy. In this case, the auditor is checking the addition and mathematical accuracy of the bank reconciliation.

QUESTION 17

D

Stratified sampling groups similar items within the population into subpopulations, allowing auditors to focus on specific characteristics and improve sample precision.

QUESTION 18

C

Sampling risk arises because the sample may not perfectly represent the population, potentially leading to incorrect conclusions.

QUESTION 19
B
Substantive procedures are focused on identifying material misstatements in the financial statements at the assertion level.

QUESTION 20
D
The finding affects the Existence assertion (since inventory items may not physically exist), Rights and Obligations (potential issues with ownership of the inventory), and Valuation and Allocation (discrepancies in values vs. market prices).

QUESTION 21
A
ISA 315 requires auditors to identify and assess risks in IT systems relevant to financial statement preparation and control activities.

QUESTION 22
B
- Statement 1 is false because input controls focus on the accuracy and completeness of data entered, not restricting access.
- Statement 2 is true because processing controls ensure unauthorised transactions are not processed.
- Statement 3 is true because output controls verify processing accuracy and restrict access to authorised individuals.
- Statement 4 is false as application controls go beyond physical IT asset protection, covering input, processing, and output of data.

QUESTION 23
C
Frequent errors reported by management signal potential risks, so auditors increase testing to ensure thorough examination.

QUESTION 24
C
Organisation charts depict the formal structure and reporting lines but do not provide details of specific duties or informal relationships.

QUESTION 25
D
An effective internal audit function may reduce the extent of work required from external auditors if evaluated positively.

QUESTION 26
D
The information system captures, processes, and communicates information necessary for operations and decision-making.

QUESTION 27

B
ISA 315 requires auditors to assess risk to create a basis for designing and performing further audit procedures (audit execution).

QUESTION 28
B
Higher reliance on controls typically requires a larger sample size to provide sufficient assurance of control effectiveness.

QUESTION 29
B
Tests of controls assess whether controls are appropriately designed and operating effectively to prevent or detect errors. (Assess Control Risk)

QUESTION 30
D
Linking risks to assertions enables the auditor to develop targeted audit procedures to address specific risks.

QUESTION 31
A
1 - Trace additions to supporting documentation (Correct) - This procedure involves reviewing purchase documents, invoices, or title deeds to confirm that non-current assets are properly acquired and owned by the entity. It provides evidence that the assets have been recorded accurately and are legitimately owned.
2 - Perform inquiries with third parties (Correct) - Inquiries with third parties, such as the land registry or legal representatives, help verify ownership from external sources. This is especially useful for confirming the existence and ownership of significant assets and adds an additional layer of assurance.
3 - Test the accuracy of depreciation calculations (Incorrect) Testing the accuracy of depreciation calculations pertains to ensuring that expenses and asset valuations are properly recorded and distributed in the financial statements. This procedure does not verify the ownership of non-current assets.
4 – Perform physical verification of non-current assets – (Incorrect) – Confirms existence of the asset but not ownership.

QUESTION 32
B
The valuation of inventory must reflect its fair value, and inventory should be recorded at the lower of cost or net realisable value. Testing write-downs for obsolete or slow-moving inventory helps ensure that inventory is not overstated on the financial statements. By evaluating the appropriateness of inventory write-downs, the auditor verifies that management has adequately considered the potential reduction in value due to obsolescence or slow movement. This procedure directly addresses the valuation assertion.

QUESTION 33
A
Testing the completeness of accounts payable ensures that all liabilities have been recorded in the financial statements. By sending confirmation requests to suppliers, the auditor can verify that there are no unrecorded or understated payables. This procedure helps identify any liabilities that may have been omitted, directly addressing the completeness assertion and ensuring that all obligations are accurately reflected in the financial statements.

QUESTION 34
C
The valuation assertion ensures that accruals are recorded at the correct amounts. If accruals are calculated using inconsistent methods, there is a risk that they are not accurately valued, leading to potential misstatements in the financial statements.

QUESTION 35
C
1 - Reviewing the adequacy of the allowance for doubtful accounts (True): This ensures that accounts receivable is properly adjusted for expected credit losses, addressing the valuation assertion.
2 - Sending confirmation requests to customers to verify outstanding balances (True): While primarily an existence test, confirmations can also provide evidence related to the valuation of accounts receivable if customers dispute balances.
3 - Inspecting physical evidence of goods shipped related to sales invoices (False): This procedure tests the existence of accounts receivable by confirming that goods were shipped, but it does not address valuation.
4 - Analysing aging schedules to assess collectability (True): This is a key test for determining whether accounts receivable is likely to be collected, directly affecting their valuation.

QUESTION 36
C
The audit plan outlines the audit's overall approach, including its scope, timing, and direction, to guide the audit team.

QUESTION 37
D
When significant new risks are identified, the auditor must modify the audit plan to address them effectively, ensuring the audit remains relevant. Documentation of changes is necessary to comply with professional standards.

QUESTION 38
C
Tests of controls assess the operating effectiveness of internal controls, such as verifying that invoices are reviewed for proper classification.

QUESTION 39
B
Existence Assertion: The existence assertion verifies that the cash balances recorded in the financial statements actually exist at the balance sheet date. A direct confirmation from the bank provides independent and highly reliable evidence of the existence of cash because it comes from a third party and confirms the account's actual balance.
Ownership Assertion: The ownership assertion verifies that the cash recorded belongs to the company and not a third party. Bank confirmations typically identify the account owner, ensuring that the reported balances are owned by LMN Corporation.
Direct confirmation is most reliable as it is obtained directly from a third party – not the audited entity.

QUESTION 40
A
Reviewing legal documentation confirms that the entity has ownership rights to the building.

QUESTION 41
C
1 - (True): Inspecting subsequent bank statements ensures that reconciling items are legitimate and have cleared.
2 - (False): The auditor must check the mathematical accuracy of the reconciliation.
3 - (True): Differences should be explained and resolved in the subsequent period to ensure accuracy.
4 - (True): Evidence of management review, such as signatures or initials, confirms proper oversight and monitoring of the reconciliation process.

QUESTION 42
D
Unusual items that could materially impact the financial statements must be referred to the engagement partner for further consideration and potential additional audit work.

QUESTION 43
A
A control deficiency should be reported to management who are then responsible for taking corrective action, and the audit approach may need to be adjusted to include more substantive testing.

QUESTION 44
C
The error rate of 2% (20,000/1 million) is applied to the total accounts payable balance of FRW 500 million.

Calculation: 2% of FRW 500 million = 0.02 × 500,000,000 = FRW 10 million. This extrapolated error represents the estimated potential misstatement in the full accounts payable balance.

QUESTION 45
A
The audit opinion focuses on the truth and fairness of the financial statements, not on internal control recommendations.

QUESTION 46
D
Prioritising findings helps management allocate resources efficiently to address the most significant risks.

QUESTION 47
B
The auditor should fairly consider management's perspective and document it before making a final judgment.

QUESTION 48
C
1 - (False): A qualified opinion is issued when there are material misstatements or limitations on the audit scope, but they are not pervasive.
2 - (True): An adverse opinion is issued when material misstatements are so pervasive that the financial statements are unreliable.

3 - (True): A disclaimer of opinion is issued when the auditor cannot obtain sufficient evidence, and the effects are material and pervasive.
4 - (True): An unmodified opinion indicates that the financial statements are free from material misstatements and presented fairly in accordance with the applicable financial reporting framework.

QUESTION 49
D
ISA 220 states that the Engagement Partner is responsible for the direction, supervision, and performance of the audit engagement.

QUESTION 50
A
According to ISA 200, an auditor is only permitted to disclose confidential client information when there is a legal or professional requirement or right to disclose.

END OF MARKING GUIDE AND MODEL ANSWERS