

Ans.1 In order to establish whether the preconditions for an audit are present, I will:

- (i) determine whether the financial reporting framework to be applied in the preparation of financial statements is acceptable;
- (ii) obtain the agreement of management that it acknowledges and understands its responsibility:
 - for the preparation of the financial statements in accordance with the applicable financial reporting framework.
 - for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
 - to provide us with all relevant and requested information and unrestricted access to all personnel.

Ans.2 (a) Procedures to be followed and formalities to be complied with for removal of existing auditors and appointment of new auditors:

- ABDL shall give a notice at least 14 days before the annual general meeting to the company, for a resolution for appointment of your firm as an auditor at a Company's annual general meeting.
- HGM shall forthwith send a copy of such notice to the retiring auditor and shall also give notice thereof to its members not less than seven days before the date fixed for the general meeting
- HGM shall, within fourteen days from the date of appointment of our firm, send to the registrar intimation thereof, together with our consent in writing.
- HGM shall, within fourteen days from the date of removal of the existing auditor, send intimation thereof to the registrar.

Rights of the existing auditors:

- Where a notice is given of such a resolution and the retiring auditor makes with respect thereto a representation in writing to the company not exceeding a reasonable length and requests its communication to the members of the company, the company shall:
 - in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
 - send a copy of the representation to every member of the company to whom notice of the meeting is sent.

and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may, without prejudice to his right to be heard in person, require that the representation shall be read out at the meeting:

(b) Responsibilities of our firm and of the existing auditors:

Our firm will communicate with the existing auditors to establish if there are any matters that it should be aware of when deciding whether or not to accept the appointment. The following points should be noted in connection such communication:

- HGM permission is required for any such communication. If HGM refuses to give its permission, the appointment as auditor should not be accepted.

- If HGM does not give the existing auditor the permission to reply to any relevant questions of our firm, the appointment as auditor should not be accepted.
- If existing auditor provides the required information, our firm should assess all the available information and take a decision about whether or not to accept the audit engagement.
- If the existing auditor does not provide any information relevant to the appointment, we may accept or reject the engagement based on other available knowledge.
- Even if the existing auditor provides professional reasons to suggest that we should not accept the audit, the final decision in this regard shall be based on our professional judgment.

Ans.3 (a) Fraud Risk Factors:

Rapid Changes in Technology:

Products like mobile phones are likely to become obsolete very quickly, as more advanced products come on to the market. The company faces a threat due to rapid changes in technology; therefore the management may be inclined to manipulate the accounting records.

Lack of Segregation of Duties/ Dominance of management by a single person:

As Anwar is the Chief Executive and is also responsible for finance and operations of the company, this gives him a personal motivation to misstate figures to show improved performance.

Long Term Loan:

As the company has applied for long term loan, it may be inclined to manipulate the figure to show better financial position to the bank.

Demand for early completion of audit:

The demand by Anwar for early completion of audit creates undue suspicion because such pressures are sometime applied to distract the auditor from his responsibilities.

(b) Whether it would be advisable to use the internal audit working papers in the above situation and give three distinct reasons to support your decision:

It is not advisable to use the work of internal audit for external audit purposes due to following reasons:

- **Status of the internal audit function within the entity**
Administratively all the internal audit staff are under the influence of Anwar and hence their independence is impaired.
- **Conflicting responsibilities:**
The internal audit staff's responsibilities for preparing bank reconciliation statement is in conflict with its responsibility as a member of the internal audit function.
- **Qualifications of internal audit staff:**
All the internal audit personnel are graduates and do not have required competence about various aspects of the internal audit function.

Ans.4 The audit approach to gathering evidence on contingencies and commitments is as follows:

(i) Accrued expenses:

- Obtain or prepare a listing of accrued expenses as at the end of the reporting period. Check the calculations and additions for arithmetical accuracy.
- Check the amounts in the listing against the balances in the relevant main ledger expense accounts and ensure that the amounts are the same.
- Verify the invoices received or payments made after the year end and ensure that the amount accrued appears reasonable in relation to this evidence.
- Compare the list of accrued expenses with the list that was prepared at the same date in the previous financial year, and enquire about items not listed in the current year that were in the list in the previous year.
- Review the list of accruals for completeness, based on the auditor's knowledge of the business.
- Relate items on the list of accruals to other audit areas, such as the bank confirmation letter (which might provide details of unpaid/accrued bank charges).
- Perform analytical procedures on accrued expenses. For example, the auditor might measure the ratio of accrued payroll expenses to total payroll costs for the year, and compare this with the similar ratio in previous years. Significant differences should be investigated.

(ii) Contingencies:

- Ascertain the approach taken by the client's management for identifying contingencies.
- Review the minutes of board meetings (where such matters are likely to be discussed).
- Review relevant material related to the industry as a whole such as financial statements of major companies in the industry to identify possible industry-wide contingencies.
- Review the client's correspondence with lawyers.
- Review the invoices for legal services to identify undisclosed contingencies and additional information about contingencies
- Consider direct confirmation from the company's lawyers and legal advisors.
- Consider whether expert advice may be required from outside sources other than lawyers.
- Ensure that provisions have been made in case the relevant condition as specified in IFRS are met.

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Ans.5	Weakness	Implications
	The warehouse incharge is supervising the inventory count procedure.	The warehouse in charge is himself responsible for the inventory, therefore he lacks independence.
	Temporary staff involved in the physical inventory count.	Temporary staff may not be aware of the nature of inventory, and may not have any interest in detecting or reporting discrepancies.
	Lack of precise instructions to the counting team.	The staff has been instructed to remain in constant contact with each other to avoid double counting. This depicts lack of precise instructions and it increases the risk of mistakes in counting like missing out items or double counting.
	Inventory is not tagged when it is counted.	This gives rise to a risk that items of inventory will be counted twice, and possibility that some items may not be counted at all.
	Count sheets not signed by the staff carrying out the count.	In this case, it becomes difficult to identify the staff who has carried out the count, therefore any discrepancy found cannot be investigated properly .
	Count sheets stated the quantity of items expected to be found in the warehouse.	Count teams will focus on finding the number of items mentioned on the count sheets. This could more likely result in undercounting of inventory.

Ans.6 (a) Control Environment and its elements

The 'control environment' is often referred to as the general 'attitude' to internal control of management and employees in the organization.

The elements of control environment includes the following:

- Communication and enforcement of integrity and ethical values
- Commitment to competence
- Participation of those charged with governance.
- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices

(b) Walk through tests:

Auditor is required to gain an understanding of the various elements of the internal control system operating within an entity.

Once this understanding has been gained, the auditor should confirm that his understanding is correct by performing '**walk-through**' tests on each major transaction type (for example, revenue, purchases and payroll).

Walk-through testing involves the auditor selecting a small sample of transactions and following them through the various stages in their processing in order to establish whether his understanding of the process is correct.

(c) Materiality:

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of financial statements. The auditor keeping in view the concept of **materiality** gives his opinion i.e. whether the financial statements present fairly **in all material respects** the financial position and performance of the entity.

Performance Materiality:

Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

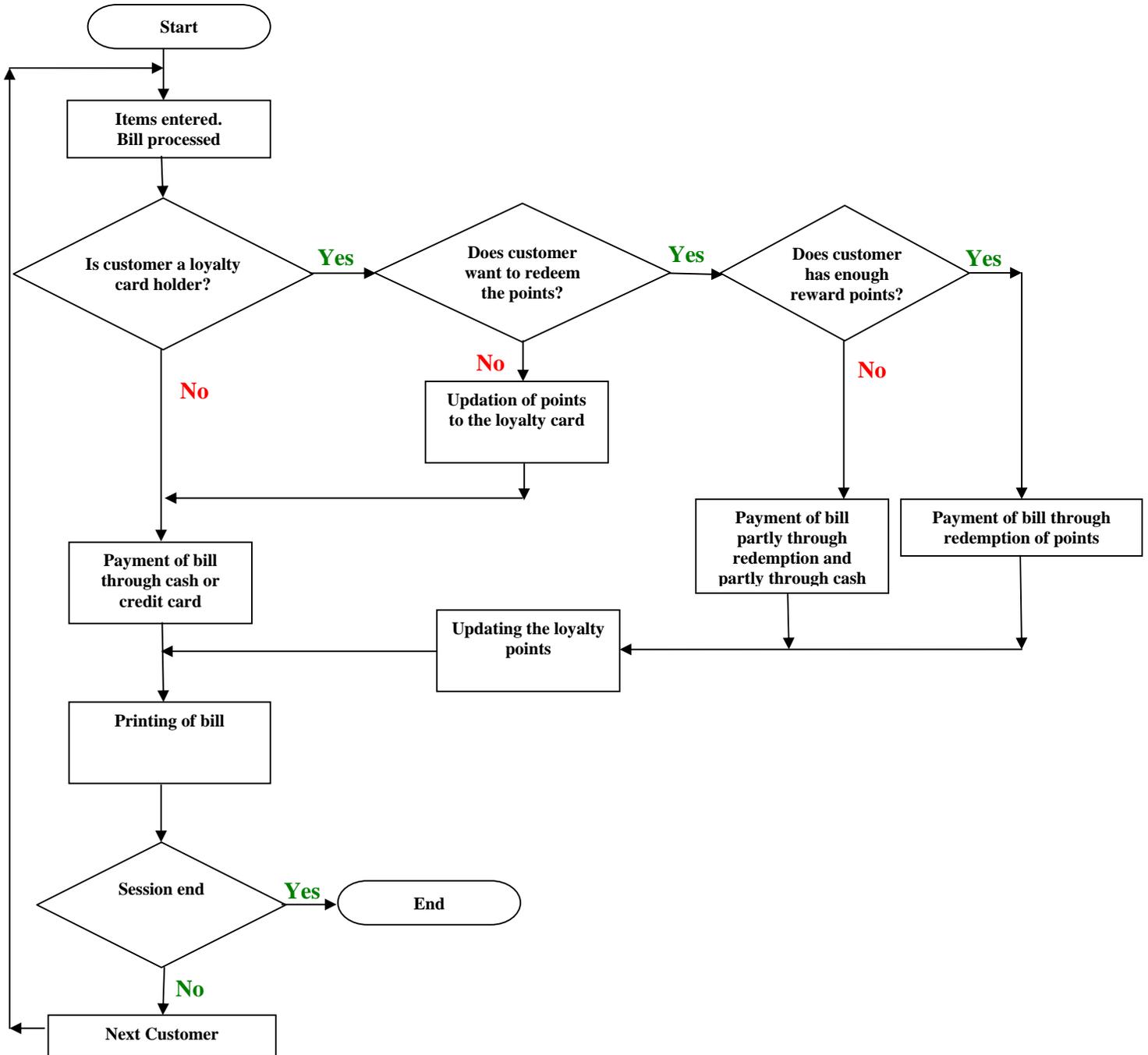
Performance materiality recognizes the fact that errors/omissions detected in a particular area may not breach the overall materiality level but when all the errors/omissions in all the areas is combined or added together, the overall materiality could be breached.

Ans.7 The management representation regarding disclosure of non compliance with law does not remain appropriate, as it contradicts with the audit evidence obtained.

To address the contradiction, we should:

- consider whether his risk assessment of that area is still appropriate.
- consider whether additional audit procedures are needed.
- consider the integrity of management, document those concerns and consider the possible course of action.

Ans.8



- Ans.9**
- (i) **Training on applicable policies, department policy/ procedures:**
It is a preventive controls, as the individuals are trained to perform their duties as per the applicable policies and procedures that are in place.
 - (ii) **Batch totals:**
It is a detective control as program will report any discrepancy between the manually counted batch total and its own batch total, as an error report.
 - (iii) **Segregation of duties:**
It is a preventive control as it involves assigning different people the responsibilities of authorising and recording transactions and maintaining the custody of assets. This reduces the likelihood of an employee being able to both carry out and conceal errors or fraud.
 - (iv) **Contingency planning:**
It is a corrective control as it involves the corrective measures to be adopted in case of any mishap.
 - (v) **System logs:**
It is a detective control as this generates an audit trail that can be used to understand the activity of the system and to diagnose problems.
 - (vi) **System backup:**
It is a corrective control as it will involve any retrieval measures in case of any damage to the original data.

- Ans.10 (a) Integrity:**
Members should be straightforward and honest in all professional and business relationships. Integrity implies not just honesty but also fair dealing and truthfulness.

A chartered accountant should not be associated with reports, returns, communications or other information which according to him is materially false or misleading.

- (b) **Advocacy threat:**
Advocacy threat occur when members promote a position or opinion on behalf of a client to the point that subsequent objectivity may be compromised.

Example:

Acting as an advocate for an assurance client in litigation or dispute with third parties.

- (c) **Actual Independence:**
Actual independence means that the auditor should not be influenced by anything which results in compromising his professional judgement while expressing an opinion.

Perceived independence:

The auditor must be seen to be independent, i.e. the auditor should avoid facts and circumstances due to which a third party may conclude that his integrity, objectivity or professional skepticism had been compromised.

- (d) The following are circumstances where chartered accountants are or may be required to disclose confidential information:
- Disclosure is permitted by law and is authorized by the client.
 - Disclosure is required by law.
 - There is a professional duty or right to disclose, when not prohibited by law:
- (e) **Systematic sampling:**
It is a method of sampling whereby a random starting point is chosen from the population and then items are selected with a standard gap between them (for example, every 10th item).
- (f) **Conditions required to be met for sending external confirmations:**
It may be appropriate to send negative confirmation request **if all of the following conditions are met:**
- The risk of material misstatement is low and controls have been tested.
 - The population comprises of large number of small account balances or transactions.
 - A very low exception rate is expected.
 - There is no specific reason which would cause the respondent to ignore the confirmation request.
- (g) **Procedures of review engagement:**
The procedures for the review of financial statements will usually include:
- Inquiry
 - analytical procedures
 - Agree and reconcile Interim Financial Information with the accounting records.
- (h) **Auditor's responsibility with respect to events between the end of the reporting period and the date of the auditor's report:**
The auditor is required to obtain sufficient appropriate evidence that all subsequent events that require adjustment or disclosure in the financial statements:
- have been identified, and
 - are suitably reported in the financial statements.
- (i) **Audit procedures to ensure completeness of related parties**
The procedures to ensure completeness of related parties will generally include:
- review of prior year working papers
 - review of company's procedures for identification of related parties
 - review shareholder's records
- (j) The auditor should consider the source of audit evidence, effectiveness of related controls, form of audit evidence etc.

(THE END)