SUGGESTED SOLUTIONS

Q. 1 In conducting an audit of financial statements, the overall objectives of the auditor are:
(a) To obtain reasonable assurance to express opinion whether financial statements are prepared, in all material respects, in accordance with an AFRF.
(b) To report on the financial statements in accordance with auditor's findings

Q. 2 The term "True and Fair View" has not been described in law or in ISAs. Generally, true means "free from error" and fair means "free from bias".

It is generally assumed that following characteristics will make financial statements present true and fair view:

True	Fair
1. There are no errors in the financial information. 2. Financial information is correctly transferred from "*accounting records*" to the "*financial statements*". 3. Financial statements are prepared in accordance with requirements of AFRF.	Financial Statements should show following characteristics: a) Consistency (i.e. accounting policies should be consistently applied unless a change is necessary to presents fair view) b) Neutrality (e.g. accounting estimates should be reasonable) c) Substance over Form d) Completeness e) Understandability f) Relevance & Reliability

Q. 3 **Assurance Engagement:**
"Assurance engagement" means an engagement in which a practitioner (i.e. assurance provider) obtains evidence about evaluation of a subject matter against a suitable criteria, and expresses his conclusion to enhance the confidence of the intended users (other than the responsible party).

Types of Assurance Engagement:
Two types of assurance engagement are:
1. Reasonable Assurance Engagement
2. Limited Assurance Engagement

Reasonable Assurance Engagement:
1. Reasonable assurance engagement is an engagement to provide high but not absolute level of assurance. Objective is to reduce the risk to an appropriate level to provide basis for positive form of conclusion.
2. Practitioner for this engagement is appointed by shareholders.
3. Practitioner is required to be independent of client in this engagement.
4. Practitioner performs procedures, in accordance with International Standards on Auditing, to gather sufficient appropriate evidence to obtain reasonable assurance.
5. Report is provided to shareholders, which includes Positive form of conclusion.

Limited Assurance Engagement:
1. Limited assurance engagement is an engagement to provide moderate level of assurance. Objective is to reduce the risk to an appropriate level to provide basis for negative form of conclusion.
2. Practitioner for this engagement is appointed by shareholders.

3. Practitioner is required to be independent of client in this engagement.
4. Practitioner performs procedures, in accordance with International Standards on Review Engagements, to gather sufficient appropriate evidence to obtain limited assurance.
5. Report is provided to shareholders, which includes Negative form of conclusion.

Elements of Assurance Engagement:

Element	**Explanation (with respect to assurance on financial statements)**
A three party relationship	1. Intended users (the party which requires subject matter and assurance i.e. stakeholders) 2. a responsible party (the party which prepares subject matter i.e. management) and 3. a practitioner (the party which provides assurance on subject matter i.e. auditor)
A subject matter	Subject matter is the information which management is required to prepare i.e. Financial Statements
Suitable Criteria	Criteria means Framework (i.e. rules and regulations) under which financial statements are prepared e.g. GAAP or IFRS. Suitable means it should be selected appropriately.
Evidence	Evidence means information on which practitioner's conclusion is based. Every conclusion should be backed by sufficient appropriate evidence.
Written Assurance report	It is a page which is written in standard format. It includes conclusion of practitioner, and it is provided by practitioner to intended users.

Q. 4 Assurance engagement includes two types of engagement i.e. Reasonable Assurance Engagement and Limited Assurance Engagement. Audit of financial statements is an example of Reasonable Assurance Engagement in which reasonable assurance is provided.

<u>Examiners' Comments:</u>
Students confused the question with engagement letter. Even very few students wrote correctly about the audit engagement.

Q. 5

Type of Engagement	**Level of Assurance Given**
Audit	Reasonable Assurance (also called High/Positive Assurance)
Review	Limited Assurance (also called Moderate/Negative Assurance)
Agreed upon procedures	No Assurance is provided.
Compilation	No Assurance is provided.

Q. 6

	Audit	**Review**	**Agreed upon Procedures**
Objective	An engagement to provide high but not absolute level of assurance. Objective is to reduce the risk to an appropriate level to provide basis for positive form of conclusion.	An engagement to provide moderate level of assurance. Objective is to reduce the risk to an appropriate level to provide basis for negative form of conclusion.	The objective is to carry out procedures of audit nature which are specified by entity, and to report on factual findings.

Level of Assurance	Reasonable/High	Limited/Moderate/ Negative	No Assurance
Engagement Risk	Low	Moderate	Not Applicable
Report	Positive form of conclusion is expressed in Report.	Negative form of conclusion is expressed in Report.	No conclusion is expressed. Factual Findings of Procedures is included in Report.

Q. 7 **Scope of Audit:**

Scope of audit means nature, timing and extent of audit procedures which are necessary to achieve the overall objective of audit (i.e. to obtain reasonable assurance).

Scope of Audit of a listed company:

Scope of Audit is determined considering requirements of:

1) International Standards on Auditing (e.g. ISAs require auditor to express opinion on Financial Statements only).
2) Legal and Professional Requirements in a jurisdiction e.g. In Pakistan, C.O. 1984 requires auditor to express 5 opinions in addition to opinion on financial statements
3) Terms of Engagement between Auditor and Client.
4) Auditor's Professional Judgment

Examiners' Comments:
It was a routine question which was well answered by most of the students. Some students stated that only Companies Ordinance, 1984 determines the scope of audit and forgot to mention ISA, IAS, ICAP's and other local bodies pronouncement and the terms of audit engagement.

Q. 8

1. Audit enhances credibility of financial statements.
2. It facilitates in selling business or shares in business.
3. It facilitates in obtaining bank loans.
4. Most of the errors and frauds are identified as a result of audit.
5. It improves efficiency and effectiveness of operations.
6. It is a check on employees, hence deterrent to fraud.

Examiners' Comments:
It was a basic question that was well answered by the students.

Q. 9 **Distinction between absolute and reasonable assurance:**

Absolute assurance is a perfect level of assurance.
Reasonable assurance is a high but not absolute level of assurance.

Type of assurance expected in an audit:

Reasonable assurance is provided in an audit because absolute assurance can never be provided by any auditor for following reasons:

1. There are uncertainty/subjectivity/ judgments involved in preparation of financial statements. These cannot be completely eliminated.
2. There are inherent limitations of internal control.
3. Auditor has to complete the audit within reasonable time and within reasonable cost.
4. Audit procedures may not detect a sophisticated and carefully organized fraud

5. Management may not provide complete information to auditor, and auditor does not have specific legal powers e.g. power to search.
6. Auditor's procedures may be inefficient/ineffective because of poor judgments.

Alternatively, you can refer to the solution of Question # 2 of ICAP's Official Question Bank.

Exam Tip

This is a poorly drafted question with two sub-parts. As a good practice, whenever a question with sub-parts is drafted, marks are allocated to each part separately to indicate weightage to be given to each sub-part. If such a question appears in your exam, you are advised to answer each part separately and judge yourself weightage to be given.

Examiners' Comments:

Seemingly, a significant number of candidates found it to be the easiest question. This question was set to test the candidate's knowledge about the concept of absolute and reasonable assurance and their relevance in audit, and was based on ISA 200.

Most candidates answered it to a pass standard with an encouraging number obtaining 7 or more marks.

Q. 10 Not.

Auditor provides only reasonable assurance whether financial statements are free from material misstatements i.e.

1. Auditor is not responsible for immaterial errors or frauds.
2. For material errors or frauds, auditor provides only reasonable assurance (no absolute assurance because of inherent limitations of audit)

Inherent Limitations include nature of financial statements, limitations of internal control, time and cost limitations, difficulty in detecting fraud etc.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with ISAs.

Examiners' Comments:

The performance of the students was just average. Although most of them were aware of the basic answer but they failed to explain the reasons like inherent limitations of audit, reasonable and not absolute assurance. Students who discussed the reasons in an organized manner managed to get good marks.

Q. 11 Audit of a "Public company" or "Private company which is subsidiary of a public company" or "Private company with paid up capital of three million rupees or more" shall be conducted only by:

- A Chartered Accountant or
- A firm of Chartered Accountants in firms' name (provided all partners of firm are chartered accountants)

Following persons are disqualified for appointment as auditor under Companies Ordinance 1984:

1. If auditor (i.e. sole-practitioner or any partner in a firm) or his spouse or minor child holds shares in a company. However, such a person can be appointed if he discloses the fact at time of appointment and disposes shares within 90 days of appointment.

2. If auditor is indebted to the company. However following are not considered debt in this regard:
   a. sum payable up to Rs. 500,000 payable to a credit card issuer.
   b. sum payable to a utility company outstanding for 90 day.
3. If auditor is or was an employee (or officer or director) of the company in last 3 years.
4. If auditor is a partner or employee of an employee (or officer or director)of the company.
5. If auditor is Spouse of a director.
6. If auditor is a Body corporate.

Examiners' Comments:
It was a simple question based on the Knowledge of Companies Ordinance, 1984 and most of the students got above average marks in this part. ***(CA Inter, Autumn 2003)***

Q. 12 (a)

Company A:
Members will appoint auditor at Annual General Meeting of the company for the subsequent period.

Company B:
If auditors are removed before completion of term, then power to appoint auditor to fill such vacancy rests with Securities and Exchange Commission of Pakistan.

Company C:
As auditor has become disqualified and casual vacancy has arisen; Directors have authority to fill casual vacancy within 30 days (i.e. till March 14).

Company D:
As auditor has resigned and casual vacancy has arisen; Directors should have filled casual vacancy within 30 days of occurrence of casual vacancy. But this timeframe has passed, therefore, appointing authority will be SECP. Company should inform SECP within one week of its authority becoming exercisable.

(b)
In all above situations, term of office of auditor will be from date of appointment till conclusion of next AGM.

Examiners' Comments:
This was one of the easiest questions set in the paper and generally the performance of the candidates was satisfactory. However, in Part (a), in case of Company D, the students failed to appreciate that the time frame of filling out casual vacancy by directors has elapsed and authority to appoint auditors then rested with SECP. Part (b) of this question was well performed by majority with some exceptions where students related auditors' term with directors term.

Q. 13 (a)
A person becomes disqualified as auditor if he is indebted to the audit client. However, amount payable to a utility company is not considered debt if it is outstanding for 90 days or lesser period.

Therefore appointment of Farrukh & Co., Chartered Accountants is valid.

(b)

Directors can appoint first auditor of the company within 60 days of its incorporation. As 70 days have passed since incorporation, therefore, appointment of auditor can be made by members and NOT by directors.

Further, a person becomes disqualified as auditor if he is officer/director/employee of the company or has been an officer/director/employee of company in last 3 years.

If Mr. Shahid has been an employee within last 3 years, he cannot be appointed as auditor. If 3 years have passed since he left employment, he can be appointed as auditor.

(c)
A person becomes disqualified as auditor for a company if he or his spouse or his minor child holds shares in that company. The person will also be disqualified for all of its associated companies.

As proposed audit client is the associated company of company in which auditor holds share, auditor becomes disqualified unless auditor:
1. Discloses the shareholding at time of appointment, and
2. Disposes the shareholding within 90 days of appointment.

(d)
Audit of a private company whose paid-up capital is more than 3 million can be conducted by only a chartered accountant (within the meanings of CA Ordinance 1961) or a firm of chartered accountants. As Mr. Dawood is not a chartered accountants, he cannot be appointed as auditor of Najam (Pvt.) Limited.

Further, under Companies Ordinance 1984, authority to appoint auditor rests with members and not with directors.

(e)
A person becomes disqualified as auditor if he is a body corporate. As Hussain Associates (Pvt.) Limited is a body corporate, it cannot perform audit for any organization.

Further, under Companies Ordinance 1984, authority to appoint auditor rests with members and not with directors.

Alternatively, you can refer to the solution of Question # 19 of ICAP's Official Question Bank.

Q. 14 (i)
A person becomes disqualified as auditor if he is officer/director/employee of the company or has been an officer/director/employee of company in last 3 years.

If Zakir Ali has been an employee within last 3 years, he cannot be appointed as auditor. If 3 years have passed since he left employment, he can be appointed as auditor.

(ii)
A person becomes disqualified as auditor if he is a body corporate. As Diamond Associates (Pvt) Limited is a body corporate, it cannot perform audit for any organization.

(iii)

A person becomes disqualified as auditor if he is employee/partner of an officer/director/employee of company. However, as Miss Fatima has left employment of company's director two months before the offer, she can be appointed as auditor of the Neelam Limited.

(iv)
Mr. Farid Hussain is a partner of Farid & Company, Chartered Accountants. The firm has been offered appointment in Feroza Limited as external auditor. Son of Mr. Farid holds shares of Feroza Limited.

A person cannot be appointed as auditor of the company if he or his spouse or minor children holds any shares in a company.
If son of Mr. Farid Hussain has attained age of majority, Mr. Faird Hussain can be appointed as auditor of Feroza Limited. However, if son is minor, Mr. Farid Hussain auditor becomes disqualified unless he:
1. Discloses the shareholding at time of appointment, and
2. Disposes the shareholding within 90 days of appointment.

Examiners' Comments:
Legal provisions regarding appointment of statutory auditor is a topic regularly asked and was attempted fairly by most students. The general deficiencies noted in the answers were as follows:
- *The time lapse after which an ex-employee can become an external auditor was not mentioned.*
- *There were many examinees who said that a private limited company having paid up capital less than rupees three million can appoint, even a body corporate, as its auditors.*
- *There was a general misconception that an ex-employee of a director also needs a time lapse of three years for appointment as an external auditor.*
- *Very few students knew that if shares are held by the minor son of a person, he cannot accept appointment as an external auditor. There is no such restriction if the son has attained the age of majority.*

Q. 15 (a)
A person becomes disqualified as auditor if he is indebted to the audit client. However, amount payable on a credit card is not considered debt if it is outstanding upto Rs. 500,000.

As none of credit card has amount exceeding Rs. 500,000, therefore, appointment of firm is valid under Companies Ordinance 1984.

(b)
Status of Companies i.e. Banana Limited and Water Melon Limited:
A director in Banana Limited (nominated by Govt) holds more than 20% shares in Water Melon Limited. However, both companies do not become associated companies because directors nominated by government are not considered in determining the status of associated companies.

Therefore, shareholding by spouse of partner in Water Melon Limited does not disqualify firm for appointment as auditor of Banana Limited. Hence, appointment is valid.

(c)
Audit of following companies is required to be conducted only by a chartered accountant or firm of chartered accountants:
1. Public company
2. A private company which is subsidiary of public company

3. A private company whose paid up capital is three million or more.

Status of LPL:
1. LPL is not a public company.
2. JPL is not a subsidiary of any public company (listed company holds only 40% shares in LPL)
3. Paid up capital of JPL is less than three million.

Therefore, Mr. Zaheer is legally qualified to act as auditor of LPL.

(d)
Walnut and Company should take following steps before accepting the engagement:
- communicate with predecessor auditor (to know if there is any reason that threaten compliance with ethical or legal principles) with permission of client.
- should inform Institute about the offer of appointment.
- should not accept the offer without prior clearance from the Institute.

(e)
A person becomes disqualified as auditor if he is officer/director/employee of the company or has been an officer/director/employee of company in last 3 years.

As Mr. Sadiq has been a director of audit client in preceding 3 years (to be counted from date of appointment i.e. 31 August 2011), hence, the firm cannot be appointed as auditor of company.

Directors nominated by Government are not considered to determine status of associated company, however, such directors are disqualified to act as auditor of company.

Alternatively, you can refer to the solution of Question # 24 of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>
In this question the students were supposed to give their views on five different situations with reference to appointment of auditor. Most of the students seemed to have studied the related guidelines and scored high marks. The errors were mostly in respect of the following:
• Some students gave the decision without any reasoning.
• In part (d), many students did not specify that in the given situation the incoming auditor was also required to obtain prior clearance from the Institute of Chartered Accountants of Pakistan.
• Only few students knew that there is no specific qualification for auditors of private companies having paid-up capital of less than Rs. 3 million.

Q. 16 **(i) Safe Bank Limited**
A person becomes disqualified as auditor if he becomes indebted to the audit client. Indebtedness includes lease arrangements (whether operating or finance) and credit card facility (exceeding Rs. 500,000).

If firms want to accept audit engagement, it will have to fulfil following conditions:
1. Terminate the lease agreement and settle outstanding amounts, and
2. Reduce the outstanding balance of credit card holders to Rs. 500,000 or less.

(ii) Pride Communication Limited (PCL)

A person becomes disqualified as auditor if he is officer/director/employee of the company or has been an officer/director/employee of company in last 3 years. Director in this context includes directors nominated by federal/provincial government.

If firms want to accept audit engagement, it will have to ensure that 3 years have passed since the partner resigned from client. If less than 3 years have passed, firm will have to remove the relevant partner from partnership.

(iii) Gama Limited
A person becomes disqualified as auditor for a company if he holds shares in that company. The person will also be disqualified for all of its associated companies.

As Gama Limited is the associated company of Beta Limited, hence auditor is disqualified for Gama limited as well.
If firms want to accept audit engagement, it will have to fulfill following conditions:
1. Disclose the shareholding at time of appointment, and
2. Dispose the shareholding within 90 days of appointment.

Alternatively, you can refer to the solution of Question # 1 of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>
Three situations were given in the question and in each case the students were required to determine and explain whether the auditor can accept appointment offered by the prospective clients. Although many students were well prepared for such questions, a large number also displayed poor knowledge and understanding of relevant provisions contained in the Companies Ordinance, 1984.
Many students failed to explain the following:
(i) The firm cannot be appointed as auditor of the company unless the lease agreement is terminated and credit card balance of the partners is reduced to Rs. 500,000 or less.
(ii) A director can be appointed as external auditor of the company three years after the date on which he ceases to be a director of the company. Therefore, it was only possible for the firm to accept the appointment if the concerned partner resigned from the firm.
(iii) The firm can accept appointment as auditor of a company if a partner of the firm holds shares in the associated undertaking of that company, provided he disposes off the shares within ninety days of appointment. Some of the students gave reasons because of which the firm may not accept appointment as auditors, but did not explain as to what it should do if it did want to accept the appointment. Many of the students could not produce exact answers i.e. in the third situation they explained that the concerned partners will have to dispose of the shares but did not mention that such disposal can be made within 90 days of appointment.

Q. 17 (a) All three companies DKL, ML and KL are associated companies. If auditor holds shares in ML. he will be disqualified to act as auditor of ML as well as all of its associated companies i.e. DKL and KL unless he:
1. Discloses the shareholding at time of appointment, and
2. Disposes the shareholding within 90 days of appointment.

(b)
Status of IJK and LMN:
LMN holds 2 million ordinary shares out of total 13 million i.e. 15.38%. As the shareholding is below 20% hence both companies are NOT associated companies. (non-voting shares are not considered in this regard).

Faryal as director and shareholder in LMN:
As LMN and IJK are not associated companies, therefore directorship/shareholding of spouse of auditor in LMN does not disqualify auditor for IJK. Therefore, appointment is valid.

Alternatively, you can refer to the solution of Question # 1 of ICAP's Official Question Bank.

Examiners' Comments:
In this question, the candidates were required to comment on two independent situations pertaining to appointment of auditors.
(a) Generally, the students answered well. However, some of them mentioned different types of safeguards which were not relevant in the given situation as the only remedy available in such a situation is to dispose of the shares of the subsidiary or to decline the offer of appointment as auditors.
(b) The key issue which was tested in this part of the question was whether holding of non–voting shares is relevant in determining that the two companies are associated companies or not. Majority of the students did not seem to know the answer and tried to avoid this point.

Q. 18 (a)
Preconditions for an audit means:
1. use by management of an acceptable financial reporting framework in the preparation of the financial statements and
2. agreement of management and TCWG to the premise on which an audit is conducted.

(b)

Preconditions	Procedure to establish Precondition
AFRF is acceptable.	Auditor shall consider following factors in determining whether AFRF is acceptable. – nature of entity – nature of F/S – purpose of F/S – legal requirements
Management agrees to the Premise on which audit is conducted	Auditor shall obtain agreement of management (via engagement letter) that it understands and acknowledges its responsibilities i.e. management understands and accepts it responsibilities: a) For the preparation of financial statements in accordance with AFRF; and for true and fair view of financial statements (if fair presentation framework is used). b) For such internal control system which is necessary to prepare financial statements in accordance with AFRF; and c) To provide the auditor with: i. Access to all information relevant to the preparation of the financial statements of which management is aware; ii. Additional information that the auditor may request from management for the purpose of the audit engagement; and iii. Unrestricted access to persons within the entity to obtain audit evidence.

(c)

Preconditions	**Auditor's Course of Action if Precondition is Not Present**
AFRF is acceptable.	If AFRF is not acceptable, auditor can accept engagement only if following conditions are met: 1. AFRF is required by law, and 2. Management agrees to provide additional disclosure in financial statements (to avoid F/S being misleading), and 3. It is mentioned in Engagement Letter that auditor's report: ▪ will include Emphasis of Matter paragraph (to draw users' attention towards additional disclosure) ▪ will not include phrases "give a true and fair view" or "present fairly, in all material respects".
Management agrees on Premise of Audit	If management does not agree on premise of audit, auditor shall not accept the proposed audit engagement.

Alternatively, you can refer to the solution of Question # 23 of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>
(a) Most of the candidates identified the appropriate preconditions for audit and started well in the question. However, due to lack of grip over auditing standards many students were found deviating from the preconditions listed in ISA-210.
(b) The overall performance of a large number of students was good. However, most of them were confused between 'acceptable' and 'applicable' financial reporting framework.
(c) Most students said that if a precondition for an audit is not present, the auditor should not accept the assignment. Consequently, very few students could explain as to what the auditor should do if he has to accept the audit on account of application of any law or regulation.

Q. 19 *Refer to the solution of Question # 16a of ICAP's Official Question Bank.*

<u>Examiners' Comments:</u>
Students performed well in this part and were able to list down the principal contents of an audit engagement letter enumerated in para 6 of ISA 210.

Q. 20 **(a)**

Acceptance and Continuance Procedures are still to be performed even if we have been auditor of the client for past many years.

Following matters are considered in assessing acceptance and continuance of client relation:

Acceptance & Continuance Procedure	**Matters to Consider**
Evaluate competence, capability and objectivity of firm to perform the engagement.	1. Firm has sufficient personnel. 2. Firm has sufficient time to complete the engagement within reporting deadline. 3. Firm personnel have relevant knowledge/expertise, ***or*** have ability to gain them. 4. External Expert, Component Auditor, Quality Control Reviewers are available (if required)

	5. Firm and engagement team are independent of client. 6. Other significant matters arisen during other engagements with client
Evaluate integrity of management	1. Reason for change in auditors. 2.Indication of inappropriate scope limitation/disagreement by management. 3.Reputation of client's owners, key management, TCWG and related parties. 4.Indication of involvement of client in criminal and fraudulent activities 5.Nature of client's operations, financial position of client 6. Competence of management 7. Attitude of owners, key management and TCWG towards accounting standards and internal control. 8. Whether firm's fee is reasonable or not.
Establish preconditions for audit	1. Whether AFRF is acceptable. 2. Obtain Agreement of Management that it acknowledges and understands its responsibilities

(b)

For a *recurring audit*, it is not required to send engagement letter every year. However, it may be appropriate to send fresh engagement letter on recurring audit (to remind client of existing terms or to revise the terms) when there is:

1) Legal requirements.
2) Any indication that client misunderstands the objective and scope of the audit.
3) Any major change in entity's
   - Ownership.
   - Senior management.
4) Any major change in entity's
   - Nature or size of business.
   - Applicable Financial reporting framework.
5) Changes in terms of engagement

Alternatively, you can refer to the solution of Question # 17 of ICAP's Official Question Bank.

Examiners' Comments:

While a good proportion of answers submitted were concise and correct, it was apparent that few candidates did not bother to understand the exact requirement of the question and drafted a standard engagement letter. Those who may have done so deliberately because they didn't know the answer to the actual question, are advised that such a practice does not benefit them in any way. In fact it results in wastage of time which could otherwise be utilized in improving the answers to other questions.

Q. 21 Following matters are required to be documented in every engagement letter:

a) The objective and scope of the audit;
b) The responsibilities of management;
c) Identification of the AFRF;
d) The responsibilities of the auditor;
e) Reference to the expected form and content of Reports to be issued by the auditor and
f) A statement that there may be circumstances in which a report may be different from its expected form and content.

Alternatively, you can refer to the solution of Question # 28 of ICAP's Official Question Bank.

Examiners' Comments:
This was an easy question and the students were able to fulfill the requirement of the question. However, some students wasted time in writing the entire engagement letter or giving further details about each key component.

Q. 22 (a) Management can request auditor to change terms of audit engagement in following circumstances:

1. Change in circumstances affecting need for audit.
2. A misunderstanding of client about nature of audit.
3. Limitation on scope of audit (whether imposed by management or by circumstances)

(b) Auditor shall consider following factors before accepting change:

1. Whether there is a reasonable justification for the change.
    a. A change in considered reasonable if it is due to change in circumstances affecting need for audit *or* a misunderstanding of client about nature of audit.
    b. A change in considered unreasonable if it is due to incomplete/incorrect information (indicating scope limitation or risk of fraud)
2. Legal or Contractual implications of the change (i.e. change should not violate any legal or contractual requirements)

(c) If auditor does not accept the change, he shall continue to perform the audit engagement as per original terms of engagement. If management does not permit auditor to perform original engagement, it will be similar to scope limitation and auditor shall:

- Withdraw from engagement if possible and practicable.
- Consider whether there is any professional or legal requirements to communicate to appointing persons or regulatory authorities about withdrawal and reason of withdrawal.

Alternatively, you can refer to the solution of Question # 27 of ICAP's Official Question Bank.

Examiners' Comments:
Most students did not seem to have adequate knowledge of the Auditing Standard.
(a) In part (a) there was too much elaboration of change in circumstances, like change in management, ownership and/or business whereas following factors were rarely mentioned:
• Misunderstanding about the original assignment.
• Restriction on the scope of an audit engagement, whether caused by management or caused by other circumstances.
(b) The following points were hardly mentioned:
(i) The information in respect of which the change is requested by the management.
(ii) Legal or contractual implication of the change.
(c) The performance in Part (c) was much better and most students were able to mention that if a change in terms of engagement is not acceptable to the auditor he may consider withdrawing from the engagement or to report the matter to those charged with governance or to the regulator.

Q. 23 Whenever auditor is asked by client to revise terms of engagement during audit, auditor shall consider following factors before accepting change:

1. Whether there is a reasonable justification for the change.
2. Legal or Contractual implications of the change.

As certain problems have been identified for which no satisfactory replies have been given by the client, it seems that this change in engagement is due to incorrect or incomplete information and client wants to avoid qualified opinion by changing terms of engagement.

In this situation, auditor should continue to perform the audit engagement as per original terms of engagement. If management of Clever Limited does not permit auditor to perform original engagement, it will be similar to scope limitation and auditor shall:

- Withdraw from engagement if possible and practicable.
- Consider whether there is any professional or legal requirements to communicate to appointing persons or regulatory authorities about withdrawal and reason of withdrawal.

Examiners' Comments:
It was a situation-based question that required understanding of ISA. Instead of analyzing the whole situation and different aspects involved, students usually addressed any one aspect given in the question and therefore, could not get good marks. For example, many students managed to understand that the auditors have faced limitations by the client but they did not discuss the change of scope aspect.

Q. 24 *(a)*

Audit Strategy	**Audit Plan**
Audit Strategy means deciding about Scope, Timing and Direction of whole/overall audit.	Audit Plan means nature, timing and extent of audit procedures to be performed to obtain evidence on individual elements of financial statements.
Audit strategy developed is applicable on whole audit.	Separate audit plan is developed for each area of financial statements.
It addresses the issues at financial statement level.	It addresses the issues at assertion level.
It is initial planning, which guides development of audit plan.	Audit Plan is developed after audit strategy and is detailed form than audit strategy.

(b)
For an initial audit engagement, additional matters/activities that auditor may consider in establishing the overall audit strategy and audit plan include the following:

1. Performing Acceptance Procedures as required by ISA 220
2. Discussion with management on any major issue (including application of accounting or auditing standards) in connection with change of auditor
3. Communication with predecessor auditor (in accordance with code of ethics)
4. Arrangements to review working papers of predecessor auditor
5. Procedures to obtain sufficient appropriate audit evidence regarding opening balance

Other procedures in accordance with firm's quality control procedures

Alternatively, you can refer to the solution of Question # 22 of ICAP's Official Question Bank.

Q. 25 **(a)**

Audit Strategy	**Audit Plan**
Audit Strategy means deciding about Scope, Timing and Direction of whole/overall audit.	Audit Plan means nature, timing and extent of audit procedures to be performed to obtain evidence on individual elements of financial statements.
Audit strategy developed is applicable on whole audit.	Separate audit plan is developed for each area of financial statements.

It addresses the issues at financial statement level.	It addresses the issues at assertion level.
It is initial planning, which guides development of audit plan.	Audit Plan is developed after audit strategy and is detailed form than audit strategy.

(b)
Overall Audit Strategy:
Characteristics of the Engagement: ***(Scope)***

- Financial Reporting Framework
- Industry-specific reporting requirements
- Nature of business (considering need of specialized knowledge).
- Effect of information technology on the audit procedures (understanding of IT system and its Controls will also be obtained)

Reporting objectives, Timing of the Audit and Nature of Communication: ***(Timing)***

- Entity's timetable for reporting
- Organization of meeting with TCWG and Management to discuss important matters of audit.
- Discussion with management regarding expected type and time of auditor's report to be issued and other communication (e.g. Management Letter, Communication with TCWG)

Significant matters directing engagement team and preliminary engagement activities: ***(Direction)***

- With respect to entity
  - Understanding of Entity and its environment
  - Understanding of different accounting system of entity
- With respect to risk
  - Risk at Financial Statement Level.
  - Risk at Assertion Level.
- With respect to Internal Controls
  - Understanding of design, implementation and operating effectiveness of internal control.
  - Internal control deficiencies identified.
  - Whether or not to rely on internal control (this decision will significantly affect audit procedure).
- With respect to materiality:
  - Overall Materiality
  - Materiality for particular areas of financial statements.

Nature, timing and extent of resources:

- Engagement Budgeting
- Selection of the engagement team (including Quality Control Reviewer) and assignment of audit work to members

Audit Plan:

a) The nature, timing and extent of planned risk assessment procedures
b) The nature, timing and extent of planned further audit procedures at assertion level
c) Other planned audit procedures to comply with requirements of ISAs (e.g. extended procedures required by ISA 240)

Q. 26 (a)

In an audit of financial statements, management (and where applicable TCWG) is responsible:

1. For the preparation of financial statements in accordance with the AFRF; and for true and fair view of financial statements (if fair presentation framework is used), and
2. For such internal control system which is necessary to prepare financial statements in accordance with AFRF.

Preparation of financial statements requires management to:

1. Identify AFRF
2. Prepare financial statements in accordance with AFRF
3. Describe AFRF in notes to the accounts.
4. Exercise judgments in making reasonable accounting estimates in accordance with AFRF.
5. Select and apply appropriate accounting policies in accordance with AFRF.

(b)

Audit Skepticism:

Professional skepticism means not to accept management assertion without corroboration. It is an attitude which includes:

- questioning mind (recognizing that there ***may be*** a material misstatement in financial statements), and
- critical assessment of audit evidence.

Elaboration on the response of the audit team manager:

Viewpoint expressed by member of the audit team is Incorrect, and is not agreed. However viewpoint expressed by audit manager is correct and is agreed.

Though Professional skepticism does not disregard past experience about competence and integrity of management; but auditor should be aware that each audit is independent from previous audit. Circumstances, events, conditions change day by day so there may be more and different situations and risks in this audit than they were in previous audit.

A belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.

Alternatively, you can refer to the solution of Question # 4 of ICAP's Official Question Bank.

Q. 27 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 28 *Refer to the solution of Question # 29 of ICAP's Official Question Bank.*

Q. 29 **Risk Assessment Procedures:**

Risk Assessment Procedures are procedures to obtain understanding of the entity and its internal control to assess the risk of material misstatement at financial statement level and at assertion level.

Auditor shall perform following risk assessment procedures to obtain understanding of entity and its internal control:

Risk Assessment Procedures:

1) Inquiries of Management, TCWG and others within the entity

2) Observation (e.g. Walk-through tests)
3) Inspection of records or documents (e.g. of Standard Operating Procedures)
4) Analytical procedures

Related Activities:

i. Discussion among engagement team
ii. Other Related Activities (e.g. Information obtained from Acceptance & Continuance Procedures, from Other non-assurance engagements, from Prior periods, from external sources etc.)

Q. 30 (i)

Risk assessment procedures are performed at the planning stage of an audit to obtain an understanding of the entity and its environment. The purpose is to assess the risks of material misstatement at the financial statements and assertion levels so as to determine the audit strategy. They assist the auditor to determine the nature, timing and extent of audit procedures to be performed.

(ii)

Tests of controls are tests performed to obtain audit evidence about the effectiveness of the:

- Design of the accounting and internal control system for the prevention, detection and correction of material misstatements.
- Operation of internal controls throughout the period.

(iii)

Substantive procedures are tests performed by the auditor to detect material misstatements in the financial statements and the tests include:

- Tests of details of transactions, account balances and disclosures, and
- Substantive analytical procedures.

Q. 31 Materiality and Risk have inverse relationship between them e.g. if risk is higher in an audit, lower materiality level will be set which result in increased audit procedures to reduce the risk.

Q. 32 (a)

Materiality:

Misstatements, including omissions, are material if they, individually or in aggregate, influence the economic decisions of users taken on the basis of financial statements.
Materiality depends on size as well as nature of misstatement.

Examples of Qualitative Materiality:

1. Non-compliance of regulatory requirements (e.g money laundering).
2. Key Performance Indicators of the company (e.g. converting loss into profit).

(b)

Auditor considers materiality throughout the audit i.e.

1. Planning Stage
   - In Risk Assessment (to assess significance of risk in different areas)
   - In designing Audit Plan (to determine nature, timing and extent of audit procedures to be performed)
2. Performance Stage

- To evaluate whether misstatements identified during the audit are material or not on *individual basis*.

3. Reporting Stage
   - To evaluate whether uncorrected misstatements identified during the audit are material or not on *aggregate basis*.

Examiners' Comments:
It appears that it was the most difficult question for the students in the paper. Even very few students wrote the definition of materiality in a proper way. Apart from the definition of materiality, the students were mostly making wild guesses. Very few students managed to get passing marks in this question.

Q. 33 Materiality is defined in ISA 320 as follows:
'Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.' Auditor must consider both the amount (quantity) and the nature (quality) of any misstatements, or a combination of both.

'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.'

Q. 34
- Consider the implications for the financial statements
- Could result in fines for the company which have implications for provisions (if probable) or a contingent liability disclosure (if possible)
- If material and provision or disclosure not made qualify audit report
- It also affect integrity of management and increases risk of material misstatement
- May even have going concern implications if there is a risk of closure by the Regulator

Q. 35 **Business Risk:**
A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives.
Business risk is broader than audit risk and arises from change or complexity.

Q. 36 **Audit Risk:**
It is the risk that auditor expresses an inappropriate opinion when financial statements are materially misstated.

Inherent Risk:
The probability that material misstatements (*material individually or in aggregate*) will occur in financial statements before consideration of any related controls.
Inherent risk arises from factors e.g. entity's environment, nature of business, nature of transactions.
Control Risk:
The probability that material misstatements (*material individually or in aggregate*) will occur in financial statements and will not be detected or corrected, on a timely basis by the entity's internal control.

Detection Risk:
The risk that auditor will not be able to detect a material misstatement (*material individually or in aggregate*) in financial statements by his audit procedures.

Q. 37 *(a)*
Objectives/Benefits:
1. More experienced members share their insights based on their knowledge of the entity.
2. Team members exchange information about the business risks of entity and how financial statements may be misstated.
3. Team members gain a better understanding of audit risk in specific areas assigned to them, and how the results of their work can affect other aspects of audit.
4. Team members communicate and share new information obtained throughout the audit that may affect the audit risk or audit procedures

(b)
Risk of material misstatement is higher in non-routine transactions because of following reasons:
- Lack of effective controls over such risks (as these are not a part of normal flow of transactions)
- Specialized skills may be needed to perform the activity.
- Greater manual intervention for data collection and processing.
- Greater management intervention to specify accounting treatment.

Risk of material misstatement is higher in judgmental matters because:
- They involve management's judgments or assumptions
- There may be different interpretations of accounting principles in this regard.

Alternatively, you can refer to the solution of Question # 25 of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>
(a) In general the students had an idea that appropriate and effective discussion should take place amongst team members. However, about half the students produced to the point and relevant material whereas the rest relied on general discussion which contained few of the relevant points with a lot of repetition as well as irrelevant material also.
(b)
Most of the students were able to describe non-routine transactions as well as judgmental matters. However, some of them described judgmental matters as "Judgments taken by the auditor".

Q. 38 Going concern issues e.g.:
- Loss of significant customers
- Constraint on availability of capital and loan

Operations in:
- New/Growing/Changing markets (e.g. expansion through new products or new locations)
- Markets with high degree of regulation/competition
- Unstable markets/countries.
- Likely to be sold segment

Complex business structure e.g.:
- Off balance sheet financing
- Special purpose entities
- Significant transactions with related parties

Changes in Systems:
- Installation of new IT system
- Changes in accounting/regulatory requirements

Lack of Appropriate Personnel e.g.
- Lack of personnel with appropriate accounting skills
- Turnover in key personnel
- Deficiencies in internal control

Problems at assertion level:
- Accounts having history of errors
- Accounts involving Complex calculations, Estimates/judgments, Subjective valuation
- Significant non-routine transactions particularly at year end
- Pending litigation and contingent liabilities

Examiners' Comments:
A number of students did guess work in replying the question and could only identify one condition, that is, the weakness of accounting and internal control systems.

Q. 39

Audit risks and responses

Audit risk	Audit response
The finance director of Abrahams is planning to capitalise the full $2·2 million of development expenditure incurred. However in order to be capitalised it must meet all of the criteria under IAS 38 *Intangible Assets*.	A breakdown of the development expenditure should be reviewed and tested in detail to ensure that only projects which meet the capitalisation criteria are included as an intangible asset, with the balance being expensed.
There is a risk that some projects may not reach final development stage and hence should be expensed rather than capitalised. Intangible assets could be overstated and this risk is increased due to the loan covenant requirements to maintain a minimum level of assets.	
The inventory valuation method used by Abrahams is standard costing. This method is acceptable under IAS 2 *Inventories*; however, only if standard cost is a close approximation to actual cost.	The standard costs used for the inventory valuation should be tested in detail and compared to actual cost. If there are significant variations this should be discussed with management, to ensure that the valuation is appropriate.
Abrahams has not updated their standard costs from when the product was first developed and hence there is a risk that the standard costs could be out of date, resulting in over or undervalued inventory.	
The work in progress balance at the year end is likely to be material; however there is a risk that due to the nature of the production process the audit team may not be sufficiently qualified to assess the quantity and value of work in progress leading to misstated work in progress.	Consideration should be given as to whether an independen expert is required to value the work in progress. If so this will need to be arranged with consent from management and in time for the year-end count.
Over one-third of the warehouses of Abrahams belong to third parties. Sufficient and appropriate evidence will need to be obtained to confirm the quantities of inventory held in these locations in order to verify completeness and existence.	Additional procedures will be required to ensure that inventory quantities have been confirmed for both third party and company owned locations.
In September Abrahams Co introduced a new accounting system. This is a critical system for the accounts preparation and if there were any errors that occurred during the changeover process, these could impact on the final amounts in the trial balance.	The new system will need to be documented in full and testing should be performed over the transfer of data from the old to the new system.
The new accounting system is bespoke and the IT manager who developed it has left the company already and his replacement is not due to start until just before the year end. The accounting personnel who are using the system may have encountered problems and without the IT manager's support, errors could be occurring in the system due to a lack of knowledge and experience. This could result in significant errors arising in the financial statements.	This issue should be discussed with the finance director to understand how he is addressing this risk of misstatement. In addition, the team should remain alert throughout the audit for evidence of such errors.
Significant finance has been obtained in the year, $1 million of equity finance and $2·5 million of long-term loans. This finance needs to be accounted for correctly, with adequate disclosure made. The equity finance needs to be allocated correctly between share capital and share premium, and the loan should be presented as a non-current liability.	Check that the split of the equity finance is correct and that total financing proceeds of $3·5 million were received. In addition, the disclosures for this finance should be reviewed in detail to ensure compliance with relevant accounting standards.
The loan has a number of covenants attached to it. If these are breached then the loan would be instantly repayable and would be classified as a current liability. This could result in the company being in a net current liability position. If the company did not have sufficient cash flow to meet this loan repayment then there could be going concern implications.	Review the covenant calculations prepared by Abrahams Co and identify whether any defaults have occurred; if so then determine the effect on the company. The team should maintain their professional scepticism and be alert to the risk that assets have been overstated to ensure compliance with covenants.

The land and buildings are to be revalued at the year end, it is likely that the revaluation surplus/deficit will be material. The revaluation needs to be carried out and recorded in accordance with IAS 16 *Property, Plant and Equipment*; otherwise non-current assets may be incorrectly valued.	Review the reasonableness of the valuation and recalculate the revaluation surplus/deficit to ensure that land and buildings are correctly valued.
The reporting timetable for Abrahams Co is likely to be reduced. The previous timetable was already quite short and any further reductions will increase detection risk and place additional pressure on the team in obtaining sufficient and appropriate evidence.	The timetable should be confirmed with the finance director. If it is to be reduced then consideration should be given to performing an interim audit in late December or early January, this would then reduce the pressure on the final audit.

Q. 40

Audit risks and responses:

Audit risk	Audit response
Donald Co has ordered six planes which may not have been received by the year end. Only assets which physically exist at the year end should be included in property, plant and equipment.	Discuss with management as to whether the planes have arrived, if so then physically verify a sample of these planes to ensure existence.
The existing planes have been refurbished at a cost of $15m. This expenditure needs to be reviewed to assess whether it is of a capital nature and should be included within assets or expensed as repairs.	Review a breakdown of the costs and agree to invoices to assess the nature of the expenditure and if capital agree to inclusion within the asset register and if repairs agree to the income statement.
Donald Co has applied for a loan of $25m. It has not received this loan yet, but it has already ordered the planes and if it does not receive the money in time then it may struggle to pay for the planes ordered and this could result in going concern difficulties.	Discuss with management the status of the loan application and if still outstanding whether any other banks have been approached for the loan. Perform a detailed going concern review.
The travel agents who sell tickets on behalf of the airline are struggling to pay their outstanding balances to Donald Co. This could result in an increase in irrecoverable debts and receivables being overvalued.	Extended post year-end cash receipts testing and a review of the aged receivables ledger to be performed to assess valuation. An allowance for receivables to be discussed with management.
Donald Co's website has encountered difficulties with recording sales, this could lead to errors in relation to completeness of income.	Extended controls testing to be performed over the sales cycle to assess the extent of the errors. Detailed testing to be performed over completeness of income.
Due to the website errors tickets have been sold twice, therefore some customers will require refunds. At the year end there is a risk that the tickets to be refunded have not been removed from sales.	Review the cut-off of customer refunds around the year end to ensure that sales are complete and accurate.
Donald Co is closing its call centre and making the workforce redundant; as it has announced this to the staff then under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* a redundancy provision will be required for any staff not yet paid at the year end.	Discuss with management the status of the redundancy programme and review and recalculate the redundancy provision.

Q. 41

(i) Control Risk
(ii) Inherent Risk
(iii) Detection Risk
(iv) Control Risk
(v) Control Risk

(vi) Detection Risk
(vii) Inherent Risk
(viii) Inherent Risk
(ix) Control Risk
(x) Inherent Risk

Q. 42 *Refer to the solution of Question # 20 of ICAP's Official Question Bank.*

Q. 43
- Complexity and extent of regulation
- Significance of cash donations
- Terms and conditions attached to grants and donations/significance of restricted funds
- Uncertainty of future income meaning unpredictable relationships between expenditure and income
- Extent and nature of trading activities and whether consistent with charitable status
-Complexity of tax rules

Q. 44

Inherent Risk	**Effect on Audit**
Source of Income is donation only, which may decrease anytime specially in times of economic fall.	It will be difficult to determine appropriateness of Going Concern Assumption.
There is no control (e.g. sales invoice) that income is complete. Donation may also be stolen.	Audit procedures might not be effective to ensure completeness of income and audit report may need to be modified.
There is a risk that funds are spent outside the aims of the charity.	Careful review of expenditure will be necessary to ensure that expenditure is not '*ultra vires*' the objectives of the charity.
Complex rules of tax may cause errors in calculation of tax expense and liability.	staff familiar with the taxation rules affecting the charity should be in audit team.
Because of 10% limit, income may be overstated or Admin expense may be misclassified.	Auditor should focus on overstatement of income and understatement/misclassification of expenses.

Alternatively, you can refer to the solution of Question # 21 of ICAP's Official Question Bank.

Q. 45 *Refer to the solution of Question # 33 of ICAP's Official Question Bank.*

Examiners' Comments:
4a
Candidates were required to explain the term audit risk and then the three elements of risk that contribute to total audit risk. The question was worth 4 marks. The question requirement was for 4 explanations, so 4 marks was 1 mark per explanation. Many candidates were uncertain of these concepts and did not manage to obtain the marks on offer.
Common errors included:
– Explaining audit risk in terms of errors in the financial statements rather than inappropriate audit reports.
– Omitting to explain that inherent risk is linked to the nature of the entity.
– Stating that control risk was the problem of not identifying the risk, rather than the error or fraud because the control system was inadequate.

– Explaining detection risk as the only risk that the auditor can amend rather than the auditor not detecting errors in the books, records, financial statements, etc.
The overall standard was therefore inadequate. Certainly an area to visit again at some stage.

4b

Candidates were expected to identify areas of inherent risk in the charity scenario provided and then to explain the effect of each risk on the audit approach. The question was worth 12 marks. Given that the question requirement contained two requirement verbs, namely list and explain, and was linked to a scenario, then the mark allocation is 2 marks per point made. 1 mark was available for finding the inherent risk and 1 for explaining the effect on the audit approach. The question contained no upper limit on the number of points to make so marks could be accumulated from more than 6 points. A minority of candidates did mention more than 6 points, although most struggled to mention more than 4. The standard of answer varied considerably. It appeared that the use of a charity was marginally concerning, although this was within the bounds of the study and followed the style of the examiner from previous diets.
Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment

"Cash is collected by volunteers in a public place. The auditor will need to review the effectiveness of internal controls over this procedure."

Examiners assessment of comment

This point was typical of many. "Cash being collected by volunteers" starts to identify the risk but does not show sufficient detail; mentioning the potential for fraud shows what the risk is. The effect on the audit approach is weak, at best. The internal control system is limited to non-existent, so reviewing the effectiveness of this has little benefit. Other effects on the audit approach that could be mentioned would be the use of substantive analytical review to compare the trend of donations, or possibly observing the collectors to make sure they were not stealing donations for themselves.

Answer comment

"There are very few staff meaning that the control system will be weak".

Examiners assessment of comment

The point is potentially correct, as few staff generally means lack of segregation of duties. However, the question requirement was to identify inherent risks, not control risks, hence the point is not relevant.
Other common errors included:
– Not being able to state a clear and logical effect on the audit approach for inherent risks identified, as noted above.
– Explaining control risks such as lack of segregation of duties, as mentioned above.
– Stating the effect on the audit approach in very general terms e.g. for each point stating that "additional substantive procedures will be required." More focused comments were expected.
– In many situations, simply not stating the obvious. For example, the scenario stated that the taxation of charities was complicated in this specific jurisdiction. Many candidates explained the effect on the audit approach in terms of verifying income and expenditure to source documents, ensuring that the tax liability was paid, or even recommending the appointment of a qualified accountant at the charity to prepare the taxation computation. The obvious thing to do though was simply have a charity taxation specialist on the audit team.
Overall, this was a question that required some thinking but also use of common sense. As the last bullet point above suggested, stating the obvious for the weaknesses mentioned in the scenario would have provided some benefit to many candidates. The standard was therefore inadequate.

4c

Candidates were required to explain why the control environment may be weak in the charity in the question scenario. The question was worth 4 marks. 4 points would therefore obtain the 4

marks on offer. The aim of the question was to try and get candidates to think about the bigger "control environment" issues within the entity. The relatively low mark allocation was to recognise that the question was actually quite difficult as candidates are more used to looking for detailed control weaknesses (see question 1b in this paper).
Common errors included:
– Re-stating points from part (b) as also relevant to part (c). For example, suggesting that cash collection tins should be sealed donations could be recorded incorrectly.
– Omitting the question completely from the candidate's answer.
The standard of answers for this question was inadequate. In any similar question in the future, candidates are recommended to "think big", that is to see the larger picture of the control system rather than the detailed points such as lack of cash receipts which relate more to control components.

Q. 46 *Refer to the solution of Question # 30 of ICAP's Official Question Bank.*

Q. 47 *Refer to the solution of Question # 18 of ICAP's Official Question Bank.*

Examiners' Comments:
(a) This part of the question was based on ISA 315, and required students to describe their understanding of the term risk of material misstatement at the financial statement level and to list down the risk assessment procedures for identification and assessment of such risks.
Only few candidates were well versed and obtained a high proportion of the marks available and correctly described that risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect a number of assertions.
They are not necessarily identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level. For example, through management override of internal control.
The risk assessment procedures mentioned by most students, in response to sub part (ii), displayed their lack of knowledge as they mentioned dozens of unrelated procedures also. Only few candidates could correctly list down the following:
• Inquiries of management and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement.
• Analytical procedures.
• Observation and inspection.
(b) This part required candidates to outline the reason as to why the auditors assessment of materiality and audit risk at the planning stage may change later i.e. at the time of evaluating the results of audit procedures.
About half the students correctly identified the following reasons:
• change in circumstances;
• change in auditors knowledge as a result of performing audit procedures;
• because the auditor may have intentionally set the materiality at a lower level, to reduce the likelihood of undiscovered misstatement.
(c) This was a straightforward question dealing with the assertions used by auditors in respect of account balances, classes of transactions and presentation and disclosures. The students are generally well prepared to answer such questions and accordingly good performances were witnessed.

Q. 48 **Sufficiency of Evidence:**

Sufficiency is a measure of quantity of audit evidence and is affected by Risk Assessment and Quality of evidence.

- The higher the risk, the more evidence required.
- The higher the quality, the less evidence required.

Appropriateness of Evidence:
Appropriateness is a measure of quality of audit evidence and is affected by its Relevance and Reliability.
Relevance of evidence means audit procedure and evidence should relate to objective of auditor.
Reliability refers to the extent of trust that auditor can place on audit evidence. The reliability of evidence is influenced by its source, nature, and the circumstances under which it is obtained.

Q. 49 Following general rules are established to determine reliability i.e.

- Evidence from independent external source is more reliable than internal evidence (e.g. confirmation from customer is more reliable than a sales invoice)
- Documentary evidence is more reliable than oral (e.g. a written confirmation from a debtor is more reliable than a telephone confirmation)
- Evidence in the form of original document is more reliable than photocopy/fax
- Evidence obtained directly by the auditor is more reliable than evidence obtained from the client (e.g. a confirmation obtained directly from the bank is more reliable than inspecting a copy of a bank statement held by the client)
- Evidence generated internally is more reliable when internal control is effective (e.g. pre-numbered documents are more reliable than unnumbered documents because sequence check can be verified.)

Q. 50 *Refer to the solution of Question # 66 of ICAP's Official Question Bank.*

Q. 51 The potential misstatements are not material in isolation:
- disputed receivable: 3.8% of profit before tax
- cut off error: 2.3% of profit before tax

However, potential misstatement in aggregate is £695,000 which is 6.1% of draft profit before tax
This could be material in aggregate as it falls into the 5-10% of profit range
Additional work is therefore required to ascertain:
- if any adjustment is required to the financial statements
- whether there are further errors in the financial statements that might be material

The impact on the audit opinion will need to be considered in light of further findings
Disputed trade receivable
One relevant procedure such as: Review any additional correspondence up to date of audit report for indication of whether amount will be paid
Cut-off error
One relevant procedure such as: Review year-end inventory count records to ascertain whether the inventory delivered post year end was correctly included in the inventory listing

Examiners' Comments:
Answers to this question were mixed. A significant number of candidates did not use the information in the question regarding the amounts of the unadjusted errors and consequently failed to consider their materiality. Of those who did consider materiality, many candidates correctly concluded that the items were not material individually, but lost marks by failing to consider the aggregated amount. A large

proportion of candidates were unable to identify audit procedures to address the errors identified, with procedures either being vague or inappropriate, and a number of candidates wasted time by listing more than one audit procedure.

Q. 52 *Refer to the solution of Question # 13 of ICAP's Official Question Bank.*

Q. 53 (i)
Significant matters are matters which affect Auditor's Report or Risk Assessment. Judging the significance of matter depends on objective analysis of the facts and circumstances.

Examples of significant matters include:
- Matters that could result in a modification to the audit opinion.
- Matters indicating that financial statements could be materially misstated.
- Matters that cause significant difficulty in applying necessary audit procedures.
- Matters that give rise to significant risks (as defined in ISA 315).
- Matters indicating need to revise risk assessment.

(ii)
Firm should establish its quality control policies and procedures for the timely completion/assembly of audit files. An appropriate time for completion/assembly of audit files is 60 days after the date of auditor's report.

Alternatively, you can refer to the solution of Question # 16 (b) of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>
Instances were noted where students started listing down all the contents of audit working papers/evidences instead of restricting their answers to significant matters only. Students listed the usual components such as planning documents, third party confirmations, enquiry letters etc. as significant matters.
The time allowed for completion of audit file i.e. 60 days from the date of audit report was correctly identified by most of the candidates.

Q. 54 *Alternatively, you can refer to the solution of Question # 52 of ICAP's Official Question Bank.*

Q. 55 Working papers are ownership of auditor. Audit documentation is not a substitute for the entity's accounting records.

Q. 56 There are two types of audit files i.e.
1. Current File (this file contains documents relevant to current audit only)
2. Permanent File (this file contains documents of continuance relevance i.e. relevant to current as well as future audits)

Examples of Current Audit File	**Examples of Permanent Audit File**
▪ Overall audit strategy ▪ Audit Plan/Audit Program ▪ Details of procedures performed ▪ Summary of Audit Adjustments ▪ Confirmation Letter ▪ Representation Letter ▪ Audit Report	▪ Engagement Letter ▪ Long term loan agreements. ▪ Copies of Legal and Tax Status of client. ▪ Organizational chart ▪ Accounting System Notes (e.g. summary procedures of Sales system, Purchase system) ▪ Minutes of meetings of shareholders and directors. ▪ Previous years' financial statements

Q. 57 ***(a)***

- Auditor can delete only superseded/duplicate pages after auditor's report but cannot delete document forming part of his opinion until the end of the retention period.
- Appropriate time for retention of documents depends on firms' quality control policies and procedures, however, it should not be less than 5 years from date of auditor's report or from date of group auditor's report, whichever is later.

(b)

- Adding/replacing documentation for which evidence has been obtained before audit report.
- Deleting superseded/duplicate pages.
- Sorting and cross- referencing working papers.

(c)

Following are three circumstances under which existing documents are modified or new documents are added after the issuance of auditor's report:

Example of Situation	**Matters to be documented if change is made**
Administrative changes during File Assembly Period	None
Changes after file assembly period (e.g. when there is external quality control review)	– specific reason for making change – when and by whom changes were made and reviewed
An exceptional matter arises after auditor's report (e.g. subsequent discovery of misstatement in F/S)	– specific reason for making change – new audit procedures performed, new conclusion drawn and their effect on audit report – when and by whom changes were made and reviewed

Alternatively, you can refer to the solution of Question # 56 of ICAP's Official Question Bank.

Examiners' Comments:
(a) This part was well attempted except that few candidates mentioned the minimum retention period of six or ten years instead of five years. However, a large number of students could not state that each firm should establish its own policies and procedures for retention of engagement document, subject to the above limitation.
(b) Very few candidates seemed to have exact knowledge of what was required. Very few of them could quote appropriate examples such as deleting/discarding of superseded documents, cross referencing and signing off etc.
(c) Some candidates listed the new audit documents that could be added to audit files but could not mention the circumstances which may necessitate the modification of existing audit documents or adding of new audit documents after the issuance of the auditor's report.

Q. 58 *Refer to the solution of Question # 64 of ICAP's Official Question Bank.*

Q. 59 *(a)*

Situation	**Effect on Sample Size for Tests of Controls**	**Effect on Sample Size for Substantive Procedures**
i) Sample Deviation Rate > Tolerable Rate of Deviation	–Risk of material misstatement is increased (because of increase in control risk). –Auditor places no reliance on Internal control.	As internal controls are not being relied, substantive procedures will be increased, hence, sample size for tests of detail will also be increased.
ii) Increase in population	There will be negligible effect on Sample size.	There will be negligible effect on Sample size.
iii) –Decrease in expected misstatements –Increase in Tolerable Misstatement	No effect. Procedures do not relate to tests of controls.	Sample Size will be decreased because of both factors.

Alternatively, you can refer to the solution of Question # 59 (a) of ICAP's Official Question Bank.

(b) & (c)
Refer to the solution of Question # 59 (b) & (c) of ICAP's Official Question Bank.

Examiners' Comments:
(a)
This part of the question on sampling was not appropriately attended to by the majority. It appeared that most of the students had not thoroughly studied the related auditing standard and were not able to appropriately structure their answers.
(b)
This was a knowledge based question direct from the Auditing Standards. However, only few students were able to mention all the factors that are relevant to the auditor's consideration of the expected rate of deviation.
(c)
This was fairly well answered by the majority of students.

Q. 60 ***(i)***
100% examination of population is not done in Tests of Controls but may be done in Substantive Procedures when:

- Population consists of small number of large values *or*
- There is a significant risk which cannot be reduced by other means *or*
- 100% examination becomes cost effective (e.g. when a repetitive calculation is performed automatically by computer).

(ii)
Usually, auditor selects following items specifically:

1. Items to obtain information (e.g. about nature of the entity or the nature of transactions)
2. Key items (e.g. suspicious, unusual, risk-prone or that have a history of error)
3. All items over a certain amount (to verify a large proportion of account)

Examiners' Comments:
This question tested knowledge of two important techniques of selecting items for audit i.e. selecting all items of a population and selecting specific items from a population. Generally, the candidates did well and identified the circumstances in which these techniques are used.

Q. 61

Factors (Increase in)	**Effect on Sample Size for Tests of Control**	**Effect on Sample Size for Tests of Details**
Tolerable rate of deviation (in TOC)/misstatement (in TOD)	Decrease	Decrease
Expected Rate of Deviation (in TOC)/Misstatement (in TOD)	Increase	Increase
Desired Level of Assurance (that tolerable rate of deviation/misstatement is not exceeded by actual rate of deviation/misstatement in the population)	Increase	Increase
Extent to which auditor considers controls in Risk Assessment	Increase	N/A
Risk of Material Misstatement	N/A	Increase
Stratification of Population	N/A	Decrease
Other Substantive Procedures (e.g. analytical procedures)	N/A	Decrease
Population Size	Negligible	Negligible

Examiners' Comments:
Many candidates correctly identified factors influencing sample size for tests of controls and tests of details based on ISA 530. However, many candidates simply mentioned the same factors under both headings while there were few who knew the difference but could not describe it manifestly probably due to poor command of English.

Q. 62 **Statistical Sampling:**
An approach of sampling is called Statistical Sampling, if it has following characteristics:
i. Use of Random selection to select items.
ii. Use of Probability theory to evaluate results.
e.g. Random Selection, Systematic Selection

Stratification :
It is the process of dividing a population into subpopulations, each of which is a group of sampling units which have similar characteristics, often monetary value.

Q. 63 **(i)**
Statistical Sampling:
An approach of sampling is called Statistical Sampling, if it has following characteristics:
i. Use of Random selection to select items.
ii. Use of Probability theory to evaluate results.
e.g. Random Selection, Systematic Selection

Non-Statistical Sampling:
A sampling approach that does not have characteristics of Statistical Sampling, is called Non-Statistical Sampling e.g. Haphazard Selection.
(ii)
Sampling risk is the risk that auditor's conclusion based on sampling might be different from the conclusion if entire population would have been tested.

Non-sampling risk is the risk that auditor's conclusion may be wrong for any reasons/errors other than sampling risk.

Examiners' Comments:
Good performance was witnessed from majority of the students. However those who had opted for a cursory study were easily exposed as their response was restricted to general discussion only.

Q. 64 *Refer to the solution of Question # 62 of ICAP's Official Question Bank.*

Q. 65 (a)

Customer Segment	**Type of Circularisation**	**Basis of Decision**
Super markets	Positive confirmation requests to all customers	Because population consists of large values of small number of customers.
Wholesalers	Positive confirmation requests to a sample of customers.	There are large number of customers in this category, so it would not be efficient to send requests to all customers, hence, a sample should be selected. Sample should also cover debtors with low/zero/negative balances alongwith high balances (to ensure completeness).
Retailers	Negative confirmation requests should be sent to a sample of customers.	Because population consists of small values of large number of customers.
Five star hotels	Positive confirmation requests to all customers	Because population consists of large value of small number of customers.

(b)

Audit Procedures in case of Exception found in a confirmation request:

Reply of confirmation	**Interpretation and Audit Procedures**
This amount was paid on December 28	This account is probably valid; however, auditor should verify date of receipt: – if date of receipt is before year end, cut-off on cash receipts is not proper (i.e. this year's collection is not recorded). – if date of receipt is after year end, this indicates timing difference.
We received these goods on January 3	This account is probably valid; however, auditor should verify date of shipment: – if date of shipment is before year end, this indicates timing difference. Ensure that inventory is also excluded from closing stock. – if date of shipment is after year end, cut-off on sales is not proper (i.e. next year's sale is recorded this year).
We have paid this amount since long. OR We have returned these goods since long. OR We never ordered/received these goods.	This indicates misstatement and auditor should investigate it and should: – Discuss it with client and confirming party. – Test internal control over transactions. – If there is misstatement in client's record, propose adjustment and re-assesses risk (including risk of fraud i.e. existence of Teeming and Lading).

Alternatively, you can refer to the solution of Question # 60 of ICAP's Official Question Bank.

Examiners' Comments:
(a)
Majority of the students preferred to discuss the theoretical aspects of sampling only without considering the given scenario. Most students wrote all they knew about positive and negative confirmations but avoided discussing the debtors to whom negative confirmation may be given. Some of them were of the opinion that negative confirmation should be sent to the retailers but did not provide any reasons to support their point of view.
(b)
This was a simple question and the students were required to state how they would deal with a situation where a debtor confirms a different balance. Majority of the students were able to specify that the auditor will ask the client to reconcile the difference. However, very few were able to explain correctly the steps that would be required to be taken by the auditor if the difference cannot be reconciled.

Q. 66 (1)
The objective of stratification is to reduce the variability of items within each stratum. This reduces sampling risk. Alternatively, sample size can be reduced without increase in sampling risk, which increases efficiency of audit.

Audit efficiency can be improved by using following procedures:
- Stratify population on the basis of monetary value.
- Select all transactions from upper stratum (to verify a large portion of the total amount through a few transactions)
- Apply audit sampling on each remaining stratum of population.

(2)
- Product wise
- Geographical Location wise
- Customers wise
- Cash and Credit Sales wise

Precaution: Categorization should be made in such way that there should not be double-counting of sampling units.

(3)
Opinion on Sohail's view:
This view is incorrect. If audit sampling is not applied on whole population, results of audit procedures do not provide evidence about population.
If there is risk of material misstatement in the remainder population, auditor will also have to examine remaining items. As the remainder population is major portion of population, hence it should not be ignored.

Opinion on Other Team Member's view:
This view is also incorrect. Stratification improves representation of population and audit efficiency. Hence, stratification should not be ignored.

Alternatively, you can refer to the solution of Question # 47 of ICAP's Official Question Bank.

Q. 67 *(a)*

(i)

An approach of sampling is called ***Statistical Sampling***, if it has following characteristics:

iii. *Random selection* of the items ***and***

iv. Use of probability theory to *evaluate results*.

e.g. Random Selection.

A sampling approach that does not have characteristics of Statistical Sampling, is called ***Non-Statistical Sampling*** e.g. Haphazard Selection.

(ii)

Sampling risk is the risk that auditor's conclusion based on sampling might be different from the conclusion if entire population would have been tested. This risk always exists in sampling because no sample in the world could be 100% representative of population.

Non-sampling risk is the risk that auditor's conclusion may be wrong for any reasons/errors other than sampling risk e.g not designing audit procedures appropriately, not performing audit procedures appropriately, misinterpretation of audit evidence in making conclusion, failure to recognize a misstatement or deviation, and no proper supervision and reviews.

(b)

i) Sampling has following drawbacks:

- All of 50 largest debtors should have been selected for confirmation (to cover the large portion of financial statements).
- Debtors below Rs 5,000 should not be ignored. There is still risk of understatement.
- Auditor should also cover government and related parties, even if they have not responded in past (prior non-response indicates that auditor should send positive confirmation instead of negative confirmation).

ii)

Audit efficiency can be improved by using following procedures:

- Stratify population on the basis of monetary value.
- Select all transactions from upper stratum (to verify a large portion of the total amount through a few transactions)
- Apply audit sampling on each remaining stratum of population.

Alternatively, you can refer to the solution of Question # 55 of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>

(a)

Good performance was witnessed from majority of the students. However those who had opted for a cursory study were easily exposed as their response was restricted to general discussion only.

(b)

The candidates appeared to be confused in identifying deficiencies in the sample and the best possible alternate method of sampling in the given scenario. A significant number of students preferred discussing everything they knew about sampling and suggested varied options but could not focus on the guidelines envisaged in the standards and in appendix to the related standard.

Q. 68 Auditor is required to obtain understanding of internal control. This understanding shall cover following:

1. **Control environment:** it includes awareness and actions of TCWG and management regarding entity's internal control and its importance in the entity.
2. **Relevant Information system:** it means methods and processes by which entity obtains, records and presents transactions. This system could be manual as well as IT.
3. **Entity's Risk Assessment Process:** Auditor shall obtain an understanding of whether or not entity has a Business/Entity Risk Assessment Process.
4. **Control Activities:** Auditor shall obtain an understanding of control activities/procedures relevant to audit (including control activities on risks arising from I.T.) to assess risk at assertion level.
5. **Monitoring of control** is a process to evaluate the internal control. It evaluates whether internal control system is operating effectively and taking necessary remedial actions.

Q. 69 **IT Application controls:**

Application controls are those controls that operate at assertion level and relate to the processing of transactions in individual applications. Application controls help to ensure that transactions are properly authorized, accurately processed and timely distributed.

Type of Control	Example
Controls over Input of system	Validation (Edit) checks e.g. Range test, Sequence test, Control totals.
Controls over Processing of system	Controls over duplication, loss of data during processing
Controls over Output of system	Restricting distribution of output reports

IT General Controls:

General Controls are those controls that operate at financial statement level and relate to all or many applications. General Controls help to ensure the effective functioning of application controls.

Type of Control	Example
Access Controls	–Logical security via password/biometrics –Access rights –Activity log
Data center and computer operation controls	–Proper allocation of IT responsibilities –Offsite backup of data –Disaster recovery procedures
Controls over acquisition and maintenance	–Controls over acquisition and maintenance of softwares –Controls over acquisition and maintenance of related equipments –Program change and Development Controls

Q. 70

Sr. #	Type of Control
(a)	Application Control
(b)	General Control
(c)	General Control
(d)	General Control
(e)	Application Control
(f)	Application Control
(g)	Application Control
(h)	Application Control

Q. 71 **Control Environment:**

i. Approving and controlling of documents.
ii. Limiting direct physical access to assets and records.
iii. Checking the arithmetical accuracy of the records.

Control Activities/Procedures

i. Management's control system including the internal audit functions, personnel policies and segregation of duties.
ii. The function of the board of directors and its committees.

Q. 72 Control environment provides foundation for other components of internal control and is considered the most important component. Although, control environment, itself, does not prevent, detect or correct specific misstatement but it influences the effectiveness of other controls and, thereby, affects auditor's risk assessment at financial statement level. An effective control environment may allow the auditor to have more confidence on internal control.

Q. 73

(a) Control Procedure/Activity
(b) Control Environment
(c) Control Procedure/Activity
(d) Control Procedure/Activity
(e) Control Environment

Q. 74 *Refer to the solution of Question # 35 of ICAP's Official Question Bank.*

Examiners' Comments:
(a) This was an uncomplicated, easy and bountiful question for the students and was attempted reasonably. Most of the students correctly identified the situations where the auditor may decide to test the controls which had also been tested in the immediately preceding year. Weak control environment, weak monitoring of controls, change in personnel & circumstances are logical examples of situations where the auditor takes such a decisions.
(b) The response was good and majority of the students scored good marks as they were able to identify and explain the components of internal control as referred to in ISA-315 and appendix 2 of the said ISA.

Q. 75 *Refer to the solution of Question # 38 of ICAP's Official Question Bank.*

Q. 76 Internal Control system is never perfect. It cannot provide absolute assurance about achievement of objectives because of Inherent Limitations of Internal Control i.e.

i. Breakdowns caused by human errors
ii. Cost-benefit trade off may not justify a control
iii. Segregation of duties in smaller entities not possible.
iv. Often Judgments are involved in risk assessment, and implementation of control which can be faulty
v. Management may also override the controls
vi. Circumvented intentionally through collusion

Q. 77 Control environment includes awareness and actions of TCWG and management regarding entity's internal control and its importance in the entity. It provides an atmosphere in which people conduct their activities and carry out their control responsibilities.

Control activities are the policies and procedures that help ensure that management directives are carried out.

Q. 78 Management Letter is a document prepared by auditor which states internal control weaknesses discovered during the audit. To provide value-added service to audit client, auditor also communicate to management recommendations to overcome weakness.

Management Letter is normally issued at the conclusion of the audit engagement and contains following elements:

- Internal Control Weakness
- Risk (Financial or non-financial) faced by entity because of weakness
- Suggestions by auditor to remove control weaknesses

Q. 79 **Consequences**

- duplicate orders/over-ordering/unwanted goods
- purchase of unauthorised non-business goods and services
- use of unauthorised suppliers
- may result in loss of discounts for bulk purchases
- goods may not be to the appropriate standards or requirements

Recommendations

- circulate company policy to all staff
- invoices, delivery notes etc to quote order number
- only buying department to have access to order forms/on-line ordering facilities
- management to monitor compliance with company policy

Examiners' Comments:

Answers to this question were disappointing. In general the consequences were dealt with better than the recommendations which were often vague and unrelated to the circumstances given in the scenario. In respect of the consequences, the point most commonly overlooked was that relating to breach of budgets and loss of control by the buying department. In respect of the recommendations, many failed to appreciate that the key issue was the breach of a company procedure and proceeded to write at length about the procedures to be followed in a purchases system instead of focussing on how the company's policy could be enforced. Weaker candidates strayed beyond the consequences and wrote about the implications for the audit and some candidates wasted time writing a covering letter.

Q. 80 Principal methods of documentation of accounting system and internal control are:

1. Narrative Notes (Narrative notes are a written description of the accounting system and controls that are in place. They are mainly used to make a record of control activities in processing of transactions.)
2. Questionnaires (A questionnaires is a list of questions about controls in a particulars aspect of operations or accounting.)
3. System flowcharts (System flowcharts provide a representation of accounting system and internal control in the form of a diagram which shows process, documents generated and flow of documents between different departments.)

Q. 81

	Narrative Notes	**Questionnaires**	**System flowcharts (given for knowledge purpose only)**
Advantages	▪ Simple to prepare. ▪ Focuses on detailed review accounting system and internal control	▪ Is easy to complete. ▪ Has checklist of questions. ▪ Decreases chance of overlooking something important.	▪ Provides graphic presentation of systems. ▪ Shows the steps required and the flow of forms and documents. ▪ Is easy to read and analyze. ▪ Is easy to update in subsequent years.
Disadvantages	▪ Is difficult to write, often lengthy and time consuming. ▪ Is difficult to revise in subsequent years.	▪ May contain numerous irrelevant questions. ▪ Tends to be treated like another form to fill out.	▪ Takes a significant amount of time to complete. ▪ Can be quite complex, requiring specific skills to complete.

Q. 82

Kida Company - Special Ordering System

(b)
Kida Company's major internal control deficiencies are:
Purchasing:

- The buyer does not verify that the department head's request is within budget limitations.
- No procedures have been established to ensure that the best price is obtained. Large-euro requisitions should be ordered after receiving quotes and/or sealed bids.
- Prior to placing an order, the buyer does not determine the adequacy of the vendor's past record as a supplier to Kida.

Receiving:

- Written notice of equipment received is not sent to the purchasing department.
- Written notice of equipment received is not sent to accounts payable department.

Accounts Payable:

- The mathematical accuracy of the invoice is not recomputed.
- Invoice quantity is not compared with a report of quantity received.
- Notification of the acceptability of the equipment from the requisitioning department is not obtained before the payable is recorded.

Treasurer:

- Documentation supporting the cheques is not sent by the accounts payable Department to the cashier in order for the cashier or treasurer to be assured that the cheque is for properly authorized and received equipment.
- Cheques for large-euro purchases are not signed by two officers of Kida Company to ensure that material expenditures are proper.
- All documentation to support a cheque is not cancelled by the cheque signer and returned to the accounts payable department.
- The cashier alone has custody of the key, the signature plate, and record of usage.

Q. 83 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Examiners' Comments:
(3a)
Candidates were expected to explain the benefits of using audit software and the problems in a specific audit where using audit software was one of those problems.
The question was worth 14 marks. Part (i) was worth 4 marks; candidates explaining 4 benefits obtained full marks. Part (ii) was worth 10 marks with the more complicated requirement to explain problems and then show how each problem could be overcome. The general marking guide for this question is 0.5 marks for identifying the problem. 0.5 mark for explaining it and finally 1 mark for showing how it could be overcome. A candidate explaining 5 problems would therefore obtain full marks.
Most candidates provided sufficient points in their answers; although a minority spent too much time on (ii) by including up to 8 or 9 points; marks in this situation had to be capped at the stated 10.
In part (i), most candidates demonstrated basic knowledge of the use of audit software explaining the "standard" benefits of time, cost, use of actual data in the computer etc. A few candidates made some good links to the scenario, for example, explaining how data could be amalgamated to avoid having to visit the 25 branches in the company.

In part (ii), again most candidates provided a range of valid points and obtained decent marks. However, common weaknesses in this section included:
- Not explaining had to overcome the weakness either by omitting this comment or by making unrealistic comments. For example, in terms of potential damage to client systems from the use of test data suggesting the weakness would be overcome by "being careful" or in a handful of answers by simply not accepting the audit engagement.
- Suggesting weaknesses that were not mentioned in the scenario. For example, suggesting that inventory valuation would be difficult as experts on car parts were difficult to find, or that the auditor had to attend all 25 locations simultaneously to prevent the client double counting inventory in more than one location.
- Recommending amendments to the client systems for other perceived weaknesses. For example, stating that a distributed processing system was not appropriate for the client and recommending a centralised system instead. Even if this was a recommendation to the client, it would not affect audit planning now and so was not relevant as a current audit problem.

Example comments provided and reasons why those comments did not obtain a pass standard are noted below (for part (ii)):
Answer comment
"The audit cannot obtain sufficient information on the client's system in the time allowed and so should resign."
Examiners assessment of comment
The answer has started to identify a weakness although this is not clearly explained. However, the solution of resigning the audit is not really acceptable as the client has only just been accepted; other methods of overcoming the problem such as careful planning, use of experienced staff or approaching the client for an extension of the audit deadline are more relevant.
Answer comment
"Inventory must be valued at the lower of cost and net realisable value. To overcome this problem the auditor must attend all 25 inventory locations.".
Examiners assessment of comment
The inventory valuation method mentioned is correct; however, there is no indication in the scenario that inventory valuation is a problem. The fact that the auditor must attend all 25 locations also does not overcome this problem; attendance at inventory count is more concerned with existence while valuation focuses more on cost and sales evidence.
The standard of answers for this question was satisfactory.
(3b)
Candidates were required explain how documentation produced by internal audit would be evaluated prior to placing reliance on that documentation.
The question was worth 6 marks. The marking scheme allowed for 1 mark for each point made. Most candidates obtained a marginal result explaining either how the internal audit department itself could be relied on or the documentation; only a minority of answers mentioned both. Marks were generally obtained from:
- Considering the work of internal audit in areas such as experience in computer systems, and quality of documentation provided, and
- Testing the documentation itself for example, in comparison to the actual system using walk-through or similar testing methods, or obtaining advice from external specialists.

There were relatively few less relevant points in this section. The main area of weakness related to candidates spending too much time explaining the appointment and general work of internal audit rather than placing reliance on this function.

The overall standard of answers was fair. A clear pass standard was obtained where both reliance on internal audit and testing the documentation was mentioned; marginal results tended to focus on too few relevant areas.

Q. 84 **(i)** Tests of control test the operating effectiveness of controls in preventing, detecting or correcting material misstatements. Substantive procedures are aimed at detecting material misstatements at the assertion level. They include tests of detail of transactions, balances, disclosures and substantive analytical procedures.

(ii)
Example tests of control over sales invoicing
– Inspect numerical sequence of sales invoices, if any breaks in the sequence noted, enquire of management as to missing invoices.
– Review a sample of sales invoices for evidence of authorisation by a responsible official of any discounts allowed.
– Inspect customer statements for evidence of regular preparation.

Example substantive procedures over sales invoicing
– Select a sample of pre and post year end goods despatch notes and follow through to pre or post year end sales invoices, to ensure the sales cut-off has been correctly applied.
– Perform an analytical review of monthly sales, compare any trends to prior years and discuss significant fluctuations with management.
– Review post year end credit notes to identify if any pre year end sales should be removed.

Q. 85 **(i)** Audit procedures using CAATS

1. The audit team can use audit software to calculate inventory days for the year-to-date to compare against the prior year to identify whether inventory is turning over slower, as this may be an indication that it is overvalued.
2. Audit software can be utilised to produce an aged inventory analysis to identify any slow moving goods, which may require write down or an allowance.
3. Cast the inventory listing to confirm the completeness and accuracy of inventory.
4. Audit software can be used to select a representative sample of items for testing to confirm net realisable value and/or cost.
5. Audit software can be utilised to recalculate cost and net realisable value for a sample of inventory.
6. CAATs can be used to verify cut-off by testing whether the dates of the last GRNs and GDNs recorded relate to pre year end; and that any with a date of 1 January 2013 onwards have been excluded from the inventory records.
7. CAATs can be used to confirm whether any inventory adjustments noted during the count have been correctly updated into final inventory records.

(ii) Advantages of using CAATS

1. CAATs enable the audit team to test a large volume of inventory data accurately and quickly.
2. If CAATs are utilised on the audit of Lily, then as long as they do not change their inventory systems, they can be cost effective after setup.
3. CAATs can test program controls within the inventory system as well as general IT controls, such as passwords.
4. Allows the team to test the actual inventory system and records rather than printouts from the system which could be incorrect.

5. CAATs reduce the level of human error in testing and hence provide a better quality of audit evidence.
6. CAATs results can be compared with traditional audit testing; if these two sources agree, then overall audit confidence will increase.
7. The use of CAATs frees up audit team members to focus on judgemental and high risk areas, rather than number crunching.

(iii) Disadvantages of using CAATS

1. The cost of using CAATs in this first year will be high as there will be significant set up costs, it will also be a time-consuming process which increases costs.
2. As this is the first time that CAATs will be used on Lily's audit, then the team may require training on the specific CAATs to be utilised.
3. If Lily's inventory system is likely to change in the foreseeable future, then costly revisions may be required to the designed CAATs.
4. The inventory system may not be compatible with the audit firm's CAATs, in which case bespoke CAATs may be required, which will increase the audit costs.
5. If testing is performed over the live inventory system, then there is a risk that the data could be corrupted or lost.
6. If testing is performed using copy files rather than live data, then there is the risk that these files are not genuine copies of the actual files.
7. In order to perform CAATs, there must be adequate systems documentation available. If this is not the case for Lily, then it will be more difficult to devise appropriate CAATs due to a lack of understanding of the inventory system.

Q. 86 *Refer to the solution of Question # 39 of ICAP's Official Question Bank.*

Q. 87 *Refer to the solution of Question # 40 of ICAP's Official Question Bank.*

Q. 88 **(a)**

Control objectives for sales and despatch system

a. To ensure that orders are only accepted if goods are available to be processed for customers.
b. To ensure that all orders are recorded completely and accurately.
c. To ensure that goods are not supplied to poor credit risks.
d. To ensure that goods are despatched for all orders on a timely basis.
e. To ensure that goods are despatched correctly to customers and that they are of an adequate quality.
f. To ensure that all goods despatched are correctly invoiced.
g. To ensure completeness of income for goods despatched.

(b)

Deficiencies and controls for Oregano Co's sales and despatch system

Deficiency	Control
Inventory availability for telephone orders is not checked at the time the order is placed. The order clerks manually check the availability later and only then inform customers if there is insufficient inventory available. There is the risk that where goods are not available, order clerks could forget to contact the customers, leading to unfulfilled orders. This could lead to customer dissatisfaction, and would impact Oregano's reputation.	When telephone orders are placed, the order clerk should check the inventory system whilst the customer is on the phone; they can then give an accurate assessment of the availability of goods and there is no risk of forgetting to inform customers.
Telephone orders are not recorded immediately on the three part pre-printed order forms; these are completed after the telephone call. There is a risk that incorrect or insufficient details may be recorded by the clerk and this could result in incorrect orders being despatched or orders failing to be despatched at all, resulting in a loss of customer goodwill.	All telephone orders should be recorded immediately on the three part pre-printed order forms. The clerk should also double check all the details taken with the customer over the telephone to ensure the accuracy of the order recorded.
Telephone orders are not sequentially numbered. Therefore if orders are misplaced whilst in transit to the despatch department, these orders will not be fulfilled, resulting in dissatisfied customers.	The three part pre-printed orders forms should be sequentially numbered and on a regular basis the despatch department should run a sequence check of orders received. Where there are gaps in the sequence, they should be investigated to identify any missing orders.
Customers are able to place online orders which will exceed their agreed credit limit by 10%. This increases the risk of accepting orders from bad credit risks.	Customer credit limits should be reviewed more regularly by a responsible official and should reflect the current spending pattern of customers. If some customers have increased the level of their purchases and are making payments on time, then these customers' credit limits could be increased. The online ordering system should be amended to not allow any orders to be processed which will exceed the customer's credit limit.
A daily pick list is used by the despatch department when sending out customer orders. However, it does not appear that the goods are checked back to the original order; this could result in incorrect goods being sent out.	In addition to the pick list, copies of all the related orders should be printed on a daily basis. When the goods have been picked ready to be despatched, they should be cross checked back to the original order. They should check correct quantities and product descriptions, as well as checking the quality of goods being despatched to ensure they are not damaged.
Additional staff have been drafted in to help the two sales clerks produce the sales invoices. As the extra staff will not be as experienced as the sales clerks, there is an increased risk of mistakes being made in the sales invoices. This could result in customers being under or overcharged.	Only the sales clerks should be able to raise sales invoices. As Oregano is expanding, consideration should be given to recruiting and training more permanent sales clerks who can produce sales invoices.
Discounts given to customers are manually entered onto the sales invoices by sales clerks. This could result in unauthorised sales discounts being given as there does not seem to be any authorisation required. In addition, a clerk could forget to manually enter the discount or enter an incorrect level of discount for a customer, leading to the sales invoice being overstated and a loss of customer goodwill.	For customers who are due to receive a discount, the authorised discount levels should be updated to the customer master file. When the sales invoices for these customers are raised, their discounts should automatically appear on the invoice. The invoicing system should be amended to prevent sales clerks from being able to manually enter sales discounts onto invoices.

Q. 89

Internal Control	Test of Controls
There is a proper segregation of duties in respect of following functions: - Authorization of purchase requisitions - Initiation of purchase - Stock keeping - Stock recording	▪ Ensure that the person carrying out the procedures does not have incompatible functions. ▪ Enquire about what happens when any of the persons carrying out a particular function is on leave.
Stock purchase requisitions, purchase orders and GRN's are duly authorized.	Select suitable number of documents using appropriate sampling techniques and check whether each document is duly authorized as mentioned in the purchase procedures.
Purchase orders and Goods Receiving Notes are pre-numbered.	Check files of copies of purchase orders and GRN's and unused purchase orders/ GRNs to ensure that they pre-numbered and are arranged in serial.
The quality and condition of stock received are investigated on receipt thereof.	▪ Investigate a sample of goods-received notes and substantiate that the quantity and condition of stock are noted thereon. ▪ Observe the storekeeper performing these duties.
- Matching of purchase orders with purchase requisitions. - Comparison of GRN with Purchase Orders.	Select suitable number of documents using appropriate sampling techniques and check whether each document is duly matched/ compared as mentioned in the purchase procedures.

Q. 90 (see next page)

Deficiency	Implication	Recommendation
When raising purchase orders, the clerks choose whichever supplier can despatch the goods the fastest.	This could result in Fox ordering goods at a much higher price or a lower quality than they would like, as the only factor considered was speed of delivery.	An approved supplier list should be compiled; this should take into account the price of goods, their quality and also the speed of delivery.
	It is important that goods are despatched promptly, but this is just one of many criteria that should be used in deciding which supplier to use.	Once the list has been produced, all orders should only be placed with suppliers on the approved list.
Purchase orders are not sequentially numbered.	Failing to sequentially number the orders means that Fox's ordering team are unable to monitor if all orders are being fulfilled in a timely manner; this could result in stock outs.	All purchase orders should be sequentially numbered and on a regular basis a sequence check of unfulfilled orders should be performed.
	If the orders are numbered, then a sequence check can be performed for any unfulfilled orders.	
Purchase orders below $5,000 are not authorised and are processed solely by an order clerk.	This can result in goods being purchased which are not required by Fox. In addition, there is an increased fraud risk as an order clerk could place orders for personal goods up to the value of $5,000, which is significant.	All purchase orders should be authorised by a responsible official. Authorised signatories should be established with varying levels of purchase order authorisation.
Purchase invoices are input daily by the purchase ledger clerk and due to his experience, he does not utilise any application controls.	Without application controls there is a risk that invoices could be input into the system with inaccuracies or they may be missed out entirely.	The purchase ledger clerk should input the invoices in batches and apply application controls, such as control totals, to ensure completeness and accuracy over the input of purchase invoices.
	This could result in suppliers being paid incorrectly or not all, leading to a loss of supplier goodwill.	
The purchase day book automatically updates with the purchase ledger but this ledger is manually posted to the general ledger.	Manually posting the amounts to the general ledger increases the risk of errors occurring. This could result in the payables balance in the financial statements being under or overstated.	The process should be updated so that on a regular basis the purchase ledger automatically updates the general ledger.
		A responsible official should then confirm through purchase ledger control account reconciliations that the update has occurred correctly.
Fox's saving (deposit) bank accounts are only reconciled every two months.	If these accounts are only reconciled periodically, there is the risk that errors will not be spotted promptly.	All bank accounts should be reconciled on a regular basis, and at least monthly, to identify any unusual or missing items.
	Also, this increases the risk of employees committing fraud. If they are aware that these accounts are not regularly reviewed, then they could use these cash sums fraudulently.	The reconciliations should be reviewed by a responsible official and they should evidence their review.
Fox has a policy of delaying payments to their suppliers for as long as possible.	Whilst this maximises Fox's bank balance, there is the risk that Fox is missing out on early settlement discounts. Also, this can lead to a loss of supplier goodwill as well as the risk that suppliers may refuse to supply goods to Fox.	Fox should undertake cash flow forecasting/budgeting to maximise bank balances. The policy of delaying payment should be reviewed, and suppliers should be paid in a systematic way, such that supplier goodwill is not lost.

The finance director authorises the bank transfer payment list for suppliers; however, he only views the total amount of payments to be made.	Without looking at the detail of the payments list, as well as supporting documentation, there is a risk that suppliers could be being paid an incorrect amount, or that sums are being paid to fictitious suppliers.	The finance director should review the whole payments list prior to authorising. As part of this, he should agree the amounts to be paid to supporting documentation, as well as reviewing the supplier names to identify any duplicates or any unfamiliar names. He should evidence his review by signing the bank transfer list.

Q. 91 *Refer to the solution of Question # 37 of ICAP's Official Question Bank.*

Q. 92 *Refer to the solution of Question # 80 of ICAP's Official Question Bank.*

Q. 93 *Refer to the solution of Question # 41 of ICAP's Official Question Bank.*

Q. 94

Deficiency	Control	Test of Control
A junior clerk opens the post unsupervised. This could result in cash being misappropriated.	A second member of the accounts team or staff independent of the accounts team should assist with the mail, one should open the post and the second should record cash received in the cash log.	Observe the mail opening process, to assess if the control is operating effectively.
Cash and cheques are secured in a small locked box and only banked every few days. A small locked box is not adequate for security of considerable cash receipts, as it can easily be stolen.	Cash and cheques should be ideally banked daily, if not then it should be stored in a fire proof safe, and access to this safe should be restricted to supervised individuals.	Enquire of management where the cash receipts not banked are stored. Inspect the location to ensure cash is suitably secure.
Deficiency	**Control**	**Test of Control**
Cash and cheques are only banked every few days and any member of the finance team performs this.	Cash and cheques should be banked every day.	Inspect the paying-in-books to see if cash and cheques have been banked daily or less frequently. Review bank statements against the cash received log to confirm all amounts were banked promptly.
Cash should ideally not be held over-night as it is not secure. Also if any member of the team banks cash, then this could result in very junior clerks having access to significant amounts of money.	The cashier should prepare the paying-in-book from the cash received log. Then a separate responsible individual should have responsibility for banking this cash.	Enquire of staff as to who performs the banking process and confirm this person is suitably responsible.
The cashier updates both the cash book and the sales ledger. This is weak segregation of duties, as the cashier could incorrectly enter a receipt and this would impact both the cash book and the sales ledger. In addition weak segregation of duties could increase the risk of a 'teeming and lading' fraud.	The cashier should update the cash book from the cash received log. A member of the sales ledger team should update the sales ledger.	Observe the process for recording cash received into the relevant ledgers and note if the segregation of duties is occurring.
Bank reconciliations are not performed every month and they do not appear to be reviewed by a senior member of the finance department. Errors in the cash cycle may not be promptly identified if reconciliations are performed infrequently.	Bank reconciliations should be performed monthly. A responsible individual should then review them.	Review the file of reconciliations for evidence of regular performance and review by senior finance team members.

Q. 95 *Refer to the solution of Question # 36 of ICAP's Official Question Bank.*

Q. 96

(a) Audit procedures procurement and purchases system

Procedure	Reason for procedure
Obtain a sample of e-mails from the store manager's computer. Trace details to the order database.	Ensure that all orders are recorded and that the order details are correct.
Obtain a sample of orders in the order database, record details of the order and trace to the paper delivery note filed in the goods inwards department.	To confirm that all goods ordered were received.
For the sample of orders above, agree to the inventory database.	To confirm that goods received were completely and accurately recorded in the inventory database.
Obtain a sample of paper delivery notes and agree to the order database and inventory database.	To confirm that inventory received has been recorded in DinZee's accounting system and that liabilities are therefore not understated.
For a sample of orders in the orders database, agree details to the payables ledger database, confirming details against the purchase invoice.	To confirm complete and accurate recording of the inventory liability in the payables database. Note: To ensure goods received have been recorded as a payables liability the sample selected from the order database should be only those orders that have been received. The invoice number in the order database is then noted and traced to the payables ledger in the purchase database.
Within the purchase database, obtain a sample of invoices recorded in the purchase day book, agree details of price and supplier to the purchase invoice record in the database.	To confirm that purchase invoice details have been correctly recorded in the payables database.
For a sample of purchase invoices in the purchase day book, agree details to the delivery notes for items on that invoice.	To confirm that the purchase liability has been recorded only for goods actually received.
For the sample of purchase invoices above, agree details to the individual payables account in the payables database.	To confirm that the liability has been recorded in the correct payables account.
For a sample of supplier invoices, cast and cross cast invoice price and quantities confirming price to the original order.	To confirm the arithmetical accuracy of invoices and ensure the company was charged the correct price for goods received.
Select increases in the purchase daybook and vouch to the order database.	To ensure that invoiced goods have been ordered, confirming the occurrence assertion.
Using computer-assisted audit techniques, cast the purchase day book and agree total of liability incurred to the general ledger.	To confirm the completeness and accuracy of the liability recorded in the general ledger.

(b) Audit procedures prior to inventory count attendance

Procedure
- Review prior year working papers
- Contact client to obtain stocktaking instructions
- Book audit staff to attend the inventory counts
- Obtain copy of inventory count instructions from client
- Ascertain whether any inventory is held by third parties
- Obtain last year's inventory count memo
- Prepare audit programme for the count.

(c) Weaknesses in counting inventory

Weakness	Reason for weakness	How to overcome weakness:
Inventory sheets stated the quantity of items expected to be found in the store	Count teams will focus on finding that number of items making undercounting of inventory more likely – teams stop counting when 'correct' number of items found.	Count sheets should not state the quantity of items so as not to pre-judge how many units will be found.
Count staff were all drawn from the stores	Count staff are also responsible for the inventory. There could be a temptation to hide errors or missing inventory that they have removed from the store illegally.	Count teams should include staff who are not responsible for inventory to provide independence in the count.
Count teams allowed to decide which areas to count	There is a danger that teams will either omit inventory from the count or even count inventory twice due to lack of precise instructions on where to count.	Each team should be given a precise area of the store to count.
Count sheets were not signed by the staff carrying out the count	Lack of signature makes it difficult to raise queries regarding items counted because the actual staff carrying out the count are not known.	All count sheets should be signed to confirm who actually carried out the count of individual items.
Inventory not marked to indicate it has been counted	As above, there is a danger that inventory will be either omitted or included twice in the count.	Inventory should be marked in some way to show that it has been counted to avoid this error.
Recording information on the count sheets in pencil	Recording in pencil means that the count sheets could be amended after the count has taken place, not just during the count. The inventory balances will then be incorrectly recorded.	Count sheets should be completed in ink.
Count sheets for inventory not on the pre-numbered count sheets were only numbered when used	It is possible that the additional inventory sheets could be lost as there is no overall control of the sheets actually being used. Sheets may not be numbered by the teams, again giving rise to the possibility of loss.	All inventory sheets, including those for 'extra' inventory, should be pre-numbered.

(d) **(i)** The aim of a test of control is to check that an audit client's internal control systems are operating effectively.

The aim of a substantive procedure is to ensure that there are no material errors at the assertion level in the client's financial statements.

(ii) Regarding the inventory count:

Test of control
Observe the count teams ensuring that they are counting in accordance with the client's inventory count instructions.

Substantive procedure
Record the condition of items of inventory to ensure that the valuation of those items is correct on the final inventory summaries.

Q. 97 **Cut off test:**
In this procedure, we select a sample of initiative documents (e.g. GRN or Delivery Note) just before and after the year-end, and compare dates of initiative documents with the dates of recording in books of accounts to ensure that every transaction is recorded in the correct period.

Cutoff on local purchases:

1. Select a sample of last Goods Receipt Notes at end of reporting period, and a sample of first Goods Receipt Notes of next period.
2. Trace the GRNs to respective vouchers and dates of recording in books of accounts.
3. Ensure that reporting period's GRNs are recorded in reporting period and next year's GRNs are recorded in next year.

Examiners' Comments:
The performance of the students was not satisfactory in this part. Instead of discussing the cut off test at the period end, many students wrote about verification of transactions occurring throughout the period. Further, purchase requisition cannot solely be used by the auditor for ensuring proper purchase cut off.

Q. 98 *Refer to the solution of Question # 81 of ICAP's Official Question Bank.*

Q. 99 *Refer to the solution of Question # 44 of ICAP's Official Question Bank.*

Examiners' Comments:
In this question the candidates were required to briefly explain procedures to be performed in case of unusual fluctuations between financial statements of current and previous years. ISA 520 has outlined the following steps in this regard:
(i) Making inquiries from the management.
(ii) Corroborating management responses by:
• comparing them with the auditors understanding of the entity; and
• other audit evidence available.
(iii) Consideration of the need to perform other audit procedures if management is unable to provide adequate explanation.
Many candidates answered accordingly and secured full marks. However, few candidates got on to the wrong track and produced irrelevant stuff such as explanation of the term "analytical procedures".

Q. 100 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 101 ***G.P. Ratio:***
Decrease in G.P. Ratio indicates decrease in sale price of output or increase in cost of inputs in manufacturing. It may also be because of understated sales.

Inventory Turnover Ratio:
Decrease in Inventory turnover ratio indicates an increased audit risk that inventory is overstated due to the presence of obsolete stock or due to overvaluation (in price or quantity) of inventory. This suggests that auditor should focus on the inventory valuation and allocation assertion.

Debtors' Turnover Ratio:
Decrease in debtors' turnover ratio indicates:

1. Increase in credit period
2. Existence of non-paying/bogus debtors
3. Decreased Sales or Understated Sales (during or end of the period)
4. Embezzlement of cash received from customer by an employee

This suggests that auditor should focus on valuation of debtors, cut-off of sales and controls over cash receipts from debtors.

Liquidity Ratios and Interest Coverage Ratios:
A major decrease in current ratio and quick asset ratio indicates company is facing liquidity problems, so auditor should also consider ability of company to pay its current liabilities. This problem is also highlighted by decrease in Times interest earned ratio which shows company is not in a position to even pay interest on its loan and has suffered loss during the year.

Fraud Risk Factors:
Operating losses and Cash flow problems are fraud risk factors, so auditor should be alert for fraudulent financial reporting (e.g. by overstatement of incomes and understatement of expenses).

Alternatively, you can refer to the solution of Question # 26 of ICAP's Official Question Bank.

Examiners' Comments:
It was a very poorly attempted question. Very general answers were given. Hardly any student analyzed the question in its right context. Some students didn't understand the exact requirement and wasted their time on writing the definition of Inherent risk, Control risk and Detection risk which were not required at all. Some students dwelled on the general audit risks without analyzing the financial position of the Company as given in the question.

Q. 102 *Refer to the solution of Question # 32 of ICAP's Official Question Bank.*

Examiners' Comments:
(b)
In this question, candidates were required to identify and try and explain unusual changes in the income statement. An income statement was provided in the scenario, with what were hopefully some fairly obvious changes that should make an auditor question the accuracy of the figures. The comment that the directors thought the company had had a difficult year, but the results appeared to be good was supposed to elicit this questioning attitude towards the income statement.
Many candidates did question the figures in the statement, as far as considering the possibility of windowdressing or fraudulent activity given the directors' initial comments. However, many comments made only basic comments such as "sales have increased" which was really self-evident from the scenario. Inadequate answers also typically covered a very limited range of points. Candidates needed to realise that because some very basic information was provided that, finding problems with that information should be relatively straight forward.
The question was worth 9 marks. The requirement verbs were identify and explain indicating, with the scenario, that identify was probably .5 mark and explain provided a further mark. Six good points would therefore provide full marks. While basic calculations were helpful, these should not have taken very long. It was evident that many candidates did not have a calculator although the examiner has noted that questions required basic calculations can be set in this paper.
Example comments provided and reasons why those comments did not obtain a pass standard are noted below:
Answer comment
"An increase in turnover shows that sales have increased."
Examiners assessment of comment
The answer does not really explain why turnover has increased – sales and turnover being the same thing. Valid explanations for increase in turnover include more marketing, changes in weather (perhaps more sunny days meaning people were outside more in their gardens, cheaper shed prices increasing demand, etc.)
Answer comment
"Selling and distribution costs increased by 20%."
Examiners assessment of comment
This comment is correct regarding identifying a movement in an item of expenditure. However, reasons for this change are not mentioned. Linking the change to the sales increase – which was not in proportion to selling and

distribution costs, to identify a potential problem would have been appropriate. Similarly, suggesting reasons for distribution costs increasing from general knowledge would also be correct; many candidates noted that increase in fuel prices worldwide would have increased distribution costs for many companies.
Other common errors included:
□ not understanding basic accounting principles meaning that some explanations were strange or in some cases simply incorrect. For example, simply stating that sales had increased because more goods were being sold on credit compared to cash (debtors may increase due to this mix change, sales would not unless linked to better credit terms being provided). Also, cost of sales falling due to stock being undervalued....
□ Lack of structure or format to answers. Very few answers followed the structure of the income statement, but tended to make points in almost any order (e.g. selling costs, cash, cost of sales, etc.). This meant that there were serious omissions from most answers regarding the changes between the two years; following the format of the income statement would have to alleviate this error.
□ Providing excessive detail on the cash and bank balances. The question requirement specifically mentioned the income statement; the cash balances were included to demonstrate that the interest paid and receivable may be suspect. Detailed speculation on why the bank balance had improved was therefore not required.
Overall, the standard of answers was unsatisfactory. Many candidates provided very brief answers with little or no explanation for changes in the income statement.

Q. 103 *Refer to the solution of Question # 31 of ICAP's Official Question Bank.*

Q. 104

- Completeness – ensure that all non-current assets are recorded in the non-current asset register by agreeing a sample of assets physically verified back to the register.
- Existence – ensure non-current assets exist by taking a sample of assets from the register and physically seeing the asset.
- Valuation and allocation – ensure assets are correctly valued by checking the reasonableness of depreciation calculations.
- Rights and obligations – ensure the company owns the asset by seeing appropriate document of ownership for example, a purchase invoice.

Q. 105

(i) Valuation of property, plant and equipment (PPE):

- Review depreciation policies for reasonableness by comparison to prior year, industry practices, the entity's replacement policy and the profits/losses arising on disposal of assets.
- For a sample of assets recalculate the depreciation charge for the year and agree to the entity asset register.
- Perform a proof in total calculation of depreciation, considering the timing of additions and disposals and compare this expectation to the actual charge, and investigate any significant differences.
- If any assets have been revalued during the year then assess the reasonableness of the valuer. In particular consider their experience, independence, scope of work and assumptions used.
- Agree the revalued amounts to a valuation report, for a sample recalculate the revaluation surplus and agree to the revaluation reserve.
- For a sample of the new surgical equipment additions vouch the cost to a recent purchase invoice.

(ii) Completeness of PPE:

- Reconcile the schedule of PPE with the general ledger.
- Select a sample of assets physically present at the entity's premises and inspect the asset register to ensure that these are included.
- Reperform the reconciliation of the non-current asset register to the general ledger, investigate any differences.
- Review the repairs and maintenance expense account in the statement of comprehensive income for items of a capital nature.

(iii) Rights and obligations of PPE:

- Verify ownership of property via inspection of title deeds and land registration documents.
- For a sample of additions agree to purchase invoices to verify invoice relates to the entity.
- Review any new lease agreements to ensure assets are correctly treated as finance or operating leases.
- Inspect vehicle registration documents to confirm ownership of motor vehicles.

Q. 106 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 107 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 108

(i)

(i) Materiality

The net book value of capitalised development costs represent 7% of total assets in 2007 (2006 – 7·7%), and is therefore material. The net book value has increased by 13%, a significant trend.

The costs capitalised during the year amount to $750,000. If it was found that the development cost had been inappropriately capitalised, the cost should instead have been expensed. This would reduce profit before tax by $750,000, representing 42% of the year's profit. This is highly material. It is therefore essential to gather sufficient evidence to support the assertion that development costs should be recognised as an asset.

In 2007, $750,000 capitalised development costs have been incurred, when added to $160,000 research costs expensed, total research and development costs are $910,000 which represents 20·2% of total revenue, again indicating a high level of materiality for this class of transaction.

Relevant accounting standard

Development costs should only be capitalised as an intangible asset if the recognition criteria of IAS 38 *Intangible Assets* have been demonstrated in full:

- Intention to complete the intangible asset and use or sell it
- Technical feasibility and ability to use or sell
- Ability to generate future economic benefit
- Availability of technical, financial and other resources to complete
- Ability to measure the expenditure attributable to the intangible asset.

Research costs must be expensed, as should development costs which do not comply with the above criteria. The auditors must consider how Sci-Tech Co differentiates between research and development costs.

There is risk that not all of the criteria have been demonstrated, especially due to the subjective nature of the development itself:

- Pharmaceutical development is highly regulated. If the government does not license the product then the product cannot be sold, and economic benefits will therefore not be received.
- Market research should justify the commercial viability of the product. The launch of a rival product to Flortex means that market share is likely to be much lower than anticipated, and the ability to sell Flortex is reduced. This could mean that Flortex will not generate an overall economic benefit if future sales will not recover the research and development costs already suffered, and yet to be suffered, prior to launch. The existence of the rival product could indicate that Flortex is no longer commercially viable, in which case the capitalised development costs relating to Flortex should be immediately expensed.
- The funding on which development is dependent may be withdrawn, indicating that there are not adequate resources to complete the development of the products. Sci-Tech has failed to meet one of its required key performance indicators (KPI) in the year ended 30 November 2007, as products valued at 0·8% revenue have been donated to charity, whereas the required KPI is 1% revenue.

  Given that there is currently a breach of the target KPIs, this is likely to result in funding equivalent to 25% of research and development expenditure being withdrawn. If Sci-Tech Co is unable to source alternative means of finance, then it would seem that adequate resources may not be available to complete the development of new products.

(ii)

Audit procedures to determine the validity of the amortisation rate of five years being applied to development costs in relation to the product Plummet would include the following:

- Obtain the papers documenting market research carried out on Plummet. Review and ascertain that the market research supports a product life span of five years.
- Review actual sales patterns since the launch of Plummet and compare to the predicted sales per the market research document.

  Tutorial note: *this will help to demonstrate the accuracy of the predicted sales forecast of Plummet.*
- Read the assumptions underpinning the market research sales projections, and consider whether these assumptions agree with the auditors' understanding of the business.
- Discuss sales trends with the sales/marketing directors and ascertain whether sales are in line with management's expectations.
- Read correspondence with retail outlets to ensure there is continued support for selling Plummet.
- Obtain marketing/advertising budgets and ascertain enough expenditure is continuing on Plummet to support continued sales.

Q. 109 **i) Trade receivables**

1. For a sample of debtors, perform a positive circularization. Compares confirmation to debtor's balance in the debtor's ledger and enquire management as to reason for significant discrepancies.
2. Where overdue debtors have not been paid, trace the balances to the provision for doubtful debts. If the balances are not included in the provision, discuss with management the basis on which they believe the debtor to be recoverable.
3. Review the reconciliation of the debtors control account to the list of individual debtor balances. Investigate any significant reconciliation items in order to establish their validity.
4. Test the accuracy of cut-off by tracing a sample of pre and post year-end delivery notes to the debtors and sales ledgers for the relevant accounting period.
5. Perform analytical procedures to confirm the verification results of year-end balance e.g. compute debtor's collection days.

ii) Bank overdrafts

1. Obtain bank reconciliation (BR) and review BR.
2. Agree bank confirmation replies to b/c per GL & investigate any significant differences.
3. Review bank confirmation replies for details of loans and title deeds held as security.
4. Review loan covenants and ascertain whether there have been breaches.
5. Check that bank overdrafts & securities, if any are properly disclosed.

iii) Goodwill

1. Trace the opening balance to the previous year's working papers.
2. Critically review the contract for purchase for the values placed on assets
3. Trace the total in the account analysis for each significant acquisition to the general ledger.
4. Examine supporting documents for evidence of continued ownership of acquisitions that resulted in the excess costs for the fair value of net assets.
5. Recomputed amortization and review the reasonableness and consistency of application of the method of amortization.
6. Determine the carrying amount does not exceed amount properly allocated to future periods.

Q. 110 **(i) The substantive audit procedures on goodwill**

1. Critically review the contract for purchase for the values placed on assets.

2. Trace the total in the account analysis for each significant acquisition to the general ledger.
3. Trace the opening balance to the previous year's working papers.
4. Examine supporting documents for evidence of continued ownership of acquisitions that resulted in excess costs as compared to the fair value of net assets
5. Review the reasonableness and consistency of application of the method of amortization.
6. Recompute amortization
7. Determine the carrying amount does not exceeds amount properly allocated to future periods
8. Trace amounts amortized during the period to the related general ledger expense accounts
9. Examine evidence supporting additions and reductions during the year
10. Ascertain whether goodwill and amortization are properly described and classified in the financial statements and disclosed in the notes to the accounts
11. Review regularly the value of the goodwill and if there is a permanent diminution ensure that the unamortized balance is written down immediately
12. Ensure that no amount has been attributed to internally generated goodwill.

(ii) **Patents and trademarks**
1. Trace opening balances to previous year's working papers.
2. Inspect the purchase agreements, assignments and any other supporting evidence for patents and trademarks acquired during the year.
3. Verify the amount capitalised with supporting costing records on patents developed by the company.
4. Verify payment of annual fees to patents agents.
5. Review regularly the value of the patent and trademarks. When necessary, to recommenced for write offs.

Q. 111 *Refer to the solution of Question # 58 of ICAP's Official Question Bank.*

Examiners' Comments:
This question required substantive procedures for verification of inventories. At this level, high marks should have been scored by all the students in this question. However, very few of the audit steps were mentioned by the students. Many of them tried to deal in detail with situations such as when stock check is carried out before or after the closing date. On the other hand, simple points were missing. For example, majority of the students didn't consider that it was a manufacturing concern and consequently ignored all steps related to raw materials, conversion costs, WIP etc. Students should remain focused on the specific requirement of the question and should not try to make unnecessary assumptions. Many students discussed physical verification but laid very little emphasis on valuation and NRV.
In such questions the students should try to follow an appropriate sequence of steps. Although they get marks for all steps they write, no matter what the sequence may be, but writing points in a haphazard manner results in important points being missed out and many points being duplicated.

Q. 112 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 113 The review of slow - moving or obsolete items includes inquiry of top management and a review of other inventory usage records. Top management would be more knowledgeable of major policy decisions that could result in large scale obsolescence; a plan to discontinue a product line or to make significant changes in a product. It would also be very useful if the auditor is aware of industry trends in product changes, supplies of raw materials and manufacturing processes. The auditor should also consider the conditions and packaging of physical inventory.

Q. 114

(i) Net realisable value is defined in IAS 2 *Inventories* as: 'the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.'

(ii) Appropriate procedures to determine that net realisable value of book inventory is above cost would include:

(1) Assessment of estimated proceeds from the sale of items of inventory. Sales price in the period following the year-end is one important element of net realisable value. Procedures to determine sales prices include:

- Obtain actual sales prices by reference to invoices issued after the year-end and determine that the sales were genuine by vouching sales invoices to orders, despatch notes and subsequent receipt of cash.
- If actual sales prices are not available, the auditor should obtain estimated sales prices from management. It would be necessary to assess how reasonable these estimated prices were. The auditor might be aided in this respect by reviewing the reports from sales staff backed up by discussions with management.
- Particular attention should be paid to sales prices of books identified as slow-moving. *(Tutorial note: Slow-moving books might be identified by obtaining lists of sales made in the preceding (say) six months and reviewing reports from sales staff. The sales statistics would also be useful in this respect.)*
- For damaged books disposal price may be nil or very low and the auditor should examine records of disposal of such books in the past. *(Tutorial note: Damaged books should have been identified during the inventory count.)*

(2) Determine estimated costs to completion. These costs represent another important element of net realisable value. Relevant procedures include:

- Some books may still be in production and will initially be included in inventory at cost to date; for example, they may have been printed but not bound. The auditor should examine production budgets and actual costs (for binding, for example) to determine actual costs to completion. *(Tutorial note: It is not uncommon for publishers to print books but leave them unbound until sales in the immediate future are expected.)*
- Books returned may incur extra costs before they can be made ready for resale and the auditor should examine cost records to obtain a reasonable estimate of such costs.

(3) Determine costs to be incurred in marketing, selling and distributing directly related to the items in question.

- In general terms the auditor may determine the percentage relationship between sales and selling and distribution expenses.
- However, the distribution costs of heavy books are likely to be higher than for (say) light paperback books and the auditor should assess whether the cost weighting is reasonable.

(4) All of the above matters should be discussed with management bearing in mind that, although they represent an internal source of evidence, they are the most informed people regarding the saleability of books on hand and regarding determination of the various elements of net realisable value.

(5) Discuss with management the need for an inventory provision for slow moving and/or obsolete books.

Q. 115 **(i)** Procedures to confirm inventory held at third party locations

a. Send a letter requesting direct confirmation of inventory balances held at year end from the third party warehouse providers used by Abrahams Co regarding quantities and condition.
b. Attend the inventory count (if one is to be performed) at the third party warehouses to review the controls in operation to ensure the completeness and existence of inventory.
c. Inspect any reports produced by the auditors of the warehouses in relation to the adequacy of controls over inventory.
d. Inspect any documentation in respect of third party inventory.

(ii) Procedures to confirm use of standard costs for inventory valuation

a. Discuss with management of Abrahams Co the basis of the standard costs applied to the inventory valuation, and how often these are reviewed and updated.
b. Review the level of variances between standard and actual costs and discuss with management how these are treated.
c. Obtain a breakdown of the standard costs and agree a sample of these costs to actual invoices or wage records to assess their reasonableness.

Q. 116 *Refer to the solution of Question # 70 of ICAP's Official Question Bank.*

Q. 117 *Refer to the solution of Question # 71 of ICAP's Official Question Bank.*

Q. 118 *Refer to the solution of Question # 78 of ICAP's Official Question Bank.*

Q. 119 *Refer to the solution of Question # 72 of ICAP's Official Question Bank.*

Q. 120 *Refer to the solution of Question # 45 of ICAP's Official Question Bank.*

Examiners' Comments:
(a) It was a relatively straightforward question based on ISA 505 and many candidates achieved good marks by clearly distinguishing between positive external confirmations and negative external confirmations.
(b) Here the candidates were asked to identify the risks associated with each of the two types of confirmations and necessary steps to be taken by an auditor to avert such risks. This was also answered well. However, few candidates wrote lengthy notes on alternative audit procedures for confirming the balances, to cover the risks, which was not a requirement of the question.
(c) In this part a high number of candidates scored good marks as they were able to list down the circumstances in which it may be appropriate to send negative confirmations and also, the situations where a combination of positive and negative external confirmations may be used in accordance with the guidance provided by ISA 505.

Q. 121 *Refer to the solution of Question # 51 of ICAP's Official Question Bank.*

Q. 122 Substantive procedures to confirm receivables balance for Tinkerbell

a. Perform a positive trade receivables circularisation of a representative sample of Tinkerbell's year-end balances, for any non-replies, with Tinkerbell's permission, send a reminder letter to follow up.
b. Review the after date cash receipts and follow through to pre-year-end receivable balances.
c. Calculate average receivable days and compare this to prior year, investigate any significant differences.
d. Review the reconciliation of sales ledger control account to the sales ledger list of balances.
e. Select a sample of goods despatched notes (GDN) before and just after the year end and follow through to the sales invoice to ensure they are recorded in the correct accounting period.
f. Inspect the aged receivables report to identify any slow moving balances, discuss these with the credit control manager to assess whether an allowance or write down is necessary.
g. For any slow moving/aged balances review customer correspondence to assess whether there are any invoices in dispute.
h. Review board minutes of Tinkerbell to assess whether there are any material disputed receivables.
i. Review a sample of post year-end credit notes to identify any that relate to pre-year-end transactions to verify that they have not been included in receivables.
j. Review the sales ledger for any credit balances and discuss with management whether these should be reclassified as payables.

k. Select a sample of year-end receivable balances and agree back to valid supporting documentation of GDN and sales order to ensure existence.

Q. 123 Substantive procedures to confirm Tinkerbell's revenue:
– Compare the overall level of revenue against prior years and budget and investigate any significant fluctuations.
– Obtain a schedule of sales for the year broken down into the major categories of toys manufactured and compare this to the prior year breakdown and for any unusual movements discuss with management.
– Calculate the gross margin for Tinkerbell and compare this to the prior year and investigate any significant fluctuations.
– Select a sample of sales invoices for larger customers and recalculate the discounts allowed to ensure that these are accurate.
– Recalculate for a sample of invoices that the sales tax has been correctly applied to the sales invoice.
– Select a sample of customer orders and agree these to the despatch notes and sales invoices through to inclusion in the sales ledger to ensure completeness of revenue.
– Select a sample of despatch notes both pre and post the year end, follow these through to sales invoices in the correct accounting period to ensure that cut-off has been correctly applied.
– Select a sample of credit notes issued after the year end and follow through to sales invoice to ensure the returns were recorded in the proper period.

Q. 124 **i) Motor Vehicles**
1. Verify the previous years figures i.e. agree to opening balances brought forward
2. Review internal control system on the purchase and usage of the asset
3. Are registers of motor vehicles maintained ?
4. Test check on the additions and disposals of assets during the year
5. Review the depreciation or amortisation policy and its adequacy provisions
6. Review the classification of capital and revenue expenditures for the amount of capitalised assets
7. Physical inspections to verify the condition and existence of the assets
8. Ensure correct treatment of revaluation
9. To exercise impairment tests
10. Any other relevant answers

ii) Account Receivables
1. Review internal controls and control account reconciliation
2. Audit the provision for doubtful debts, bad debts written off, discounts and returns in relation to credit sales and debtors
3. Review age analysis of debtors
4. Perform external confirmation (negative or positive debtor confirmation) to obtain direct confirmation from customers and the debit balances are correct
5. Vouch cash received after the year end to verify on debtors existence and evidence of recoverability
6. Perform analytical review – margin ratio, debtors turnover ratio, etc
7. Examine and test the cut-off procedure
8. Agree the balance sheet amount to the underlying records and book of accounts and proper disclosure and presentation as required by accounting and statutory requirements
9. Any other relevant answers

iii) Inventories

1. Ensure correct treatment of valuation - valuation stated at lower of cost or net realisable value
2. Correct determination of cost or net realisable value
3. Assess the effectiveness of client's stocktaking procedures
4. Obtain sufficient audit evidence regarding the existence, condition and valuation of inventories via stock count attendance
5. Ascertain the quantities and treatment of obsolete, damaged or slowmoving inventories
6. Ascertain the quantities and treatment of work-in-progress inventories
7. Examine and test the cut-off procedure
8. Pay particular attention to goods held on behalf of third party
9. Any other relevant answers

Q. 125 *Refer to the solution of Question # 79 of ICAP's Official Question Bank.*

Q. 126 *Refer to the solution of Question # 73 of ICAP's Official Question Bank.*

Q. 127 *Refer to the solution of Question # 61 of ICAP's Official Question Bank.*

Examiners' Comments:

Substantive procedures for verification of three different items were required. Since all the three areas were quite easy, almost all students were able to score good marks. However, apparently most students just started writing whatever steps they could think without planning their answers and consequently, a number of points were missed whereas a number of steps were repeated more than once.

Poor writing skill and lack of conceptual understanding was also noticed in many cases. For example, a significant number of students wrote that bank confirmations are obtained to verify bank reconciliation or that confirmation requests are circulated to the creditors to verify raw materials. A casual selection of words was observed and it seemed that students did not know with clarity, the difference between "verify", "inspect" and "ensure" etc. Many students wrote audit assertions instead of substantive procedures.

Q. 128 *Refer to the solution of Question # 74 of ICAP's Official Question Bank.*

Q. 129 *Refer to the solution of Question # 75 of ICAP's Official Question Bank.*

Q. 130 ISA 540 *Audit of Accounting Estimates* requires that auditors should obtain sufficient audit evidence as to whether an accounting estimate, such as a warranty provision, is reasonable given the entity's circumstances, and that disclosure is appropriate. One, or a combination of the following approaches should be used:

Review and test the process used by management to develop the estimate

– Review contracts or orders for the terms of the warranty to gain an understanding of the obligation of Island Co

– Review correspondence with customers during the year to gain an understanding of claims already in progress at the year end

– Perform analytical procedures to compare the level of warranty provision year on year, and compare actual to budgeted provisions. If possible disaggregate the data, for example, compare provision for specific types of machinery or customer by customer

– Re-calculate the warranty provision

– Agree the percentage applied in the calculation to the stated accounting policy of Island Co

– Review board minutes for discussion of on-going warranty claims, and for approval of the amount provided
– Use management accounts to ascertain normal level of warranty rectification costs during the year
– Discuss with Kate Shannon the assumptions she used to determine the percentage used in her calculations
– Consider whether assumptions used are consistent with the auditors' understanding of the business
– Compare prior year provision with actual expenditure on warranty claims in the accounting period
– Compare the current year provision with prior year and discuss any fluctuation with Kate Shannon.

Review subsequent events which confirm the estimate made
– Review any work carried out post year end on specific faults that have been provided for. Agree that all costs are included in the year end provision.
– Agree cash expended on rectification work in the post balance sheet period to the cash book
– Agree cash expended on rectification work post year end to suppliers' invoices, or to internal cost ledgers if work carried out by employees of Island Co
– Read customer correspondence received post year end for any claims received since the year end.

Q. 131 Substantive Procedures for verification of Long Term Bank Loan:

1. Check approval of board of directors.
2. Study loan agreement and make relevant extracts.
3. Check calculation of interest paid/ accrued.
4. Obtain bank confirmation and confirm the particulars of security deposited with the bank as security for the loans or charge created on an asset or assets of the client.
5. Ensure that the particulars mentioned in the bank confirmation are same as mentioned in the loan agreement.
6. If the loan is secured against mortgage or charge, check the mortgage deed or any other related document.
7. If there is any default in the payment of installments, check the related implications of the default and ensure they are properly reflected in the financial statements.
8. Prepare a movement schedule during the year and match the opening and closing balances, and also confirm that loan balance is appropriately reduced by the amount paid during the year.
9. Ensure proper disclosure is made in the financial statements.

Q. 132 **Audit objectives for share capital:**
(i) to ensure proper classification and disclosure of share capital in the financial statements and
(ii) there should be properly authorized movements of share capital.

2) Substantive procedures for verifying share capital
1. Agree the authorized share capital with the memorandum and articles of associations and agree any changes with proper authorized resolution
2. Trace and verify the opening balance to the previous year's working papers.
3. Verify any issue of share capital or other changes during the year with minutes of meetings/resolutions and ensure that such issue or change is within the terms of the memorandum and articles of association

4. If shares are issued at a premium, verify that the amount of premium has been credited to the share premium account.
5. Verify any transfers of shares by reference to correspondence, minutes of directors' meetings, cancelled share certificate, etc.
6. Check the balance on shareholders' accounts against with the register of members and the amount of the total list of issued share capital must tally with the amount in the nominal ledger
7. Agree dividends paid and proposed dividends to the authorization made in the minutes' book and recomputed the dividend calculations with total share capital
8. Presentation and disclosure for share capital is compliance with the accounting standards and statutory requirements

Q. 133 Payroll substantive procedures

a. Agree the total wages and salaries expense per the payroll system to the detailed trial balance, investigate any differences.
b. Cast a sample of payroll records to confirm completeness and accuracy of the payroll expense.
c. For a sample of employees, recalculate the gross and net pay and agree to the payroll records to verify accuracy.
d. Re-perform calculation of statutory deductions to confirm whether correct deductions for this year have been included within the payroll expense.
e. Compare the total payroll expense to the prior year and investigate any significant differences.
f. Review monthly payroll charges, compare this to the prior year and budgets and discuss with management any significant variances.
g. Perform a proof in total of total wages and salaries, incorporating joiners and leavers and the pay increase. Compare this to the actual wages and salaries in the financial statements and investigate any significant differences.
h. Select a sample of joiners and leavers, agree their start/leaving date to supporting documentation, recalculate that their first/last pay packet was accurately calculated and recorded.
i. For salaries, agree the total net pay per the payroll records to the bank transfer listing of payments and to the cashbook.
j. For wages, agree the total cash withdrawn for wage payments equates to the weekly wages paid plus any surplus cash subsequently banked to confirm completeness and accuracy.
k. Agree the year-end tax liabilities to the payroll records, and subsequent payment to the post year-end cash book to confirm completeness.
l. Agree the individual wages and salaries per the payroll to the personnel records and records of hours worked per clocking in cards.

Q. 134 *Refer to the solution of Question # 57 of ICAP's Official Question Bank.*

Examiners' Comments:
This could have been a high scoring question but the majority of students could secure average marks only.
A large number of students listed irrelevant steps not considering that the requirement of the question was to list the procedures which would ensure that all related parties and related party transactions are identified. Many of them seemed to believe that existence of /reference to related party always means existence of fraud and malpractices and emphasized on this aspect only.
Most of the students mentioned some of the easier points like inquiries from management, review of minutes of meetings and register of members etc. However, they emphasized on verification of

known related party transactions instead of mentioning steps aimed at identification of undisclosed related party transactions.

Q. 135 An auditor cannot be held responsible to identify all related-party relationships and transactions because:

1. Management may not provide complete information to auditor because:
   - Internal control over related party transactions may be deficient or non-existent.
   - Management may not be aware of all related party relationships/transactions (particularly if AFRF does not require management to identify/disclose).
   - Management may intentionally conceal it for fraud.
2. Some related party transactions involve immaterial values, which are difficult for auditor to detect.

Q. 136 *Refer to the solution of Question # 50 of ICAP's Official Question Bank.*

Q. 137 *Refer to the solution of Question # 53 of ICAP's Official Question Bank.*

Q. 138 ***(i)***

(i) Since related party relationship/ transactions have been identified which were not previously identified or disclosed to the auditor, the auditor shall:

- Promptly communicate the relevant information to the other members of the engagement team;
- Where the applicable financial reporting framework establishes related party requirements:
  - Request management to identify all transactions with FL for the auditor's further evaluation; and
  - Perform appropriate substantive audit procedures relating to significant related party transactions with FL;
  - Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and
  - If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.

(ii) For identified significant related party transactions outside the entity's normal course of business, the auditor shall:

- Inspect the underlying contracts or agreements, if any, and evaluate whether:
  - The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
  - The terms of the transactions are consistent with management's explanations; and
  - The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
- Obtain audit evidence that the transactions have been appropriately authorized and approved.

Q. 139 Request for confirmation that the component auditors will co-operate with the group audit team
- to ensure sufficient appropriate evidence is obtained
Timetable
- to allow component auditors to project manage their work/meet deadlines

- Reporting requirements
- a specified format of response will promote consistency across all component auditors/group auditor will get complete information
- Detail of the work to be performed
- to provide information that will allow the component auditors to decide whether to accept the assignment/nothing overlooked
- Ethical and independence requirements
- to ensure that the group auditor can rely on the work/component auditors objective and act with integrity
- Materiality levels
- to ensure items material to the group are audited
- Significant risks that are relevant to the component auditors
- to allow component auditors to focus work on high risk areas
- A list of related parties
- to allow collation of related parties for disclosure/representation purposes
- Work to be performed on intra-group transactions, unrealised profits and intra-group account balances
- to ensure no duplication or omission of transactions
- Instructions on subsequent events audit work
- to ensure that the component auditors extend subsequent events review beyond the normal period if there is a delay between completion of the overseas audit work and the signing of the group audit report.

Examiners' Comments:
Answers to this question were generally disappointing. Those candidates familiar with paragraph 40 and Appendix 5 of ISA 600, were able to list relevant items to be included in the group auditor's email to component auditors and, in the main, pr ovide plausible reasons for their inclusion. However, some candidates struggled to provide plausible reasons and wasted time listing more than the three items required.

Q. 140 If an entity has components, auditor shall:

- obtain an understanding of the group and its components and
- determine (before accepting/continuing the engagement) whether there is reasonable expectation that sufficient appropriate audit evidence can be obtained for financial information of components.

If group engagement team plans to engage a component auditor to perform work on a component, Group Engagement Team shall:

- Obtain understanding of component auditor
- Be involved in the work performed by component auditor

If group engagement team has less than serious concerns about competence, Concern may be overcome by:

- being involved in the work of the component auditor or
- performing additional risk assessment or further audit procedures on the financial information of the component.

If Group engagement team has serious concerns about Competence, Group Engagement Team shall not engage such component auditor.

Q. 141

	Internal Auditor	**External Auditor**
Relationship/Independence	Employee of entity	Independent of entity
Appointment	By BOD/Audit Committee	By Members
Qualification	Determined by BOD/Audit Committee	Determined by Law
Scope / Objectives / Activities	Objective is to evaluate and improve entity's *Governance, Risk Management and Internal Control.*	Objective is to express an opinion on financial statements and on additional matters required by law.
Scope/Objectives/ Activities determined by	BOD/Audit Committee	Determined by Laws and Regulations
Reporting	Reports To BOD/Audit Committee and his reports are restricted to them.	Reports to Members and his report is publically available.
Format of Report	Any (depending on circumstances)	Determined by Law

Examiners' Comments:
This question was answered well by most candidates with many scoring full marks.
Many candidates laid their answers out in two columns and this tended to increase their marks, as it meant they considered both internal and external audit for each point raised. Those who wrote a paragraph each for internal and external audit sometimes missed out points. For example they might answer that "external auditors report to shareholders" but then fail to say that "internal audit report to management or those charged with governance".

Q. 142 Following are objectives/scope/activities of internal audit function:

Governance Activities	Assisting Board of Directors in overseeing: ▪ strategic direction of the entity and ▪ obligations related to accountability of the entity.
Risk Management Activities	➢ Identification of Risks. ➢ Management of Risks .
Internal Control Activities	➢ Review of financial information (by performing tests of details). ➢ Review of efficiency and effectives of operating activities. ➢ Review of compliance with laws and regulations. ➢ Evaluation of Internal Control (by performing tests of controls on design, implementation and operating effectiveness of internal control).

Examiners' Comments:
This was a students' favourite theoretical question on scope and objectives of internal audit and was answered well.

Q. 143 **Evaluating the Internal Audit Function:**

Evaluation	**Factors to consider while evaluating**
Competence	– Level of education and professional qualification. – Training and experience of internal auditors. –Specific knowledge and skills relating to entity's financial statements. –Whether internal audit function is adequately resourced.
Objectivity	–Compliance with internal auditing's standards relating to objectivity –Hiring/Firing authority of internal auditors should be with TCWG. –Organizational status (e.g. whether it reports directly to TCWG). –Free from conflicting responsibilities (e.g. no managerial work).

Approach	–Whether internal auditors apply a systematic and disciplined approach. –Quality of internal auditor's working papers (covering risk assessments, work programs, documentation and reporting). –Consistency of Conclusions with work performed. –Quality Control Program for internal auditor.

Examiners' Comments:
Students did well while describing assessment of internal audit at planning stage, and discussed various criteria. However, some of them could not see the difference between assessment of internal audit function at planning stage and assessment of specific work performed by the internal auditor. Thus, mixed and confused thoughts were presented by some of them.

Q. 144 *Refer to the solution of Question # 48 of ICAP's Official Question Bank.*

Q. 145 *Refer to the solution of Question # 63 of ICAP's Official Question Bank.*

Q. 146 **Circumstances where auditor may use the work of an expert:**
Expert be required by management when financial statement involve following:
- Estimation of items in financial statements e.g.
  - estimating Useful life of Plant and Machinery
  - estimating provision for bad debts in banks
  - estimating Oil and Gas Reserves
- Valuation of items in financial statements e.g.
  - Valuation of Property (land and building)
  - Valuation of specialized assets (assets & liabilities taken in a business combination, intangible assets, work of art, antiques)
  - Valuation of environmental liabilities, and site clean-up costs
- Actuarial Calculations e.g.
  - Provision for claims in insurance companies
  - Pension schemes/ Employees Retirement Benefits Scheme
- Analysis of complex or unusual tax compliance issues
- IT Expertise

Auditor's responsibilities where auditor may use the work of an expert:
Auditor shall perform following procedures if auditor uses work of an expert.
1) Evaluate the competence, capabilities and objectivity of expert.
2) Obtain an understanding of the field of expert.
3) Evaluate the appropriateness/adequacy of expert's work as audit evidence.

Alternatively, you can refer to the solution of Question # 43 of ICAP's Official Question Bank.

Examiners' Comments:
Most of the students dealt with the first issue correctly. As regards the second point many candidates discussed the report to be issued by the auditor instead of describing the responsibilities of the auditor.

Q. 147 *Refer to the solution of Question # 54 of ICAP's Official Question Bank.*

Q. 148 *Refer to the solution of Question # 46 of ICAP's Official Question Bank.*

Examiners' Comments:
Candidates were required to describe matters to be considered by auditor before using report of an expert as enumerated in ISA 620. The guidance provided by the ISA is outlined hereunder:
(i) The auditor should evaluate the professional competence of the expert and in doing so, he should consider:
• Professional licencing and membership of the expert; and
• Experience and reputation of the expert.
(ii) The auditor should also evaluate the objectivity of the experts and the risk that it may have been impaired.
While many candidates displayed a high standard of knowledge on this topic, a large number of answers included spurious points and explanations indicating unsatisfactory preparation for this examination. Some of the candidates got confused and listed the matters to be considered before using work of **another auditor**.

Q. 149 *Refer to the solution of Question # 65 of ICAP's Official Question Bank.*

Q. 150 *Refer to the solution of Question # 76 of ICAP's Official Question Bank.*

Examiners' Comments:
2a
This was worth 3 marks and required candidates to explain 3 factors that the external auditor should consider when assessing the competence and objectivity of an expert.
Most candidates provided three, or occasionally two, valid points; appropriate qualification, experience and independence from the client being the most popular points. There were very few non-relevant points, the most common being checking the scope of work of the expert, ensuring that the expert had a confidentiality agreement and ensuring that the expert had project management experience.
In summary, the question was well-answered.

2b
This was worth 3 marks and required candidates explain 3 rights that enable auditors to carry out their duties. Most candidates provided three, or occasionally two, valid points; although there was some confusion regarding rights and professional ethics and experience. The basic points of access to documents, access to directors/explanation and attend and speak at meetings were mentioned by a majority of candidates.
Non-relevant points mentioned included:
Right to obtain a management letter
Right to obtain third party confirmations
Right to resign (unless linked to calling of a GM)
Right to use an expert.
While the auditor will normally obtain a management letter, for example, the auditor cannot force management to provide this. Marks were generally awarded for the generic points of right of obtain information from management, as noted above.
A minority of candidates approached the question by stating the professional and/or ethical requirements of an auditor; for example the auditor must be qualified and regulated. While factually correct, these points did not relate to the rights of auditors to carry out their duties and so no credit could be given.
In summary, the question was relatively well-answered.

2c
This was worth 4 marks and required candidates list four assertions relevant to the audit of tangible non-current assets and state one audit procedure which provides appropriate evidence for each assertion. With 4 assertions to mention and 4 marks, the marking scheme was clearly 0.5 for each valid assertion and 0.5 for each procedure. The question may initially appear to have been time-pressured, but given 2 marks could be obtained from writing 4 words (that is 4 assertions), this was should not have been the case.
A majority of candidates provided 4 valid assertions, with an appropriate audit procedure. However, a significant number of incorrect points were made:
Providing examples of audit procedures for current, rather than non-current assets. For example stating existence meant seeing inventory in the warehouse or valuation related to the lower of cost and net realisable value. These points were made in all paper variants indicating there may be some lack of paper F3 knowledge going into the F8 examination.
Mentioning out-of-date assertions such as measurement
Not linking the audit procedure with the assertion. The most common error here reversing audit procedures for completeness and existence.
Defining the assertion rather than providing an audit procedure for that assertion.
In summary, the standard of answer was unsatisfactory.

Q. 151 **Evaluation of Competence of Expert:**
–Whether that expert's work is subject to technical performance standards or other professional or industry requirements
– Expert's qualification and experience with respect to relevant matter and knowledge of relevant accounting requirements.

Evaluation of Objectivity of Expert:
–Inquiry of entity and expert about any interests and relationships that may create threats to the expert's objectivity
–Obtain a written representation from the expert whether he is aware about any interests and relationships that may create threats to expert's objectivity

Evaluation of Expert's work:
The auditor shall evaluate the adequacy of the expert's work, including:
1. Relevance, completeness, and accuracy of significant source data
2. Relevance and reasonableness of significant assumptions and methods
3. Relevance and reasonableness of expert's findings and conclusions

Q. 152 (a) Auditor shall determine whether to use work of management's expert or to engage auditor's expert.

Auditor shall perform following procedures if auditor uses work of an expert:
4) Evaluate the competence, capabilities and objectivity of expert.
5) Obtain an understanding of the field of expert.
6) Evaluate the appropriateness/adequacy of expert's work as audit evidence.

(b)
Auditor's procedures may include:
1. Discussing expert's report with management.

2. Review instructions given to expert and working papers of expert to ensure that valuation has been done on assumptions and methods consistent with auditor's understanding, requirements of AFRF, Management, and applied consistently on all items.
3. Review published statistical govt. data to ensure reasonable assumptions.
4. Obtain management representation regarding reasonableness of assumptions and methods
5. Discussion expert's report with another expert or third parties to ensure reasonableness of findings and conclusion.
6. Review instructions given to expert and working papers of expert to ensure that valuation has been done on date close to the year end and takes into account effect of subsequent events.
7. Auditor may also Observe expert's work, Reperform calculations and apply Analytical Procedures.

Examiners' Comments:
There seemed to be some confusion amongst candidates as to what exactly was required of them in this question. A significant number of them gave the answers to part (a) in part (b) of this question and vice versa.
Question 2 (a)
This part related to obtaining an understanding of the managements expert and factors to be considered "before" using the report prepared by the expert. The majority answered well. However, quite a few candidates went into unnecessary details regarding valuations techniques, policies and procedures involved therein, as opposed to an assessment of the factors to be considered before using the experts work such as objectivity and competence of the expert and obtaining an understanding of the work carried out and its appropriateness as audit evidence.
Question 2 (b)
It was stated in the question that a valuation had already been carried out by the expert, hence, what was required was an explanation of the procedures required to ensure that such valuation was appropriate. However, candidates went into details regarding the accounting techniques, policies, presentation and disclosure requirements instead of explaining the principal auditing procedures to be carried out.

Author's Note:
Students should note that requirement of the question is to explain "procedures to be performed" and not "matters/factors to evaluate". Both are separate concepts.

Q. 153 Auditor has sole responsibility to express opinion on Financial Statements. He shall not refer to the work of auditor's expert in auditor's report unless it is:
- Required by Law or Regulation or
- Necessary to explain nature of modification in auditor's report

Q. 154 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Examiners' Comments:
The requirement verb for this section was explain. So the marking scheme for this question was simply 1 mark for each point; effectively 0.5 for identifying the fundamental principle and 0.5 for the explanation. In other words, listing the principles was not sufficient to obtain a pass – explanation was also required. Answers to this question varied considerably. A significant number of candidates

obtained full marks by correctly listing and explaining all five principles. However, a significant minority either did not attempt the question or provided incorrect examples.

Q. 155

Threat	Explanation	Examples/Circumstances
Self-interest threat	When an assurance team member (or any of his relatives) has financial interest in an assurance client.	1. Shareholding in client, or Loan from client. 2. Undue dependence on total fees from a client. 3. Close business relationship with client e.g. J/V. 4. Contingent fee to assurance engagement. 5. Prospective/Simultaneous Employment with client (in a key post). 6. Acceptance of significant gifts or preferential treatment.
Familiarity threat	When an assurance team member (or any of his relatives) becomes too sympathetic to client because of personal interest.	1. Family relationship between assurance team and key management. 2. Long association of a senior team member with assurance client. 3. Past/Simultaneous employment with client (in a key post).
Self review threat	When an assurance provider provides assurance on his own work.	1. Performing non-assurance services that directly affect F/S. 2. Past employment with client (in a key post).
Advocacy threat	When an assurance provider promotes client's position/ opinion on a matter affecting F/S.	1. Promoting/underwriting shares of an assurance client. 2. Acting as an advocate of assurance client in litigations or disputes.
Intimidation threat	When an assurance provider is threatened/frightened by a client.	1. Litigation between auditor and client. 2. Threat of dismissal by client. 3. Client seeking second opinion on disputed matter. 4. Pressure to reduce the extent of work (to reduce fee).

Examiners' Comments:
This question was generally well attempted though quite a few students could not identify the threats and instead, delved upon lack of independence, integrity, confidentiality, technical competence, professional behaviour of the auditor, etc. Some students thought it fit to prefix 'self' with every threat eg 'self advocacy threat', 'self intimidation threat'! A fairly large number of candidates gave incorrect examples also.

Q. 156 *Refer to the solution of Question # 14 of ICAP's Official Question Bank.*

Q. 157 Refer to the solution of Question # 1 of ICAP's Official Question Bank.

Exam Tip
If you are required to briefly explain threats in exam, also give an example of each threat to secure maximum marks.

Examiners' Comments:
(a)
(i) *This question focused on the fundamental principles of professional ethics for chartered accountants and offered relatively simple marks for their identification and description. Many*

candidates displayed a good standard of knowledge on this topic and correctly identified and appropriately described the following fundamental principles:
• Integrity
• Objectivity
• Professional competence and due care
• Confidentiality
• Professional Behaviour
However, a large number of answers included spurious explanations indicating unsatisfactory preparations and lack of adequate knowledge of the code of ethics for Chartered Accountants.
(ii)
This question tested candidates' knowledge of categories of threats to compliance with the fundamental principles. Whilst few candidates correctly identified and described the threats as Self-interest threats, Self review threats, Advocacy threats, Familiarity threat & Intimidation threats, many candidates either did not attempt this part of the question or simply stated incorrect matter and consequently wasted their valuable time and effort.

(b)
Almost all the students were able to specify that under the listing regulations, auditors of listed companies are not allowed to provide accounting services and hence the auditor cannot accept the assignment. However, very few of them touched upon the requirement of specifying the extent of support that can be offered in the above situation.

Q. 158 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 159 (i)
Shamasuddin should be informed about following provisions of Code of Ethics for Chartered Accountants:
1) Advertisement for solicitation should be avoided.
2) Public notices for informative purposes can be given provided they should not:
   - Use means which bring the profession into disrepute.
   - Exaggerate work of himself
   - Degrade work of other accountants

Thus, Mr. Shamsuddin can accept a discount offer provided he ensures compliance to the above.

(ii)
This amounts to Undercutting (i.e. quoting a fee significantly lower than previous auditor) and creates unacceptable self-interest threat. Firm can accept the engagement on reduced fee than charged by predecessor auditor only if firm can demonstrate that:
1) Scope and Quantum of work differs from previous audit, and
2) All applicable assurance standards, QCR, guidelines will be complied with.

(iii)
Engagement should not be accepted on such arrangements for fee because Code of Ethics prohibits chartered accountants to charge contingent fee for any assurance or non-assurance service.

(iv)
Proposed auditor should communicate with retiring auditor to know if there are any circumstances that engagement should not be accepted by proposed chartered accountant. Further, the existing as well as the proposed auditors should immediately communicate the fact to ICAP and the proposed auditor should not accept the offer without clearance from ICAP and the existing auditor.

Alternatively, you can refer to the solution of Question # 3 of ICAP's Official Question Bank.

Examiners' Comments:
The question offered ten marks for identifying the options available to Mr. Shamsuddin, a newly qualified chartered accountant against different offers. This was the least well answered question of the whole paper with a significant number of students scoring none or only a small fraction of the marks available. Answers submitted were noticeably weak and it seemed apparent that in general, candidates had only sparse knowledge of code of ethics. Case to case analysis is as follows.
(i) As per the Code of Ethics the practicing chartered accountants are not allowed to publicize their services in a manner as is done by other normal businesses.
Appropriate newspaper/magazine may be used to inform the public of the establishment of a new practice. But such announcements should be limited to a bare statement of fact. Thus, Mr. Shamsuddin can accept a discount offer provided he ensures compliance to the above. A large number of students simply stated that Mr. Shamsuddin can accept the discount without deliberating on the issue as regards the extent to which he may publicize his firm.
(ii) Chartered Accountants in practice should be careful not to quote fee lower than that charged by their predecessors unless the scope and quantum of work materially differs from the scope and quantum of work carried out by the previous auditor. Very few of the students were able to refer to the scope and quantum of work.
(iii) As per the Code of Ethics, the professional fees should not be contingent upon the findings or results of such services. Condition imposed by Design Limited may have impaired the objectivity of the auditor on account of self interest threat. Therefore, Mr. Shamsuddin should not have accepted such a proposal. Very few of the students mentioned the issue of self interest threat and only managed to specify that such a proposal should not be accepted.
(iv) In the given situation, the existing as well as the proposed auditors should immediately communicate the fact to ICAP and the proposed auditor should not accept the offer without clearance from ICAP and the existing auditor.
Very few of the students could reply on the above lines.

Q. 160 *Refer to the solution of Question # 5 of ICAP's Official Question Bank.*

Examiners' Comments:
This question was generally well attempted though quite a few students could not identify the threats and instead, delved upon lack of independence, integrity, confidentiality, technical competence, professional behaviour of the auditor, etc. Some students thought it fit to prefix 'self' with every threat eg 'self advocacy threat', 'self intimidation threat'! A fairly large number of candidates gave incorrect examples also.

Q. 161 **(a)**
This creates Self-Interest Threat (because results of financial statements will affect wealth of team member).

Significance of threat depends on:
- Nature of Relationship with holder of shares
- Materiality of financial interest.

Safeguards By Team Member:
- Communicate the fact to audit firm.

Safeguards By Firm:

- Remove the team member from team or
- Dispose the financial interest.

For work done prior to disposal/removal:

- Independent internal quality control review of work done and significant judgments made by individual.
- Matters should be discussed with TCWG.

(b)

This creates Familiarity Threat. (because audit team member may be too sympathetic to upset "friends", and may lose professional skepticism and objectivity)

Significance of Threat will depend on:

- Length of time individual has been member of audit team.
- Seniority/Role of individual in audit team.
- Nature of the engagement.
- Changes in senior management of client

Safeguards:

If threat is significant:

1. Rotation of senior personnel off assurance team.
2. Independent internal quality control review of work done and significant judgments made by individual.
3. Discuss the fact with TCWG.

Examiners' Comments:

This question was designed to test the knowledge of the candidates on identifying independence threats and suggesting possible safeguards. The performance of the candidates remained average. The important aspects of the performance are as follows:

• Most candidates identified the threats correctly. However, some candidates tried to mention as many threats as they could think of. This is a most inappropriate way of answering the question and gives a clear indication that the candidate is not aware of the correct answer.

• While discussing the possible safeguards, many students mentioned "ensure proper safeguards" or "adopt safeguards in accordance with Firm's policies and procedures". Such answers are not acceptable as the students need to be very specific while putting forward their recommendations.

Q. 162 (a)

This creates:

- Self Interest Threat. (because it will involve a common financial interest) and
- Intimidation Threat

Significance will depend on:

- whether transaction is within ordinary course of business.
- terms of transaction is on arm's length basis.
- magnitude of transaction is immaterial for both (client and firm)

If threat is significant:

1. Ensure that transaction is on arm's length basis.
2. Terminate the business relationship or reduce it so that financial interest is immaterial and relationship is insignificant.
3. Communicate to TCWG

4. Remove the individual from engagement team

(b)
This creates:
- Familiarity Threat (because individual will have his friends in assurance team)
- Self Interest Threat (because firm may owe amounts to individual)
- Intimidation Threat (because team may be pressurised by ex-boss)

Significance depends on:
- Length of time individual has been member of audit team.
- Seniority/Role of individual in audit team.

Safeguards include:
- Individual does not participate in firm's business or professional activities.
- Firm does not owe any significant amount to individual.
- Modify the audit program.
- Assign sufficiently experienced staff in relation to individual.
- Discuss the issue with TCWG
- Independent internal quality control review of work done.

Alternatively, you can refer to the solution of Question # 6 of ICAP's Official Question Bank.

Examiners' Comments:
In this question the students were asked to identify the categories of threats involved in two different situations and to suggest appropriate safeguards.
(a) Most students were able to identify the two threats i.e. threat to independence and self interest threat. However, very few students knew that under the Companies Ordinance 1984, a person cannot become the auditor of a company to whom he/she is indebted and hence the options available in the given situation was re-payment of debt or withdrawl from the assignment.
(b) It was quite apparent that most of the students had not studied the relevant part of the Auditing Standard as very few of them were able to identify the relevant threats or the necessary safeguards. Many students misunderstood the situation as they construed that Kamal was still in the employment of the audit firm.

Q. 163 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 164 *Refer to the solution of Question # 34 of ICAP's Official Question Bank.*

Examiners' Comments:
a
Candidates were required to list audit procedures and actions in respect of the director's decision to revalue some inventory to a potentially unrealistic amount.
The question was worth 6 marks. As the requirement verb was list, then including 6 relevant procedures in the answer would obtain full marks.
This question proved to be a fairly good discriminator with many candidates struggling to obtain more than 3 marks overall. The majority of answers explained the need to discuss the matter with the directors, the effect on materiality and the need to modify the audit opinion to obtain these marks. Some answers went on to mention other points such as representation letters and reviewing the proposed policy against GAAP to see if it actually was valid.

The main weakness in many answers concerned the apparent need to go back and audit inventory from the beginning of the audit, even though the question requirement clearly stated that audit was complete apart from this issue. Audit procedures regarding existence (seeing the inventory), obtaining the government contract to determine the need to hold 6,000 barrels of oil, etc were therefore not relevant to the answer. A minority of candidates also treated the issue as an event after the reporting period and moved on to discussing the going concern status of the company. As no inventory had actually been destroyed, these comments were again treated as not relevant.
Example comments provided and reasons why those comments did not obtain a pass standard are noted below:

Answer comment (part (i))

"Verify that the inventory of oil exists by attending the client and using a dipstick to check the level of oil in the tank."

Examiners assessment of comment

Potentially a good procedure on inventory, but not relevant here because audit work was complete.

Answer comment (part Iii)

"Amend the financial statements to show the net realisable value of oil at £15 / barrel.".

Examiners assessment of comment

This was another common error in many answers. Auditors cannot amend the financial statements; only present an opinion on the financial statements provided to them by the directors.
Other common errors included:
- Considering resignation if the directors refuse to amend the inventory value; this was normally considered too extreme in this situation; a qualification of the audit report being sufficient,
- Provision of every possible type of audit report modification/qualification without clearly explaining first that the directors' amendments needed to be reviewed and then the appropriate report produced dependent on those amendments.

The overall standard of answer was inadequate. As in previous examinations, candidates need to consider carefully the time positioning of the question and not go back and repeat audit produces that should, by the end of the audit, already be complete.

5b

Candidates were expected to state and discuss various responsibilities, reporting options and safeguards regarding fraud affecting the external auditor.
The question was worth 12 marks over three sub-sections.
In part (i), candidates were required to state the responsibilities of the external auditor regarding fraud. Given revisions to ISA 240 this was a relatively topical question. Many candidates managed to state 3 or sometimes 4 responsibilities to obtain a clear pass standard.
Common weaknesses in this section included:
• Talking around the main issue. For example, many candidates explained the responsibilities of management, internal audit and even the audit committee without managing to bring external auditors into their answers.
• Providing comments that were not quite correct. For example, stating that external auditors were responsible to detect all fraud, or in some cases that they had no responsibility at all.
• Providing lengthy explanations of actual watch-dogs and blood-hounds rather than auditor responsibilities.
Overall, the question was fairly well answered.
In part (ii), candidates were required to discuss groups who could be informed regarding the fictitious inventory. 6 marks were available with up to 2 marks for each group discussed.
There were two key issues that limited the marks obtained from this question;
• Firstly, identifying the appropriate groups. The directors appear to have entrenched their view that the inventory is to be revalued; reporting back to the directors appears therefore to be inappropriate. Other reporting options are also limited by confidentiality issues; hence reporting to

the bank or payables is probably not acceptable. However, there are still plenty of groups to report to including the audit committee, various authorities potentially including fraud reporting, etc. Many candidates obtained 3 or 4 marks by simply identifying the groups.
• Secondly, discussing why each group was being reported to. Almost all candidates found this discussion element of the question difficult. For example, candidates did mention that reporting to the audit committee was appropriate, but not that the committee as independent NEDs could hopefully persuade the board that simply making up a inventory figure was wrong and could provide grounds for the members to remove the directors (let alone mentioning the legal implications of the act).
Most candidates therefore obtained marks for identifying groups, but few marks were obtained for stating why those groups were being reported.
In part (iii), candidates were required to discuss the safeguards protecting the auditor from the intimidation threat of being removed from office for qualifying the audit report. Most candidates managed to mention key safeguards of resignation and qualifying the audit report anyway. However, other points such as discussion with the audit committee, discussion with the auditors professional body, etc were not always mentioned.
Common errors included:
• Suggesting safeguards that did not appear to be effective such as referring directors to the engagement letter.
• Stating that the auditor should convene a shareholders' meeting. This point was only valid when linked to resignation as otherwise the auditor could not ask for a meeting to be convened.
• Suggesting that the auditor should speak at the annual general meeting. This would not be immediately effective and would only be helpful when linked to resignation or removal.
Overall, the standard of answers could have been better given a little thought about the effectiveness of the safeguard being mentioned in the answers.

Q. 165 Confidential information may be disclosed in following circumstances:

- If disclosure is permitted by client
- When it is legal duty e.g.
  - Violation of law (if required to be reported under relevant law).
  - Production of documents in the course of legal proceedings.
- When it is professional duty or right of chartered accountant to disclose e.g.:
  - To comply with requirements of standards or ethics (e.g. when required to communicate with lawyer, professional or regulatory authorities)
  - To comply with Quality Control Review Program of the Institute.
  - To respond to an inquiry/investigation by the institute or other regulatory authority.
  - To protect the professional interest of a chartered accountant in legal proceedings.

Alternatively, you can refer to the solution of Question # 11 of ICAP's Official Question Bank.

Q. 166 ***(a)***

A C.A. should not:

- ***disclose*** confidential information acquired as a result of professional relationships.
- ***use*** confidential information for his personal advantage or advantage of third party.

(b)

Instance: Discussion of client's information with other clients

Principle breached.

Principle of confidentiality is imposed, primarily, by profession's code of ethics and not by clients. So, whether client has asked for confidentiality or not, engagement team should not discuss client's information with anyone unless permitted/required.

Instance: Disclosure of ex-client's information to friends
Principle breached.
Principle of confidentiality applies even after end of the relationship and also applies on social environment too. It does not matter whether confidential information has been used for personal advantage or third party advantage, principle has breached.

Instance: Disclosure to client's lawyer with permission
Principle of confidentiality has not breached as the permission of client has been obtained before disclosure.
(c)
Confidential information may be disclosed in following circumstances:

- If disclosure is permitted by client
- When it is legal duty e.g.
  - Violation of law (if required to be reported under relevant law).
  - Production of documents in the course of legal proceedings.
- When it is professional duty or right of chartered accountant to disclose e.g.:
  - To comply with requirements of standards or ethics (e.g. when required to communicate with lawyer, professional or regulatory authorities)
  - To comply with Quality Control Review Program of the Institute.
  - To respond to an inquiry/investigation by the institute or other regulatory authority.
  - To protect the professional interest of a chartered accountant in legal proceedings.

Examiners' Comments:
(a) Most of the students were able to quote the principles of confidentiality correctly and secured good marks.
(b) The students were able to identify the breaches committed by the trainees.
(c) The replies to the question relating to circumstances under which disclosure of client's information is allowable were generally correct. These include the situations:

- Where the disclosure is required by law
- Where the disclosure is necessary to comply with technical standards or quality control review program of the Institute
- When authorized by the client

Q. 167 **Auditor's Responsibility:**
Auditor's responsibility is to perform audit procedures to obtain sufficient appropriate audit evidence that:

1. all events subsequent to the date of the financial statements (upto date of auditor's report)have been identified by management.
2. events requiring adjustments have been adjusted, and requiring disclosures have been disclosed.

These procedures should be performed as near as possible to the date of auditors' report.

Auditor's Procedures to fulfill responsibility:
To meet his responsibility, auditor shall perform following procedures:

1) Inquiring of management and TCWG as to whether any subsequent events have occurred which might affect the financial statements.
2) Obtaining an understanding of procedures established by management to identify subsequent events.
3) Reading minutes of subsequent meetings of the entity's owners, management and TCWG and inquiring about matters discussed at any such meetings for which minutes are not yet available.
4) Reading the entity's subsequent interim financial statements, if any.
5) Requesting management to provide written representation that "all events subsequent to the date of the financial statements requiring adjustment or disclosure have been adjusted or disclosed".

Q. 168 (i)

If after the date of issuance of financial statements, auditor becomes aware a material misstatement in financial statements (e.g. an error/fraud in financial statements), auditor shall:

- Discuss with management to determine whether financial statements need amendment.
- If amendment is required, auditor shall inquire whether management agrees to amend financial statements or not.

If management agrees to amend financial statements:

Auditor shall:

– Review the steps taken by management to ensure that users do not rely on previously issued financial statements.

–Carry out necessary audit procedures on the amendment.

–Provide a new audit report (on amended financial statements) that shall include an Emphasis of Matter Paragraph or Other Matter Paragraph, referring to the

- note in financial statements that explains reason for the amendment in financial statements, or
- earlier report provided by the auditor.

If management does not agree to amend financial statements

Auditor shall take appropriate action to ensure that users are informed not to rely on financial statements.

(ii)

1. If Law or AFRF does not require management to issue amended financial statements, and
2. Issuance of the financial statements for the following period is imminent, and appropriate disclosures are made in such financial statements.

Q. 169 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Q. 170 (a)

When the representations relate to matters material to the financial statements:

1. Whether the representations appear reasonable and consistent with other audit evidence obtained.
2. Whether the individuals making them can be expected to be well informed on such matters.
3. Integrity of those making the representations.
4. Accuracy of representations made in the past.
5. Corroborate audit evidence from sources inside or outside the entity.

(b)

If management does not provide one or more of the requested written representations, the auditor shall:

1. Evaluate whether sufficient, appropriate audit evidence can be obtained from other sources;
2. If sufficient appropriate audit evidence cannot be obtained from other sources than this will constitute a scope limitation and the auditor should express a qualified opinion or disclaimer of opinion.
3. Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
4. Consider possible implications that the refusal may have on the auditor's report.
5. Re-assess the continuation of engagement with the audit client

Q. 171 Written Representations are not substitute of other audit evidence which is expected to exist. Management's representation is NOT a sufficient appropriate audit evidence and should not be accepted as sole audit evidence regarding repair and maintenance of a material amount. Auditor should inquire and insist on other documentary evidence and, if not provided, should issue qualified opinion as this will amount to scope limitation and the amount involved is material.

Examiners' Comments:
Again an easy and marks gaining question. Majority of the students got good marks. However, several students incorrectly concluded that management representation should be accepted as audit evidence in the given situation.

Q. 172 *Refer to the solution of Question # 1 of ICAP's Official Question Bank.*

Examiners' Comments:
The question was poorly answered by most students. Generally they failed to identify that the auditor doubts the reliability of written representation where he has concerns about the competence, integrity, ethical values or diligence of management or about its commitment for enforcement of controls or when the representations is inconsistent with other audit evidence. The answer to latter part of the question was even worse as very few could describe the course of action that the auditor takes in such situations.

Q. 173 *Refer to the solution of Question # 42 of ICAP's Official Question Bank.*

Q. 174 *Refer to the solution of Question # 86 of ICAP's Official Question Bank.*

Q. 175 Expectation Gap is the difference between 'What general public expects auditor does (or is responsible for)' and 'What auditor actually does (or is responsible for)'.

Expectation Gap can be reduced by profession:

- By mentioning Management's Responsibilities, Auditor's Responsibilities and Inherent limitations of audit in Engagement Letter.
- By mentioning Management's Responsibilities and Auditor's Responsibilities in Auditor's Report.
- By obtaining Written Representation from management that it has fulfilled its responsibilities.
- Major steps taken by SECP and ICAP e.g. the Code of Corporate Governance to reduce the expectation gap.

Q. 176 Following are nine elements of an unmodified auditor's report:

Sr. #	Content	Brief Explanation
1.	Title	Title tells that this is a report by auditor.
2.	Addressee	Addressee is the stakeholder whom report is issued.
3.	Introductory Paragraph	This section includes description of financial statements.
4.	Management's Responsibility Paragraph	This section describes responsibilities of management for preparation of financial statements and maintenance of internal control.
5.	Auditor's Responsibility	This section describes responsibilities of auditor to express opinion on financial statements and a brief description of audit.
6.	Auditor's Opinion	This is most important section in which auditor states whether or not financial statements present true and fair view.
7.	Signature	This section contains signature by auditor.
8.	Date	Auditor should put the date on report when he has obtained sufficient appropriate audit evidence on which to base the auditor's opinion. Date informs users that auditor has considered the effect of subsequent events upto this date.
9.	Auditor's Address	This is the name of city where auditor practices.

Q. 177 *Refer to the solution of Question # 82 of ICAP's Official Question Bank.*

Q. 178 *Refer to the solution of Question # 88 of ICAP's Official Question Bank.*

Q. 179 (i)
Accounting policies should be consistently applied. However, an entity can change its accounting policies only if the change:
(a) is required by an IFRS; or
(b) results in more relevant and reliable information in financial statements

(ii)
It is auditor's responsibility to state in auditor's report whether accounting policies have been consistently applied.

If an accounting policy is changed, auditor shall:
1. Ensure that change in accounting policy is either required by IFRS or results in more relevant and reliable information in financial statements.
2. Refer the change in accounting policy in auditor's report.
3. State in auditor's report whether he concurs with change or not.

<u>Examiners' Comments:</u>
This was a relatively simple question. Generally, the students were able to satisfactorily answer the question. However, there were certain responses which were totally irrelevant and wrong. For example, some students stated that memorandum and articles of association needed to be amended for a change in accounting policy, some stated that approval of the Corporate Law Authority/Registrar and approval of the general meeting was required.
In the second part of the question, although the students in general correctly answered but, except for one or two students, they failed to state that in case of companies, the auditors are also required to state whether or not they concur with the change in accounting policy.

Q. 180 Auditor is required to express opinion on following additional matters in accordance with Form 35A of Companies Rules 1985:

1. Whether or not proper books of accounts have been kept by the company as required by the Companies Ordinance, 1984.
2. Whether or not the balance sheet and profit and loss account together with the notes thereon have been drawn up in conformity with the Companies Ordinance, 1984, and are in agreement with the books of accounts and are further in accordance with accounting policies consistently applied.
3. Whether or not the expenditure incurred during the year was for the purpose of the company's business.
4. Whether or not the business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the company.
5. Whether or not Zakat deductible at source under the Zakat and Ushr Ordinance, 1980 (XVIII of 1980), was deducted by the company and deposited in the Central Zakat Fund established under section 7 of that Ordinance.

Examiners' Comments:
This was one of the easiest of questions. Most students were able to list the matters which are required to be reported in the audit report. However, some students misunderstood the question and instead of restricting themselves to matters referred to in Section 255 of the Companies Ordinance 1984, they started to list and describe matters on the basis of which the audit report is qualified.
(CA Inter, Autumn 2007)

Q. 181

Element	**Error/Omission**
Addressee	Statutory auditor's report should be addressed to "Members" and not to "Directors"
Introductory Paragraph	Complete set of financial statements is not mentioned i.e. cash flow statement is missing.
Management's Responsibility Paragraph	This paragraph is not mentioned in the report at all.
Auditor's Responsibility Paragraph	- Auditor's responsibility to express opinion on financial statements is not mentioned. - "as applicable in Pakistan" should be added to the end of "We conducted our audit in accordance with the auditing standards" - Phrase "on a test basis" is omitted from description of audit. - "all estimates" should be replaced by "significant estimates"
Opinion Paragraph	- Opinion whether proper books of accounts have been maintained, is not mentioned. - cash flow statement is missing from complete set of financial statements.. -"conform with International Financial Reporting Standards" should be replaced by "approved accounting standards as applicable in Pakistan"
Date	"xx" is not any date in the month of September.
Name of Engagement Partner	- This is not mentioned in auditor's report.

Alternatively, you can refer to the solution of Question # 83 of ICAP's Official Question Bank.

Q. 182

Element	Error/Omission
Introductory Paragraph	–"income and expenditure account" should be replaced by "profit and loss account". –phrase "to the best of our knowledge and belief" is missing in sentence "we have obtained all the information ....."
Management's Responsibility Paragraph	–Reference of "auditing standards" should be replaced with reference of "accounting standards". –Reference of fourth schedule is not to be given.
Auditor's Responsibility Paragraph	– Responsibility of auditor is to express an opinion of financial statements, and not to audit. –Auditor obtains only reasonable assurance in audit and not limited assurance so reference of limited assurance should be removed. –Auditor obtains reasonable assurance about whether financial statements are free of any ***material*** misstatement; so word "material" should be inserted in the sentence. –Phrase "on a test basis" is missing in the description of audit.
Opinion Paragraph	–In the opinion "a", reference to "as required by the Companies Ordinance, 1984" is missing. –In the opinion "b(ii)", auditor expresses opinion whether the expenditure incurred during the year was "for the purpose of the company's business " and NOT "in accordance with the objects of the Company" –In the opinion "b(iii)", auditor expresses opinion whether the business conducted, investments made and the expenditure incurred during the year were "in accordance with the objects of the company" and NOT "for the purpose of the Company's business". –In the opinion "c", reference to the "profit, cash flows and changes in equity" are missing.
Signature	–Signature of auditor is missing from auditors' report.
Place	–Place is missing from auditors' report.
Name of Engagement Partner	–Name of Engagement Partner is missing.

Alternatively, you can refer to the solution of Question # 85 of ICAP's Official Question Bank.

<u>Examiners' Comments:</u>
This question was an easy one. The students were asked to identify the errors in the given report in comparison with a standard statutory audit report. Majority of the students were able to identify the errors correctly and scored good marks. Many students were able to gain full marks also. However, some students produced the whole report (after making the corrections) or extracts of the Report instead of highlighting the errors in the report.

Q. 183 (a)

	Reasonable Assurance Engagement	Limited Assurance Engagement
Examples	Audit of Financial Statements	Review of Financial Statements
Definition/ Objective	An engagement to provide high but not absolute level of assurance. Objective is to reduce the risk to an appropriate level to provide basis for positive form of conclusion.	An engagement to provide moderate level of assurance. Objective is to reduce the risk to an appropriate level to provide basis for negative form of conclusion.

Level of Assurance	Reasonable/High/Positive	Limited/Moderate/ Negative
Governed by	International Standards on Auditing (ISAs)	International Standards on Review Engagements (ISREs)
Procedures	Procedures to gather sufficient appropriate evidence.	Procedures are deliberately limited as compared to a reasonable assurance engagement.
Report	Positive form of conclusion is expressed in Report.	Negative form of conclusion is expressed in Report.

(b)
The auditor should make inquiries, primarily of persons responsible for financial and accounting matters, and perform analytical and other review procedures to enable the auditor to conclude on financial statements. A review ordinarily does not require tests of the accounting records through inspection, observation or confirmation.

Ordinarily auditor performs the following procedures:

- Obtaining underlying evidence that the interim financial information agrees with the underlying accounting records.
- Inquires of management about:
  - Whether the interim financial information has been prepared in accordance with AFRF.
  - Whether there have been any changes in accounting principles or in the methods of applying them.
  - Whether related party transactions have been appropriately accounted for and disclosed in the interim financial information.
  - Significant changes in contingencies and commitments.
  - Compliance with debt covenants.
  - Any known uncorrected misstatements.
  - Significant transactions immediately before and after period-end.
  - Knowledge of any fraud or suspected fraud affecting the entity.
- Reading the minutes of the meetings of shareholders, and TCWG.
- Applying analytical procedures i.e. comparing interim financial information with
  - Prior Period, Budgets competitors and industry
  - Other financial elements.
  - Non-financial information.
- Apply analytical procedures using disaggregated data e.g. by Period, by Product line, by Location.

Auditor shall also:

- inquire whether management has identified subsequent events after balance sheet date requiring adjustment/disclosure. (no other procedures required for auditor to identify these events)
- inquire whether management has identified events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If identified, auditor shall inquire management about future action and should consider adequacy of disclosure.
- obtain written representation letter from management.
- consider matters giving rise to modification in audit/review report in previous periods
- read other information to identify a material inconsistency

Q. 184

1) Appropriate Addressee is not mentioned.
2) Conclusion is only on current period's interim financial information, hence, reference to the last year's period should not be mentioned in Introduction.
3) In Introductory Paragraph, "Statement of changes in equity" is not mentioned in as component of financial statements.
4) Review of financial statements is conducted in accordance with International Standards on Review Engagement (ISRE) and NOT in accordance with International Standards on Auditing. Moreover, reference to ISRE is given in scope paragraph and NOT in introductory paragraph.
5) Auditor's Responsibility is not mentioned in Introductory paragraph.
6) Scope Paragraph does not state that "we do not express an audit opinion."
7) Conclusion paragraph does not state words ""in accordance with approved Accounting Standard as applicable in Pakistan".
8) Conclusion paragraph does not contain word "material". "in all respects" should be replaced by "in all material respects"
9) Restriction on use should not be mentioned in conclusion paragraph.
10) Auditor should qualify its review report on the basis of misstatement in financial statements. Emphasis of Matter paragraph is not a substitute of Qualified Conclusion.
11) Address of auditor is not mentioned in review report.
12) Date is not mentioned in review report.

Q. 185 **Auditor's Procedures:**

When, as a result of this inquiry or other review procedures, the auditor becomes aware of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor should:

a) Inquire of management as to its plans for future actions based on its going concern assessment (to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital), the feasibility of these plans, and whether management believes that the outcome of these plans will improve the situation; and
b) Consider the adequacy of the disclosure about such matters in the interim financial information.
c) The auditor should inquire whether management has changed its assessment of the entity's ability to continue as a going concern.

Going Concern Issues and Effect on Review Report:

Result	Effect on Report
When a Material Uncertainty exists which is adequately disclosed	Emphasis of Matter paragraph
When a Material Uncertainty exists but NOT adequately disclosed	Qualified or Adverse Conclusion

Alternatively, you can refer to the solution of Question # 90 of ICAP's Official Question Bank.

Examiners' Comments:
This proved to be the most difficult question for the candidates. Their approach in addressing the situation indicating potential going concern uncertainty and the resultant implications on review

report of interim financial information left much to be desired. Only few of the candidates tackled the question in a desired order.

Q. 186 *Refer to the solution of Question # 91 of ICAP's Official Question Bank.*

Examiners' Comments:
This question was not appropriately understood by many candidates. The question focused on updating auditors information for review of interim financial statements whereas most of the candidates structured their response with reference to client acceptance procedures or the procedures for understanding the client's business.

Q. 187 *Refer to the solution of Question # 89 of ICAP's Official Question Bank.*