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<td>Not for profit organisations</td>
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</table>
OVERVIEW OF SYLLABUS AND EXAM

• Core areas of the syllabus:

<table>
<thead>
<tr>
<th>Syllabus area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate governance and Ethics</td>
</tr>
<tr>
<td>Internal audit</td>
</tr>
<tr>
<td>Planning and risk assessment</td>
</tr>
<tr>
<td>Internal controls</td>
</tr>
<tr>
<td>Substantive audit evidence</td>
</tr>
<tr>
<td>Review</td>
</tr>
<tr>
<td>Reporting</td>
</tr>
</tbody>
</table>

• Exam is 3 hours 15 minutes reading
• 5 compulsory questions
• Predominantly written

• Pass mark 50%. Only 31% – 43% of people pass this paper a sitting!

The paper format (attempt in order)

<table>
<thead>
<tr>
<th>Question</th>
<th>Topic</th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 1</td>
<td>Audit Procedures – Scenario Based</td>
<td>30</td>
</tr>
<tr>
<td>Question 2</td>
<td>Knowledge Based</td>
<td>10</td>
</tr>
<tr>
<td>Question 3</td>
<td>Risk and Audit Approach</td>
<td>20</td>
</tr>
<tr>
<td>Question 4</td>
<td>More Specialised Audit Area</td>
<td>20</td>
</tr>
<tr>
<td>Question 5</td>
<td>Audit Evidence/Completion/Reports</td>
<td>20</td>
</tr>
</tbody>
</table>

5 STEPS TO SUCCESS

1. To pass this exam you must apply your answers to the scenarios

2. Expect to get 5 marks per page – therefore a 15 mark questions needs to be 3 pages long. A 4 mark question no longer than 1 page.

3. Read the requirements first. Set up your answer (plan)

4. Start each question and section on a separate page Clearly identifying to the marker what question you are answering.

5. DO PAST QUESTIONS TO TIME!!!!

IT’S IN YOUR BEST INTEREST TO DO THIS MOCK, IT IS THE BEST MEANS OF ENSURING A PASS. GIVE YOURSELF THE BEST POSSIBLE CHANCE – DON’T LET YOURSELF DOWN.
Benefits of assurance work

- Enhances credibility of financial information (less so for limited assurance but still some)
- Reduces risk of management bias.
- Relevance of information enhanced by assurance firm’s experience and expertise.
- Qualified opinion and additional information can draw attention to risks.

Why have accounts audited

Due to the directors most likely differing to the shareholders, the shareholders will need some protection, and therefore the auditors will independently review that the directors have acted in the best interests of the shareholders.

Discuss what the Agency theory is

The relationships between the various stakeholders in a company. The Agency relationships occurs when one party, the principle, employs another party, the agent, to perform a task on their behalf.

What are the different levels of assurance

- Reasonable assurance
  - High level of assurance
  - Positive opinion e.g. “in our opinion the FS show a T&F view”
  - Audit is not an absolute guarantee that FS are free from material misstatement.
  - Auditors cannot provide a guarantee because of limitations.
- Limited assurance
  - Moderate level of assurance
  - Negative assurance e.g. “nothing has come to our attention to suggest that the FS do not show a T&F view” therefore looks reasonable
- Need more evidence to support a higher level of assurance so limited assurance generally is for cash flow forecasts, budgets etc…

Different assurance assignments

- Statutory audit
- Fraud investigations
- Working capital reports
- Internal control reports
- Reports on business plans and forecasts

Past Exam Questions

- June 05, Question 5 (c): Briefly explain the difference between positive and negative assurance, outlining the advantages to the directors of providing negative assurance on their cash flow forecast. (4 marks)
Statutory audit compared to other assurance engagements

<table>
<thead>
<tr>
<th>Statutory audit</th>
<th>Other assurance work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope of work governed by the law</td>
<td>Scope of work decided by parties involved</td>
</tr>
<tr>
<td>Carry out in accordance with ethics, ISAs</td>
<td>Carry out in accordance with ethics, maybe</td>
</tr>
<tr>
<td></td>
<td>other guidance</td>
</tr>
<tr>
<td>Report on T&amp;F, Properly Prepared and directors’ report consistent with FS</td>
<td>Reporting depends on scope of work</td>
</tr>
<tr>
<td>Report to members</td>
<td>Report to party who engaged</td>
</tr>
</tbody>
</table>

Should a company have an audit?

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent confirmation to directors of profits</td>
<td>Cost</td>
</tr>
<tr>
<td>Assurance of compliance with accounting standards</td>
<td>Time consuming</td>
</tr>
<tr>
<td>Can make recommendations on systems</td>
<td></td>
</tr>
<tr>
<td>Adds credibility to financial information</td>
<td></td>
</tr>
</tbody>
</table>

How can we narrow the expectations gap

- Audit report includes details on responsibilities of auditors and directors.
- Audit report explains how the audit is conducted (test basis, reasonable assurance etc.)
- Engagement letter.
- Statement of directors’ responsibilities in the financial statements.

Discuss how the expectation gap has an impact on the auditor

The expectation gap is the difference between the auditors responsibilities and the understanding the users have of assurance reports.

1. Users assume that the auditors are responsible for the preparation of the financial statements, when in fact it’s the directors.
2. Users assume it’s the auditor is responsibility for detecting fraud when in fact the auditors are concerned about detecting material misstatement which could include fraud.
3. Users assume that the auditors check all work when in fact they test a sample.
4. Users assume that the audit report is stating the Financial Statements are correct when actually the auditors are stating they are factually materially correct.
OVERVIEW OF THE STATUTORY AUDIT PROCESS

- ISA 200 General principles
- Legally allowed to audit?
  - ISA 240 Fraud
  - Issue engagement letter
    - ISA 210 Engagement terms
    - ISA 250 Laws & regulations
    - ISA 300 Planning
    - ISA 230 Documentation
    - ISA 320 Audit materiality
    - ISA 315 Understanding & risk assessment
  - Audit planning
    - ISA 330 Auditor’s procedures
  - Risk assessment
  - ISA 500 Audit evidence
  - ISA 530 Audit sampling
  - ISA 540 A/c estimates
  - ISA 570 Going concern
  - ISA 700 Audit reports
    - ISA 505 Confirmations
    - ISA 520 Analytical procedures
    - ISA 550 Related parties
    - ISA 560 Subsequent events
    - ISA 570 Going concern
    - ISA 580 Management representations

- ISA 220 Quality control
- ISA 260 communication of audit matters
Who can act as an auditor?

W Has to be a member of a Recognised Supervisory Board (RSB)
H Allowed by the rules to be an auditor
A Or someone authorised by the state

Excluded even if three conditions met above (law):

E An officer (director or secretary) of the company
A An employee of the company
A A business partner or employee of the above

Ethically – we need to review independence, if this is lacking then we should not accept.

Audit exemption

- Small companies do not need an audit (basic rules – revenue up to £5.6m, gross assets up to £2.8m).
- The following must be audited regardless of size:
  - Banks or other FSA regulated companies.
  - Insurance companies.
  - PLCs.
  - Subsidiaries of groups containing the above.
  - Charities.

Rights of the auditor

- Access to books and records.
- Information and explanations.
- Receive notice of and attend general meetings.
- Speak at general meetings on relevant matters.
- Special rights attaching to resignation.

Duties of the auditor

- Report on T&F, properly prepared, directors’ report consistent with FS.
- In UK also report by exception on RAPID (ISA 210 appendix)

Appointment

- By ordinary resolution of members.
- Directors may also appoint, or in rare cases the Secretary of State.
### How can an auditor be removed or resign

<table>
<thead>
<tr>
<th>Method</th>
<th>Removal</th>
<th>Resignation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Process</td>
<td><strong>Arrange for a meeting of the shareholders regarding an ordinary</strong></td>
<td><strong>Submit written notice.</strong></td>
</tr>
<tr>
<td></td>
<td><strong>resolution with special notice. Write to shareholders and auditors.</strong></td>
<td><strong>Company must tell Companies House.</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Shareholders can attend the AGM and vote.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>When removed shareholders and directors will need to appoint new</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>auditors.</strong></td>
<td></td>
</tr>
<tr>
<td>Rights</td>
<td><strong>The auditors have the right to</strong></td>
<td><strong>Request EGM.</strong></td>
</tr>
<tr>
<td></td>
<td><strong>receive notice of, attend and speak at AGM.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Shareholders simple majority vote required</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Have representations circulated to members.</strong></td>
<td></td>
</tr>
<tr>
<td>Duties</td>
<td><strong>Deposit statement of circumstances at company’s registered office.</strong></td>
<td><strong>Deposit statement of circumstances at</strong></td>
</tr>
<tr>
<td></td>
<td>*</td>
<td><strong>company’s registered office.</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Give written notice.</strong></td>
<td><strong>Give written notice.</strong></td>
</tr>
</tbody>
</table>

*Statement of matters to be brought to attention of members / creditors, or statement that there are no such matters*
Directors' responsibilities

- Manage the business
- Assess business risks
- Safeguard assets
- Implement a system of internal controls to prevent and detect fraud and error
- Maintain books and records
- Preparation and delivery of financial statements – suitable policies, judgements and estimates
- Compliance with laws and regulations – relevant disclosures in accounts
- Stewardship of the business – fiduciary relationship - Agent
- Accountability
- Ensure the business is a going concern and can continue to be.

Auditors' responsibilities

<table>
<thead>
<tr>
<th>Statutory audit</th>
<th>Other assurance engagements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form an opinion (T&amp;F, and disclosure notes, Directors’ report)</td>
<td>Determined by laws and regs where applicable (e.g. environmental audit)</td>
</tr>
<tr>
<td>Plan the audit</td>
<td>As defined in the Terms of Engagement for that assignment</td>
</tr>
<tr>
<td>Gather sufficient, appropriate audit evidence</td>
<td>Ethical and professional standards</td>
</tr>
<tr>
<td>Review the work</td>
<td>Quality control standards</td>
</tr>
<tr>
<td>Draw valid conclusions, supported by the evidence gathered</td>
<td></td>
</tr>
</tbody>
</table>

Law and regulations / fraud and error

<table>
<thead>
<tr>
<th>Directors’ responsibilities</th>
<th>Law and regs (ISA 240)</th>
<th>Fraud and error (ISA 250)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compliance with laws and regs</td>
<td>Prevent and detect fraud and error</td>
<td></td>
</tr>
<tr>
<td>Auditors’ responsibilities</td>
<td>Plan and perform the audit so as to have reasonable assurance of detecting material misstatements, however caused</td>
<td>Plan and perform the audit so as to have reasonable assurance of detecting material misstatements, however caused</td>
</tr>
<tr>
<td>Report to</td>
<td>Members if impact on audit report Management (unless involved) Consider duty or right to report to third parties</td>
<td>Members if impact on audit report Management or audit committee. (unless involved) Consider duty or right to report to third parties</td>
</tr>
</tbody>
</table>
Money laundering

- Auditor has duty to report where actual knowledge or reasonable grounds for suspicion.
- Wide definition of money laundering – any money from “criminal conduct”.
- Concept of materiality is not applicable – all amounts are relevant.
- Report to firm’s MLRO.
- MLRO decides whether to report to SOCA.
- Avoid warning client – offence of tipping off.
Accepting engagements

Usually by tendering for the engagement, considerations including:
- Fees
- Experience
- Reputation
- Resources
- Ethical issues
- Legal considerations re. remove / resignation of previous auditor
- Risk analysis

The engagement letter (ISA 210)

- Purpose
  - Confirms acceptance of appointment.
  - Sets out the scope of work and responsibilities.
  - Lays out the form of any reports
  - Narrows the expectation gap and minimises the possibilities of misunderstanding.
- Main contents of the letter :-
  - Objective of the audit
  - Management responsibilities
  - Scope of audit work
  - Deadlines
  - Fees
  - Complaints procedure
  - Access of information
  - Holding clients’ money
  - Data protection
- Consider the need to update the letter when there are changes in the engagement / management – but do not have to reissue every year.

Outgoing auditor

- Reply to requests for information from incoming auditor – assuming client gives permission.

Incoming auditor

- Write to client asking for permission to contact the previous auditors.
- If client declines, do not accept engagement.
- If client allows, write to previous auditor asking them about matters that may be relevant to acceptance.
- Follow up if no reply.
- Consider reply e.g. unpaid fees, disagreements about accounting treatment.
- If no reply, can accept the engagement but be sceptical.
Sources of ethical guidance

- IFAC Code of Ethics – governs audits carried out under ISAs.
- ACCA Code of Ethics – to be followed by ACCAs, but is practically identical to the IFAC code.

**Fundamental principles**

IFAC Code of Ethics

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour

**D TOPIC**

**General threats to objectivity**

- Self-interest
- Self-review
- Management - doing the management role
- Advocacy - seems to represent the client's views / position on a matter
- Familiarity or trust
- Intimidation

**Integrity, Objectivity and Independence**

- Sets out requirement for firms to have policies and procedures relating to ethics.
- The firm should appoint an ethics partner.
- For listed clients, compliance with ethical standards should be reviewed by an independent partner.
- Matters that bear on the auditors' objectivity and independence should be communicated to client management.
## Detailed guidance

<table>
<thead>
<tr>
<th>Specific threats</th>
<th>Why</th>
<th>Safeguards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beneficial interest in shares</td>
<td>• Will want the highest value for shares therefore will not disclose anything that will devalue shares</td>
<td>• Audit partner and staff cannot hold shares in audit client so resign or not accept.</td>
</tr>
<tr>
<td>Mutual business interest</td>
<td></td>
<td>• Should not go into business with audit client</td>
</tr>
<tr>
<td>Staff moving from audit firm to client</td>
<td>• May lose professional scepticism as you know the people involved, familiarity threat.</td>
<td>• Partner becomes client management within 2 years of being involved in the audit – firm should resign as auditors</td>
</tr>
<tr>
<td></td>
<td>• They know the systems and may work around the auditors weaknesses.</td>
<td>• Other staff – firm must consider implications for independence</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• All – partners and staff should disclose intention to move to client and be removed from the audit team</td>
</tr>
<tr>
<td>Client staff joining audit firm</td>
<td>• as above</td>
<td>• Should not be allowed to work on the audit for 2 years</td>
</tr>
<tr>
<td>Acting for a prolonged period for listed clients</td>
<td>• Lose professional scepticism.</td>
<td>Rotate staff as follows:</td>
</tr>
<tr>
<td></td>
<td>• May not want to upset a friend and lose the relationship</td>
<td>• Engagement partner – 5 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Key audit partners and senior staff – 7 years</td>
</tr>
<tr>
<td>Acting for a prolonged period for non-listed clients</td>
<td></td>
<td>Rotate staff as follows:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Engagement partner – 10 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Rules more relaxed – might be able to make a case that partner should remain for longer</td>
</tr>
<tr>
<td>Dependence on client</td>
<td>• Will have the fear of losing the money and therefore will not want to upset the client.</td>
<td>Fees for services to clients should not exceed following % of firm’s fee income:</td>
</tr>
<tr>
<td></td>
<td>• Self interest threat</td>
<td>o Listed: 10% (review at 5%)</td>
</tr>
</tbody>
</table>
|                                               |                                                                      |   o Non-listed: 15% (review at 14%)}
<table>
<thead>
<tr>
<th></th>
<th>10%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loans, etc.</strong></td>
<td></td>
</tr>
<tr>
<td>• Fear of not getting paid if we upset the client</td>
<td>• Not allowed loans or guarantees</td>
</tr>
<tr>
<td>• Not allowed loans or guarantees</td>
<td>• Overdue fees akin to a loan</td>
</tr>
<tr>
<td><strong>Hospitality or other benefits</strong></td>
<td></td>
</tr>
<tr>
<td>• Bribe</td>
<td>• Firm should have a policy</td>
</tr>
<tr>
<td>• Lose professional scepticism</td>
<td>• Basic idea is that they should be modest</td>
</tr>
<tr>
<td>• Firm should have a policy</td>
<td>• Should not accept</td>
</tr>
<tr>
<td><strong>Litigation</strong></td>
<td></td>
</tr>
<tr>
<td>• Intimidation treat</td>
<td>• Firm should resign as auditor if there is actual or potential litigation between audit firm and client</td>
</tr>
<tr>
<td><strong>Other services</strong></td>
<td></td>
</tr>
<tr>
<td>• Self review threat as if we as the auditors review our work and we find an error we may hide those errors to save face</td>
<td>• Consider the impact of non-audit services</td>
</tr>
<tr>
<td>• Consider the impact of non-audit services</td>
<td>• Establish safeguards to counter any threats – different teams</td>
</tr>
<tr>
<td>• Establish safeguards to counter any threats – different teams</td>
<td>• Communicate with those charged with governance</td>
</tr>
<tr>
<td>• Communicate with those charged with governance</td>
<td>• Document rationale for decisions taken</td>
</tr>
<tr>
<td>• Document rationale for decisions taken</td>
<td>• Do not help PLCs prepare accounts except in an emergency</td>
</tr>
<tr>
<td>• Do not help PLCs prepare accounts except in an emergency</td>
<td>• Do not carry out IA / IT / Valuation work where the external audit opinion will place heavy reliance upon this other work</td>
</tr>
</tbody>
</table>
Confidentiality

Auditors should keep client information confidential unless there is a right or duty to disclose.

<table>
<thead>
<tr>
<th>Right to disclose</th>
<th>Duty to disclose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client permission obtained</td>
<td>Money laundering or suspicions of terrorism or treason</td>
</tr>
<tr>
<td>Public interest</td>
<td>Ordered to by a court</td>
</tr>
<tr>
<td>To defend the audit firm</td>
<td>Required by a regulator</td>
</tr>
</tbody>
</table>

Duty to disclose

1) Disclose information to certain regulatory bodies:
   - Police – of breaking the law
   - Financial services
   - Banks
   - Insurance companies
   - Money laundering – drug trafficking

2) If the courts demand information and you refuse to disclose/provide the information it is likely to be considered contempt of court which is illegal

Right to disclose

3) If the actual auditors are subject to disciplinary then they can disclose information

Right to disclose

4) Auditors are allowed to disclose information if they consider it too be in the public interest. Need to take care here as it maybe difficult to prove.

5) If the client gives authorisation we have the right to disclose.
Conflicts of interest

**Definition:** Difficult situations to manage, with no obvious “correct” solution.

**Rules under ACCA** – Avoid conflicts of interest wherever possible

**Risks:**
- confidential information moving between parties
- reduced objectivity

**Safeguards**

**Firm vs client**
- E.g. where the auditor recommends another service to a client and receives a commission for doing so.
- Disclose to client.
- Obtain client consent.

**Client vs client**
- E.g. the firm audits clients who are competitors.
- Main issue is confidentiality.
- Disclose to client and then the client can decide to continue or not
- Separate teams with separate reporting lines.
- Maintain confidentiality (“Chinese walls”).
- Independent partner review.
- If sufficient safeguards cannot be implemented, consider resigning / refusing to act.
PLANNING THE AUDIT

Why plan ISA 300

- Enables the audit to be carried out in an effective and timely manner.
- To reduce audit risk.
- To determine the audit approach.
- To decide how much audit work.
- To facilitate review.

Matters to consider when planning an audit

ISA 300 suggests

- Knowledge of the business.
- Understanding accounting and internal control systems.
- Risk and materiality.
- Nature, extent and timing of procedures.
- Coordination, direction, supervision and review.
- Other matters.

In the exam you might use the mnemonic MARE

- Materiality
- Accounting treatment – problems more likely where there is
  - Complexity
  - Estimation
  - Judgement
- Risk
- Evidence – practical problems

Contents of the audit strategy memorandum Q29 – Tempest 20 marks

- Characteristics of the business – what does the business do
- Nature of assignment - what work is to be done is it and Audit??
- Key dates – interim and final audit dates, deadlines for the AGM
- Budget
- Overall audit approach – test of control and substantive assess the systems to decide reliance
- Overall materiality
- Risk areas and important figures
- Specific areas of audit work (because of issues)
- Client assistance – IA, documentation etc…
Interim and Final audit

<table>
<thead>
<tr>
<th></th>
<th>Interim audit</th>
<th>Final audit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Meaning</strong></td>
<td>It is voluntary Conducted in between two final audits (during an accounting period)</td>
<td>Done after the end of the accounting period</td>
</tr>
<tr>
<td><strong>Advantages</strong></td>
<td>Errors and Fraud are discovered at an early stage Books and records of client are always up to date Reduces workload for final audit</td>
<td>Allocation of work to staff becomes easier Costs are lower No duplication of work</td>
</tr>
<tr>
<td><strong>Disadvantages</strong></td>
<td>Audited figures may be altered Not relevant for small entities High cost</td>
<td>Delay in presentation of final accounts and completion work May overlook some detailed aspects</td>
</tr>
</tbody>
</table>

**Differences**

<table>
<thead>
<tr>
<th>Interim Audit</th>
<th>Final Audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carried out during the accounting period</td>
<td>Carried out at the end of the accounting period</td>
</tr>
<tr>
<td>Voluntary</td>
<td>Compulsory</td>
</tr>
<tr>
<td>Suitable for large organisations</td>
<td>Suitable for small organisations</td>
</tr>
</tbody>
</table>

**Contents of the audit planning memorandum**

- Risk assessment.
- Audit approach (see below).
- Sampling.
- Planned audit procedures.
- Key audit risks.
MATERIALITY AND RISK ASSESSMENT

Business risk

- Risk inherent to the business.
- Of interest to the auditor as business risks may cause material misstatement in the FS.
- Broken down into
  - Financial risk
  - Operational risk
  - Compliance risk

Audit risk

\[ AR = IR \times CR \times DR \]

Definitions are in the open book glossary of terms.

- Audit risk
- Inherent risk
- Control risk
- Detection risk

Risk is determined at the planning stage as it affects the nature, extent and timing of work to be done.

Materiality ISA 320

- Information is material if its misstatement or omission would influence the decision of users of the financial statements.
- This can result from size or nature.

Qualitative considerations

- Effect on use e.g. descriptions of accounting policies should not be misleading.
- Some items are capable of precise determination e.g. cash, share capital.
- Directors’ transactions must be accurate.

Quantitative considerations

- Auditor must use their judgement
- Some rules of thumb:
  - ½ - 1% revenue
  - 1 – 2% gross assets
  - 5 – 10% profit before tax

Identify from the above scenario the main audit risks that the auditor should address, and explain how these can be mitigated.
INTERNAL CONTROLS

Internal controls systems

- Directors are responsible for designing, implementing and monitoring the system of internal controls.
- This helps them achieve their legal responsibilities.
- Objectives of internal control are safeguarding assets, preparing financial statements accurately, efficiently and timely, and helps prevent and detect fraud and error.
- Auditors are responsible for assessing control risk as a component of audit risk, so they need to consider the internal control system as part of the audit. They may choose to test internal controls as a source of audit evidence.
- The auditor also reports on significant control weaknesses in the Report to Management.

Components of an Internal Control System [ISA 315]

Control Environment
- 3 As
  - Attitude
  - Awareness
  - Actions

Risk Assessment Procedures
- How mgmt identify risk
- Indicators that risks might be present

Information System
- What an Information system should do

Control Activities
- PACAMACS Ideas

Monitoring of Controls
- Should be on an ongoing basis
- Still working and appropriate?

Recommendating controls – ideas generator

P  Physical Controls
A  Approval (signing of documents)
C  Computer Controls
A  Account Reconciliations (bank, receivables, payables)
M  Maintain and review control a/c
A  Arithmetic Controls (sequence checks)
C  Comparison (Actual vs Budget)
S  Segregation of Duties

Identify weaknesses – what can go wrong, consequences and state recommendations

Management letter produced

IT controls – see additional sheet
Reports to management ISA 260

- Report controls weaknesses to management.

- Covering letter (not usually asked for in exam)
  - To management
  - Dated asap after completion of the audit
  - Includes a disclaimer
    - Only includes items that happen to have been discovered during the course of the audit, not a comprehensive list of weaknesses
    - For management use only
    - Not for disclosure to third parties without the prior written consent of the auditor
  - Thanks staff for their cooperation

- Appendix detailing the controls weaknesses
  - Usually in tabular format

<table>
<thead>
<tr>
<th>Weakness</th>
<th>Consequences / impact</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fact</td>
<td>e.g. lose money, increase costs, lose customer or staff goodwill</td>
<td>Specific</td>
</tr>
</tbody>
</table>

**Other matters**

ISA 260 also requires the UK auditor of listed and other public interest entities to report to those charged with governance

- Matters which have a bearing on objectivity
- Related safeguards
- Total fees charged for other services
- Written confirmation of independence
ANALYTICAL PROCEDURES

Meaning

Using relationships between financial information and other information (financial / non-financial) (ISA 520).

APs are used throughout the audit:

<table>
<thead>
<tr>
<th>Stage of audit</th>
<th>Requirement to use</th>
<th>How used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning</td>
<td>Must use</td>
<td>To identify risk and determine audit approach</td>
</tr>
<tr>
<td>Evidence gathering</td>
<td>May use</td>
<td>As a substantive test</td>
</tr>
<tr>
<td>Completion</td>
<td>Must use</td>
<td>To identify errors in the financial statements</td>
</tr>
</tbody>
</table>

Practical use of analytical procedures

1. Understand the client’s business – read the narrative first so the numbers can be placed in context.

2. Develop expectations
   - Last year?
   - Budget?
   - Auditor’s own – proof in total?

3. Compare expected amount to actual
   - Start with simple numbers e.g. trends, new balances, missing balances, profit last year vs loss this year etc.
   - May calculate ratios

4. Investigate significant differences
   - Identify as risk areas at the planning stage
   - Seek corroborative evidence at the evidence stage
   - Check whether sufficient evidence obtained at the completion stage – if not require further work to be done
AUDIT APPROACH

The audit approach must be designed to respond to the risk assessment and meet the audit objective.

Detailed audit procedures

Need to determine mix of test control and substantive testing.

- Gain an understanding of the accounting and internal control systems and document them
- Perform walkthrough tests
- Make a preliminary assessment of internal controls

Expect controls to be effective
- Perform tests of controls
- Are controls effective throughout the year?
  - Yes
  - No

Expect controls to be ineffective
- Perform substantive procedures
- Analytical procedure
- Test of detail

Perform limited substantive procedures
To ensure there are no material errors
Agree/recalculate

Test of controls

**Aim**
Obtain audit evidence about the effective operation of accounting and internal control systems, i.e. that properly designed controls identified in the preliminary assessment of control risk:
- a) exist in fact; and
- b) have operated effectively throughout the relevant period

**Description**
The control is tested, not the transaction. Examples include the following:
- a) enquiries and observations corroborating IC functions
- b) inspection of documents evidencing operation of IC, e.g. that a transaction has been authorised

A ‘deviation’ is where a control has not been operated effectively whether or not a quantitative error has occurred.
THE AUDIT PROGRAMME

Contents

a) Audit procedures
b) Audit objectives
c) Timing
d) Sample size and basis of selection

The audit programme serves as:

- A set of instructions to the audit team
- A means to control and record the proper execution of the work
- A record of the audit procedures to be adopted, the audit objectives, timing, sample size and basis of selection for each area.

The audit programme is an important part of the auditor’s working papers and records a significant part of the audit evidence required to justify the audit opinion.

Sampling

Involves the application of audit procedures to less than 100% of the items within a class of transactions or account balances.

Advantages

- Reduced work
- Only looking for reasonable assurance

Disadvantages

- Sampling risk

Design of sample

Statistical – random or using a probability theory

Non statistical - judgment
Basic principles of audit evidence

Auditor must gather sufficient appropriate audit evidence on which to base their opinion.

Sufficient
- Is there enough evidence.
- Consider risk and materiality.

Appropriate
- Relevant to financial statement assertion(s).
- Reliable – depends on nature and source.

Financial statement assertions ISA 500

<table>
<thead>
<tr>
<th>Should it be in the accounts?</th>
<th>Income statement</th>
<th>Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occurrence</td>
<td></td>
<td>Existence</td>
</tr>
<tr>
<td>Cut-off</td>
<td></td>
<td>Rights &amp; obligations</td>
</tr>
<tr>
<td>Is it included at the right amount?</td>
<td>Accuracy</td>
<td>Valuation</td>
</tr>
<tr>
<td>Are there any more?</td>
<td>Completeness</td>
<td>Completeness</td>
</tr>
<tr>
<td>Is it properly disclosed and presented?</td>
<td>Classification</td>
<td>Allocation</td>
</tr>
</tbody>
</table>

Designing substantive audit tests

- Audit tests need to be clear and specific.
- Each test has 3 components:

<table>
<thead>
<tr>
<th>ACTION</th>
<th>SOURCE</th>
<th>OBJECTIVE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Analyse</td>
<td>People</td>
<td>To confirm FS assertions</td>
</tr>
<tr>
<td>Enquire</td>
<td>Assets</td>
<td>CODRACE</td>
</tr>
<tr>
<td>Inspect</td>
<td>Documents</td>
<td>CODRACE</td>
</tr>
<tr>
<td>Observe</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RecompUte</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Audit procedures - purchases

<table>
<thead>
<tr>
<th>Audit Test</th>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain a sample of list of PO documents from the computer. Trace individual PO to the goods received note (GRN)</td>
<td>Checks the completeness of recording of liabilities</td>
</tr>
<tr>
<td>Obtain a sample of the GRNs. Agree details to the PO document on the computer</td>
<td>Ensures that the parts received had been ordered by the business, giving evidence for the occurrence assertion</td>
</tr>
<tr>
<td>Review file of unmatched GRNs, investigate reasons for any old (more than one week) items</td>
<td>Ensures the completeness of recording of liabilities. Unmatched items prior to the year end should be included in the payables accrual</td>
</tr>
<tr>
<td>Obtain the unmatched invoices file. Investigate old items obtaining reason for GRN not being received/invoice not being processed</td>
<td>Unmatched items at the year end could indicate unrecorded liabilities. Ensure included in the payables accrual if the goods had been received pre-year end</td>
</tr>
<tr>
<td>For the sample of entries on the payables ledger, agree to the electronic payments list confirming that the supplier name and amount is correct</td>
<td>Ensures that the liability has been properly discharged by the business and that the payments list is therefore complete</td>
</tr>
<tr>
<td>Obtain the bank statements. Trace a sample of payments to the electronic payments list</td>
<td>Confirms that the payment made does relate to the business, confirming the occurrence assertion</td>
</tr>
<tr>
<td>For a sample of GRNs in the week pre- and post-year-end, trace to the supporting invoice and entry in the payables ledger, ensuring recorded in the correct accounting year</td>
<td>Confirms the accuracy of cut-off in the financial statements</td>
</tr>
</tbody>
</table>

### Audit procedures - payables

<table>
<thead>
<tr>
<th>Audit Test</th>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain a list of payables balances from the computerised payables ledger as at the business’ year end. Cast the list</td>
<td>To ensure that the list is accurate and that the total is represented by the individual balances (completeness assertion)</td>
</tr>
<tr>
<td>Agree the total of payables to the general ledger and financial statements</td>
<td>To confirm that the total has been accurately recorded and that the balance in the financial statements is represented by valid payables (occurrence assertion)</td>
</tr>
<tr>
<td>Perform analytical procedures on the list of</td>
<td>Provides initial indication of the accuracy and</td>
</tr>
</tbody>
</table>
payables. Determine reasons for any unusual changes in the total balance or individual payables in the list  

completeness of the list of payables

| For a sample of payables on the list, agree to supplier statements at the year-end | Confirms that the payables balance is due from the business meeting the occurrence assertion |
| Reconcile supplier statement balances to the payables ledger | Ensures that the liabilities exist and belong to the business at the year-end |
| Review the payables ledger for old unpaid invoices. Enquire of the chief accountant the reason for non-payment | Non-payment may be indicative of goods being returned for credit indicating that the payables figure may be overstated. Alternatively, taking additional credit from payables may be a going concern indicator |
| Ensure that payables have been included in the financial statements under the heading of current liabilities | Confirm the correct classification of payables in the financial statements |

Trade Payables

- Direct confirmation – payable circularisation
- Perform Supplier statement reconciliations
- Sort out differences between the balances recorded by the company and those recorded by suppliers
- Telephoning the supplier if discrepancies can not be resolved
- Analytical procedures applied to ageing and level of trade payables by comparison with prior periods
- Variations investigated
- Sample trade payables, traced back to source documentation to ensure accuracy
- Cast the payables or clients working schedule for accuracy
- Cut-off tests
- A review of correspondence with creditors detailing disputes with creditors
- If the liability exceeds more than one year this needs to be represented in the balance sheet
Non Current Asset Testing

Substantive Procedures may include:

- Inspection of title deeds for properties
- Inspection of vehicle registration documents
- Physical verification
- Independent valuations from a qualified valuer
- Recalculation of depreciation
- Compare depreciation with similar assets – is it in line with policy
- Compare disclosure to the relevant accounting standards ensuring compliance
- Agree disposals to sales invoices
- Agree additions to purchase invoices
- Reconcile between physical and fixed asset register
- Select sample of items from factory floor and agree back to fixed asset register
- Scrutinise repairs accounts for items that should be capitalised
- Review minute book re: authorisation of capital expenditure
Inventory

Procedures

<table>
<thead>
<tr>
<th>Before = Planning</th>
<th>INVENTORY COUNT</th>
<th>AUDIT VISIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Review prior year working papers</td>
<td>a) Observe compliance with instructions</td>
<td>a) Follow-up cut-off tests</td>
</tr>
<tr>
<td>b) Discuss instructions</td>
<td>b) Make test counts (from physical to recorded and vice versa)</td>
<td>b) Ensure all copies of inventory take sheets from inventory day agree to client inventory sheet and check sequencing is complete</td>
</tr>
<tr>
<td>c) Familiarisation, nature, value, location etc</td>
<td>c) Take copies of inventory take sheets</td>
<td>c) Ensure continuous inventory records adjusted</td>
</tr>
<tr>
<td>d) Arrange third party certificates</td>
<td>d) Obtain more details of damaged inventory</td>
<td>d) Follow-up third party certificates</td>
</tr>
<tr>
<td>e) Consider need for expert (s)</td>
<td>e) Note cut-off details Obtain the last GRN and GDN on the day</td>
<td>e) Conclude on reliability of quantities used as a basis for computing inventory</td>
</tr>
<tr>
<td>f) Role of internal audit</td>
<td>f) Valuation review lower of cost and NRV</td>
<td></td>
</tr>
<tr>
<td>g) Extract representative sample</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Organisation of Inventory Taking

- Goods should be kept in bins, racks with descriptions of the item;
- Goods protected against deterioration and misappropriation;
- Goods held for third parties and slow-moving, obsolete inventory, are identified and separated;
- There is an adequate plan of the area to be covered which should be tidy;
- Each area marked as counted; and
- Movement of inventory during the count should be kept to a minimum
Substantive Testing

Valuation

Lower cost and net realisable value for separate items of inventory (IAS2).

Tests

- Agree cost to purchase invoice
- Agree costs incurred to making the product

Work-in-Progress (WIP) / Specialist Area

Need to use an expert

Net Realisable Value (NRV)

a) NRV is affected by:
   (i) obsolescence
   (ii) condition / damage etc
   (iii) market price fluctuations

b) In computerised inventory recording systems an exception report may identify items which have not moved in a specific period

c) A review of post year-end selling prices may confirm

Examples of substantive procedures in inventories

On the day

- Attendance at the inventory take
- Testing balances floor sheet and vice versa – take sample from the sheet and count the inventory or vice versa
- Take copies of inventory sheets for check back at financial statement
- Observe procedures for inventory movement during the count
- Observe at the count to ensure all stock lines actually exist

On the audit

- Examination of inventory sheets and check on arithmetical accuracy
- Vouching inventory pricing by selecting a sample of items from the inventory sheet and tallying them up to purchasing invoice or sales proceeds
- Examining slow moving and obsolete items
- Obtaining certificates for items held at third parties confirming amount and volume
- Agree that the treatment of inventory is complying with standards
- Use of an expert re: valuation
- Cut-off tests reviewing the GRN and GDN and ensuring the invoices have been raised in the appropriate financial year
- Agree breakdown of inventory to last year’s closing inventory figure
- For a sample of items inspect purchase invoices to ensure company’s name is present
## Payroll Testing

<table>
<thead>
<tr>
<th>Reason for Test</th>
<th>Audit Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completeness</td>
<td></td>
</tr>
</tbody>
</table>
| To ensure there are no unrecorded assets or liabilities for example under-declared payroll liabilities | Substantive  
Perform a starter and leaver test to ensure people and being paid correctly  
Substantive  
Rework the clients working papers to ensure the working is correctly calculated and agree back to the rates given by the government  
Test of control  
Review evidence of authorisation for payroll being processed for example for new employees, changes, payments |
| Existence       |                 |
| To ensure that the bank and cash and payroll liabilities are actually present at this point | Substantive  
Checking after date payments to staff and for taxes to see if they agree up  
Substantive  
Physically check that staff exist by selecting a couple on the payroll and vouching in person  
Test of control  
Observe the payroll clerk handing out cash wages and getting relevant signatures and following procedures |
| Occurrence      |                 |
| We need to confirm that the payroll did take place in the period | Substantive  
Perform a cut-off test to ensure payroll costs have been allocated in the right accounting period. You would do this by looking at a timesheet at year-end and tracing those charges through the nominal ledger  
Test of control  
Observe cut-off being done, reviewing the compliance with the procedures |
| Accuracy        |                 |
| Need to confirm that the charges for payroll are the right amounts and that costs have been allocated to the right account | Substantive  
By taking last years figures and updating them with this years changes comparing it to the actual figure (proof in total)  
Recalculate a sample of wages by looking at the timesheets, calculate wage, taxes and then agree the payroll to the system  
Test of control  
Observe the evidence of payroll being reviewed by a senior member of staff |
COMPUTER ASSISTED AUDIT TECHNIQUES - CAAT’s

The use of a computer to either perform, be tested or to assist the auditors in carrying out their audit procedures.

With so many accounting systems now held on computer, the assurance provider may wish to make use of CAAT’s. There are two types of CAAT’s:

1. Audit software
2. Test data

Auditing around the computer?

This term means that the ‘internal’ software of the computer is not documented or audited by the auditor, but the inputs to the computer are agreed to the expected outputs to the computer.

Audit outcome

Increases the AUDIT RISK

Why?

- The actual computer files and programs are NOT TESTED.
  Therefore no DIRECT evidence that the programs are working as documented

- Where errors are found it maybe difficult or even impossible to determine why those errors have occurred.
  If amendments cannot be made, there is an increased likelihood of audit qualifications.
  Since controls are being tested, all discrepancies between predicted and actual results must be fully resolved and documented, irrespective of financial amounts involved.
1. Audit software

Description

This is software specifically designed for audit purposes, there are a number of off-the-shelf packages available, or the auditor could have a tailor-made system. It is used to process the client’s data in order to check that the figures themselves are correct. It can therefore carry out a whole range of substantive procedure, across all sorts of different data.

Examples of what audit software can do include:
- Extract a sample according to specified criteria
  - Random
  - Over a certain amount
  - Below a certain amount
  - At certain dates
- Calculate ratios and select those outside the criteria
- Check calculations (for example additions)
- Prepare reports (budget v actual)
- Produce letters to send out to customers suppliers
- Follow items through a computerised system

Package programmes are generally designed to;
- **read** computer files
- **select** information
- **perform** calculations
- **create** data files, and
- **print** reports in a format specified by the auditor

2. Test data

The assurance provider supervises the process of running data through the clients system. To do this the auditor would have to:

- Note controls in the clients system
- Decide upon the test data

It maybe processed during a normal production run (**live** test data) or during a special run at a point in time outside the normal cycle (**dead** test data), either with **real** data or **dummy** data.

- Run the test data
- Compare results with those expected
- Conclude on whether controls are operating properly

Through test data. This is data generated by the auditor in order to test the systems, processing logic, calculations and controls, to ensure that the controls within the system are operating properly.
An auditor would take a transaction through a system, testing the systems limits. So you would have ‘normal’ transactions and invalid transactions to test that the system work. If the results are positive that means the auditor can rely on the system and have more confidence that the output is accurate.

What are the benefits of CAAT’s?

<table>
<thead>
<tr>
<th>Benefits / Advantages</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAAT’s force the auditor to rely on programmed controls during the audit. Sometimes it may be the only way to test controls within a computer system, therefore enables the auditor to test program controls.</td>
<td>Credit limits within a system can only be changed by the accountant. A computer assisted check will test that this is the case.</td>
</tr>
<tr>
<td>Using CAAT’s enables the auditors to comply with ISA of obtaining appropriate audit evidence increasing the overall confidence for the audit opinion.</td>
<td>Checking the depreciation charged on each asset would be quicker with a computer assisted program than manually.</td>
</tr>
<tr>
<td>Large number of items can be tested quickly and accurately</td>
<td>Actual wages will be tested instead of paper copies.</td>
</tr>
<tr>
<td>CAAT’s test original documentation instead of print outs, therefore the authenticity of the document is more valid this way.</td>
<td>Examples of use or audit tests for audit software:-</td>
</tr>
<tr>
<td>After initial set up costs, using CAAT’s are likely to be cost effective, as the same audit software can be used each year as long as the system doesn’t changed</td>
<td>1. Calculation checks</td>
</tr>
<tr>
<td></td>
<td>2. Reviewing lists of old or outstanding items and investing those specifically</td>
</tr>
<tr>
<td></td>
<td>3. Detecting for unreasonable items</td>
</tr>
<tr>
<td></td>
<td>4. Detecting violation of the system rules</td>
</tr>
<tr>
<td></td>
<td>5. New analysis</td>
</tr>
<tr>
<td></td>
<td>6. Completeness checks</td>
</tr>
<tr>
<td></td>
<td>7. Selects samples</td>
</tr>
<tr>
<td></td>
<td>8. Identifying exception reporting facilities</td>
</tr>
<tr>
<td>Allow the results from using CAATs to be compared with ‘traditional’ testing,</td>
<td>If the two sources of evidence agree then this too will increase the overall audit confidence</td>
</tr>
</tbody>
</table>
What are the weaknesses, or problems with CAAT’s, and how can they be resolved?

<table>
<thead>
<tr>
<th>Weaknesses / problems</th>
<th>Recommendations / resolve</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Limitations</strong></td>
<td>Ensure you understand the system to assess whether audit software will be relevant for the company.</td>
</tr>
<tr>
<td>CAAT’s will be limited depending on how well the computer system is integrated. The more integrated the better the use of CAAT’s. For example the invoices should be computer generated and then processed through the accounts system to feed in to the financial statements.</td>
<td>Need to assess whether there is a need for the audit software.</td>
</tr>
<tr>
<td>The existing system made do some of the functions of the CAAT, for example highlight old balances or obsolete inventory</td>
<td></td>
</tr>
<tr>
<td><strong>Reliability</strong></td>
<td>Assess the reliability, document and then make a decision whether it’s relevant to use audit software as part of the evidence collected.</td>
</tr>
<tr>
<td>CAAT’s are only useful methods of testing if you can rely on the system, so the auditor would have to assess the reliability first, before use.</td>
<td></td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td>A cost benefit analysis from the audit point of view should be carried out prior to deciding to use the audit software.</td>
</tr>
<tr>
<td>It takes time to design CAAT’s tests therefore may not be cost effective if the auditor is dealing with a bespoke system, as there maybe a lot of set up costs. The reason for this is it takes time to write specific test data or to program the audit software to the needs of the client.</td>
<td></td>
</tr>
<tr>
<td><strong>Lack of software documentation</strong></td>
<td>Shouldn’t use audit software until these have been identified. Hold until this point.</td>
</tr>
<tr>
<td>If the company you are auditing can not confirm all system documentation is available, then the auditors will be unable to do the tests effectively due to lack of understanding</td>
<td></td>
</tr>
<tr>
<td><strong>Change to clients systems</strong></td>
<td>A cost benefit analysis from the audit point of view should be carried out prior to deciding to use the audit software</td>
</tr>
<tr>
<td>If there is a change in the accounting year or from the previous year then the audit software will have to be reset and designed, therefore may be costly.</td>
<td>Or if you know there to be a change in the near future hold the audit software until that year.</td>
</tr>
<tr>
<td><strong>Lack of direction and useless results</strong></td>
<td>The audit manager needs to be clear exactly what audit assertions are being tested, and what the expected outputs are.</td>
</tr>
<tr>
<td>Audit tests may be done just because the auditors have the facility to do them, therefore the output of results will either be inconclusive or not required. Therefore having an inefficient and costly audit</td>
<td></td>
</tr>
<tr>
<td><strong>Use of copy files</strong></td>
<td></td>
</tr>
</tbody>
</table>
Clients tend to provide the auditors with copies of the system notes and any other relevant information. The problem here is do we know if those are the actual files?

<table>
<thead>
<tr>
<th>Test data - problems</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Damage of computer system</strong></td>
</tr>
<tr>
<td>Because we are testing the limits of the system the dummy process may damage the computer system</td>
</tr>
<tr>
<td>Ensure as auditors we understand the system and have support if need be form software experts</td>
</tr>
<tr>
<td><strong>Need to reverse or remove dummy transactions</strong></td>
</tr>
<tr>
<td>Ideally test data should be run ‘live’ if not possible then the ‘dead’ test data needs to be used under identical systems for it to be valid, and enough computer time should be provided. The transactions may be incorrectly or incompletely removed, leaving dummy data in a live system.</td>
</tr>
<tr>
<td>Ensure there is a process for ensuring all dummy transactions are cleared and the auditor has discussed when they can use the computer and for what test specifically.</td>
</tr>
</tbody>
</table>
### Examples of Test Data

<table>
<thead>
<tr>
<th>Tests</th>
<th>Reason for the test</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
</tr>
<tr>
<td>Input an order into the clients system that would</td>
<td>The order should not be accepted, or should raise a query whether you are sure you</td>
</tr>
<tr>
<td>cause a customer to exceed their credit limit.</td>
<td>wish to proceed. If this happens then the auditors will have confidence the system</td>
</tr>
<tr>
<td></td>
<td>is working properly.</td>
</tr>
<tr>
<td>Input a negative number of items on an order</td>
<td>Ensures only positive quantities are accepted.</td>
</tr>
<tr>
<td>Input incomplete customer details</td>
<td>The system should not process the order unless all information is completed</td>
</tr>
<tr>
<td>Input an excessive amount</td>
<td>There are reasonable checks in the system to identify possible input errors. A</td>
</tr>
<tr>
<td></td>
<td>warning should appear on the screen confirming the number</td>
</tr>
<tr>
<td>Input and invalid inventory code</td>
<td>Ensures that the computer detects the invalid code and presents an error message</td>
</tr>
<tr>
<td></td>
<td>rather than taking the nearest code and accepting it</td>
</tr>
<tr>
<td>Input of invalid details</td>
<td>Ensures that no errors are made for sipping and payment</td>
</tr>
<tr>
<td><strong>Purchases</strong></td>
<td></td>
</tr>
<tr>
<td>Raise an order from a supplier not on the preferred</td>
<td>A query should be raised as to whether you want to proceed with this transaction</td>
</tr>
<tr>
<td>supplier list</td>
<td></td>
</tr>
<tr>
<td>Process an order with an unauthorized staff ID</td>
<td>The system should reject the process altogether or send the request through to an</td>
</tr>
<tr>
<td></td>
<td>appropriate person for authorization</td>
</tr>
<tr>
<td>Try and make changes to the supplier standing data</td>
<td>The system should reject the process altogether or send the request through to an</td>
</tr>
<tr>
<td>using the ID of someone who is not authorized to do</td>
<td>appropriate person for authorization</td>
</tr>
<tr>
<td>so</td>
<td></td>
</tr>
<tr>
<td><strong>Payroll</strong></td>
<td></td>
</tr>
<tr>
<td>Try and set up a new employee up on the payroll</td>
<td>The system should reject the process altogether or send the request through to an</td>
</tr>
<tr>
<td>system using an unauthorized ID</td>
<td>appropriate person for authorization</td>
</tr>
<tr>
<td>Try and make employee changes of detail using an</td>
<td>The system should reject the process altogether or send the request through to an</td>
</tr>
<tr>
<td>unauthorized ID</td>
<td>appropriate person for authorization</td>
</tr>
<tr>
<td>Make an excess change for example increase someone's</td>
<td>The system should have parameters in place to question this amount, and maybe reject</td>
</tr>
<tr>
<td>salary by $1,000,000 by someone authorized</td>
<td>it due to it being outside the normal range</td>
</tr>
<tr>
<td><strong>Receivables (examples of audit software procedures)</strong></td>
<td><strong>To</strong></td>
</tr>
<tr>
<td>--------------------------------------------------------</td>
<td>--------</td>
</tr>
<tr>
<td>Cast the receivables ledger to ensure it agrees with the total on the receivables control account</td>
<td>To ensure the <strong>completeness</strong> and <strong>accuracy</strong> of the items on the receivables control account</td>
</tr>
<tr>
<td>Compare the balances to the credit limits to ensure they haven’t been exceeded</td>
<td>To check or <strong>violation</strong> of the system rules</td>
</tr>
<tr>
<td>Review the balances to ensure they don’t exceed the total sales to that customer</td>
<td>To check for <strong>unreasonable</strong> items in the ledger</td>
</tr>
<tr>
<td>To review the receivable days on a monthly basis and compare to year</td>
<td>To obtain new / relevant <strong>statistical information</strong></td>
</tr>
<tr>
<td>To form receivable balances to show all material items and select appropriate sampling for testing.</td>
<td>To select specific items for the audit test.</td>
</tr>
<tr>
<td>To produce an aged receivables analysis to assist with identification of irrecoverable receivables.</td>
<td>To assist in the receivables valuation testing.</td>
</tr>
</tbody>
</table>
RELIANCE ON THE WORK OF OTHERS

Internal audit ISA 610

Functions of internal audit
- Monitoring of internal control
- Examination of financial and operating information
- Economy, efficiency and effectiveness
- Compliance with laws and regulations
- Special investigations

Impact on external audit
- May be able to rely on work of IA
- Provides an opportunity – reliance on IA allows for a more efficient audit; but
- Also a threat to independence / objectivity and audit quality
- Note that the focus of IA work may not be appropriate – IA considers risk to the business, which may be different from audit risk that EA is interested in

Therefore if EA wants to rely upon IA they need to

1. Assess the IA function in general
   - organisational status
   - scope of function
   - technical competence
   - due professional care

2. Evaluate specific IA work on which they want to place reliance
   - adequate training
   - sufficient appropriate evidence
   - conclusions appropriate
   - exceptions are resolved
   - amendments must be made to the audit programme as a result of reliance on IA

Experts ISA 620

Similar to reliance on IA – EA needs to consider

1. Competence and objectivity of the expert - Qualifications
2. Whether the scope of the expert’s work is appropriate - experience
3. Whether the work is appropriate audit evidence
4. References of the work they do
5. Confidentiality issues – sign a confidentiality agreement
6. Acceptance by other staff within the team
Management representation letters ISA 580

Purpose

- Compulsory.
- Reduce expectations gap.
- Source of audit evidence especially where knowledge is confined to management, but should not rely on management representations alone.
- Acknowledge the directors collective responsibility of the preparation of financial statements
- Additional evidence would be required to ensure the auditor is happy with opinion
- We would only highlight material matters

- Need to think about the quality and reliability (as it’s internally generated)

What would we see in a management letter?

See attached.
Overall review of the financial statements – the checklist

- Review for compliance with CA and accounting standards – use checklist.
- Consider whether financial statements reasonable – use analytical procedures.
- Consider whether sufficient appropriate audit work has been obtained.
- Management representation letter
- Going concern review
- Subsequent review

Going concern ISA 570

- Prepare the financial statements on the going concern basis if business is expected to continue for the foreseeable future.
- Otherwise use the break-up basis.
- Audit questions may test going concern at any stage of the audit.

Planning questions
- Identify risks.
- Use the information given to identify going concern problems

Evidence questions
Actions an auditor can carry out to determine whether the entity is a going concern.

The auditors could do the following audit procedures

- Review management’s plans for future actions based on its going concern basis.
- Seek written representation from management regarding its plans for future action.
- Obtain information from company bankers regarding continuance of loan facilities.
- Review receivables ageing analysis to determine whether there is an increase in days – which may also indicate cash flow problems. Review future orders coming in
- Look at cash flow forecasts for the twelve months to identify if they have enough cash to trade.
- Review long term contracts for loss of business when the contracts come up for tender
- Look at articles on and negative press, which would have an impact on the goodwill of the company and therefore potentially create a going concern issue.
- Review legislation that the company has to comply with and ensure they are complying.
- Discuss with the lawyers the possible outcome and expected costs

Indicators of going concern problems

Financial:

- Liabilities > assets/net current liabilities
- Necessary borrowing facilities not agreed
- Breach of loan agreement/covenants
- Normal trade credit terms refused by suppliers
- Behind with paying staff
- Behind with tax payments
- Major cash outflows
- Legal claims against the company

**Operational:**
- Fundamental market/technological changes
- Loss of key management / suppliers / customers / product
- Over reliance on small number of products and staff

**Accounting Principle**

<table>
<thead>
<tr>
<th>Director</th>
<th>Auditor</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) To satisfy themselves that it is appropriate to adopt the going concern basis</td>
<td>(a) To make enquiries of directors and examine information</td>
</tr>
<tr>
<td>(b) To include such disclosures in financial statements (FS) as are necessary for true and fair (T&amp;F) view</td>
<td>(b) To plan and perform audit procedures to identify matters</td>
</tr>
<tr>
<td>(c) To determine and document his concerns</td>
<td>(c) To determine and document his concerns</td>
</tr>
<tr>
<td>(d) To consider disclosure required to give true and fair (T&amp;F) view – issue of appropriate opinion</td>
<td>(d) To consider disclosure required to give true and fair (T&amp;F) view – issue of appropriate opinion</td>
</tr>
</tbody>
</table>

**Reporting questions**

<table>
<thead>
<tr>
<th>What have directors done?</th>
<th>What do auditors think?</th>
<th>Audit opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Used going concern basis</td>
<td>Disagree</td>
<td>Adverse opinion</td>
</tr>
<tr>
<td>Used break up basis</td>
<td>Agree</td>
<td>Unqualified opinion with emphasis of matter</td>
</tr>
</tbody>
</table>
| Used going concern basis | Going concern status uncertain (significant uncertainty) | If adequately disclosed:  
  - Unqualified opinion  
  - With emphasis of matter  
  If not adequately disclosed  
  - Material disagreement |
• Except for opinion
Subsequent events ISA 560

Audit report issued

Active duty to design audit procedures to obtain sufficient, appropriate evidence.

Basically part of the audit as usual and if there is a problem may lead to a modified audit report.

No active duty but should take action if become aware the financial statements need to be modified.

Consider implications for audit report.

If directors don’t modify FS consider
• Speaking at AGM
• Seek legal advice
• Resignation

If a material subsequent event has happened then there are two possible outcomes

**Adjusting**

Events that provide additional evidence relating to the **conditions existing** at the time of the balance sheet date.

E.g
- Bad debts
- Credit notes
- Inventory sold lower than cost
- Legal costs relating to an incident that happened before the year end.

**Non Adjusting**

Events that provide additional evidence relating to the **conditions** which **arise after** the balance sheet date.

E.g
- Floods

BUT

If the incident is so major we have a going concern issue then it will most likely become an adjusting event.
Subsequent event audit procedures

- Enquire and discuss
- Review minutes of meeting
- Review budget cashflows
- Obtain a letter of representation
- Obtain information from press releases
- Review working papers – if any
- Do more testing
- Review afterdate transactions
QUALITY CONTROL

Why have QC procedures? (ISA 220)

- To reduce audit risk.
- To maintain high standards of audit work.
- To measure the quality of audit work.
- To ensure the standard of work is acceptable to the firm.
- To reduce the risk of negligence claims and disciplinary action.

What is QC?

<table>
<thead>
<tr>
<th>Direction</th>
<th>Engagement partner has overall responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Selects the appropriate staff</td>
</tr>
<tr>
<td></td>
<td>Confirms independence of staff</td>
</tr>
<tr>
<td></td>
<td>Arranges QC reviews</td>
</tr>
</tbody>
</table>

| Supervision     | Inform staff of their responsibilities        |
|                 | Explain the objective of their work           |
|                 | Explain the nature of the business            |
|                 | Address significant audit issues              |
|                 | Identify the audit approach                   |

| Review          | Work done in accordance with standards        |
|                 | Significant matters have been raised         |
|                 | Revision of nature, extent and timing if necessary |
|                 | Consultations have taken place                |
|                 | Work documented supports opinion              |
|                 | Sufficient appropriate audit evidence has been obtained |
|                 | Objectives have been achieved                 |

Hot and cold review

<table>
<thead>
<tr>
<th></th>
<th>Hot review</th>
<th>Cold review</th>
</tr>
</thead>
<tbody>
<tr>
<td>When</td>
<td>Before issuing audit opinion</td>
<td>After sign-off</td>
</tr>
<tr>
<td>On which audits</td>
<td>High risk e.g. public interest, listed</td>
<td>A sample of clients</td>
</tr>
<tr>
<td>Purpose of the review</td>
<td>Prevent an inappropriate opinion being issued</td>
<td>Check compliance with firm’s procedures, and identify lapses so</td>
</tr>
</tbody>
</table>
Working papers (ISA 230)

• Why have working papers?
  o Assist in audit planning.
  o Assist with supervision and review.
  o Record the evidence to support the audit opinion.

• What would you see on a working paper?
  o Client name
  o Period end
  o Prepared by and dated
  o Reviewed by and dated
  o Subject
  o Cross reference
  o Key

Safe custody of working papers

• What procedures would you do to ensure safe custody of working papers
  o Locked away
  o Passwords
  o Restricted access
  o Filled away if not required
  o Not to take home
  o Back up
Key elements of audit reports ISA 700

- Title
- Addressee
- Introductory paragraph
- Disclaimer
- Statement of responsibilities
- Basis of opinion
- Opinion
- Signature
- Date

Note that non-audit assurance reports will have similar contents.

Opinion

- Truth and fairness.
- Properly prepared in accordance with IAS
- Properly prepared in accordance with national rules
- Directors’ report consistent with the financial statements.
- In UK also report on RAPID.

Deciding on the audit opinion

Look at the decision tree.
The importance

- To ensure companies are run well in the interests of their shareholders

The Board

The key responsibilities of the board are:

- Reviewing and guiding corporate strategy;
- Monitoring the effectiveness of the company’s governance practices and making changes as needed;
- Selecting, compensating, monitoring and, when necessary, replacing key executives;
- Aligning key executives and board remuneration;
- Monitoring and managing potential conflicts of interest of management, board members and shareholders;
- Ensuring the integrity of the corporation’s accounting and financial reporting systems, overseeing the process of disclosure and communications; and

Composition

- Chief Executive Officer should be different to Board Chairman
- A balance of Executive and Non-executive

Audit Committees

Composition

- 3 non executives
- At least 1 with financial expertise

Objectives

- Public confidence in the credibility and objectivity of published financial information
- Assisting directors in meeting their responsibilities in respect of financial reporting
- Liaison with external auditors

Function

- Monitoring integrity of the financial statements
- Reviewing internal financial controls
- Monitoring and reviewing internal audit functions
- Making recommendations re: appointment, removal and remuneration of the external auditor
- Reviewing and monitoring the external auditor’s independence and objectivity and the effectiveness of the audit process
- Developing and implementing policy on the engagement of the external auditor to supply non-audit services
- Reviewing arrangements for confidential reporting by employees and investigation of possible improprieties – whistle blowing
Advantages

It may improve the quality of management accounting, as it is well placed to criticise internal functions

It should lead to better communication between the directors, external auditors and management

Disadvantages

Fear that their purpose is to catch management out

Non-executive directors being overburdened with detail

Additional cost in terms, at least, of time involved

The audit committee and internal audit

The audit committee should:

- Ensure internal auditor has direct access to the board chairman and to the audit committee
- Review and assess the annual internal audit work plan
- Receive reports on the results of internal audit work
- Review management’s responsiveness to the internal auditor’s findings and recommendations
- Meet with the head of internal audit without the presence of management
- Monitor the effectiveness of internal audit

REMEMBER ALSO:

- The nomination/appointment committee (Non-executive)
- The remuneration committee (Non-executive)
- Risk committee

Risk Management

All companies face risks of many kinds.

Companies must address the risk issues and:

- Identify the risk faced (e.g. operational, financial, legal)
- May maintain a risk register
- Assess the relative importance of each risk
- Sometimes accept the risk as an inevitable part of its operations
To work, the internal audit department must be:

- Sufficiently resourced
- Well organised
- Independent and objective

**Limitations of the internal audit function**

The main limitations of internal audit are:

- Independence (or lack of)
- Variation of standards – relatively new profession

**Consideration of outsourcing the internal audit function**

Possible advantages:

- Focus on cost and efficiency of the internal audit function
- Staff have broader range of expertise
- Risk of staff turnover passed to the outsourcing firm
- Specialist skills readily available
- Avoids costs of employing permanent staff
- Improves independence
- Access to new market place technologies
- Reduced management time in administering an in-house department

Possible disadvantages:

- Pressure on independence of outsourced function
- Lack of knowledge and understanding of the organisation’s objectives, culture or business
- Decisions may be based on cost not effectiveness
- Flexibility and availability lower than in-house function
- Lack of control over standard of service
- Risk of blurring of roles of internal and external audit

**Internal audit assignment**

**The general approach**

Identify key risk areas (transfer risk, reduce and accept)
Are there any procedures to mitigate the risk?
Are the procedures being followed?
Are the procedures effective?
Report and recommend

**Value for money audits**

3 Es

- Economy – least cost
- Efficiency – best use of resources
• Effectiveness – best results

To get the best value adopt the 4Cs:
• Challenge
• Compare
• Consult
• Compete

Audit of information technology
• Do the systems provide a reliable basis for the preparation of financial statements?
• Do internal controls reduce the risk of misstatement?
• Does the system represent value for money/best value?
• Are the controls over awarding contracts for IT installations effective?

Project auditing
• Does a specific project represent value for money?
• Did the project go well?

Financial internal audit
• Do the records and evidence support financial and management reporting?
• Are there errors and/or fraud?
• Does the analysis of information identify trends and potentially significant variations from the norm?

Operational and internal audit assignments

Four of the main areas where such an approach is commonly used:

• Procurement
• Marketing
• Treasury
• Human Resources

For each area

• Are controls effective?
• Can there be improvements in efficiency / economy – the three Es of value for money audits?
Differences between

<table>
<thead>
<tr>
<th></th>
<th><strong>Scope</strong></th>
<th><strong>Approach</strong></th>
<th><strong>Responsibility</strong></th>
<th><strong>Appointed by</strong></th>
<th><strong>Status</strong></th>
<th><strong>Forms of opinion</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>External Auditor</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Determined by statue</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>To satisfy himself that the financial statements to be presented to the shareholders present a true and fair view</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>To shareholder and management</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders (usually) or directors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independent of the client company</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>True and fair view and proper preparation of accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Internal Auditor</strong></td>
<td>Determined by management</td>
<td></td>
<td></td>
<td></td>
<td>Employee of the company</td>
<td>Internal controls of the company</td>
</tr>
<tr>
<td>Not for profit organisations</td>
<td></td>
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<td>-----------------------------</td>
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</table>

Review Q54 Fringe