FULL AUDIT COMPETENCE PRACTICE EXAMINATION (CPE)

SOLUTION ONE

SECTION A

(1) Evaluation of the findings contained in the Audit Monitoring Report

- **Review of the firm** – The firm does not have a clear policy on the Audit Supervisor role and no one wants this position. There are no explicit lines of authority. The firm's overriding desire for quality will necessitate policies and procedures on ensuring excellence in its staff, to provide the firm with 'reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances'. Guidance on human resources and in particular supervision is given in ISQC 1 Quality Control for Firms that perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements, and ISA 220 Quality Control for an Audit of Financial Statements respectively. The firm is responsible for the ongoing excellence of its staff, through continuing professional development, education, work experience and coaching by more experienced staff. Supervisors are very important in professional assignments. Their roles generally include the following roles:
    - Tracking the progress of the audit engagement
    - Considering the capabilities and competence of individual members of the team, and whether they have sufficient time and understanding to carry out their work
    - Addressing significant issues arising during the audit engagement and modifying the planned approach appropriately
    - Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.

  It seems the job design for the supervisory role was poorly done. There are two major reasons for attention to job design:
    - To enhance the personal satisfaction that people derive from their work and:
    - To make the best use of people as a valuable resource of the organization and to help overcome obstacles to effective performance.

There is need for the firm to immediately engage a human resource expert to carry out a job evaluation exercise and come up with suitable human resources policies and procedures, including job designs.

[Award marks as follows:

1 mark for reference to ISQC1/ISA 220

1 mark for firm's overriding desire for quality

½ mark for any valid point on supervisory role

½ mark for any valid point on job design

1 mark for immediate appointment of a human resource expert]

- **File no. 1** – No analytical procedures carried out. A note from the Audit Supervisor stated that since the client was new there was no need to perform analytical procedures. Guidance on analytical procedures is given in ISA 520 Analytical Procedures. Analytical procedures are used at three stages of the audit:
  - Planning
  - Substantive
  - Overall

  The standard requires the use of analytical procedures at the planning and overall review. Their use as substantive procedures is optional. Analytical procedures consist of comparing items, for example, current year financial information with prior year financial information, and analyzing predictable relationships, for example, the relationship between receivables and credit sales. It is, however, true that using analytical procedures is generally easier when the client is not new. This does not mean that analytical procedures cannot be used. The Audit Supervisor requires further training so that he does not continue to mislead Junior Auditors. It is also impacts on quality adversely.

[Award marks as follows:

1 mark for reference to ISA 520

1 mark for meaning of analytical review

½ mark for not true

½ mark further training]

- **File no**. **2 –** The audit programme on the section for going concern stated not applicable (N/A). This client was formed by an Act of Parliament and the Government always provides funds when necessary. However, Government policies may change and this could affect going concern of the entity. The auditors should carry out audit work on going concern. To minimize the risk of change in government policies not coming to the auditor's attention which could impact on the going concern assumption, the auditor should ascertain whether:
  - The government has declared its intention to review an area of policy affecting the audited entity
  - A review has been announced and is in progress
  - A review has indicated that an entity's future may be re-examined.

  The above clearly shows why there is need to review the going concern assumption even for a government funded institution. For the future, the firm should use appropriately qualified and experienced staff on such assignments.

  The auditor failed to follow the guidance in ISSAI 1570 may be due to incompetence.

[Award marks as follows:

½ mark for reference to ISSAI 1570

1 mark for change of policy

½ mark for auditor's attention

1 mark for need to review going concern

1 mark for use of appropriately qualified and experienced staff]

- **File no**. **3** – There was no risk assessment conducted given that this is an old client. The Audit Senior stated that the audit team was informed that there were no major changes by the audit committee. ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment states that the objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. It is therefore a professional requirement that a risk assessment should be carried out. Not carrying out risk assessment could mean the audit was not conducted properly. This could damage the firm's reputational and could also lead to unnecessary litigation if it became public knowledge. The firm must institute serious investigation into what happened and review the entire exercise and carry out appropriate disciplinary action to any audit team member who may be found wanting.

[Award marks as follows:

½ mark for reference to ISA 315

½ mark for professional requirement

1 mark for reputational/litigation risk

1 mark for review/investigation

1 mark for disciplinary action]

- **File no**. **4** – The audit evidence obtained was not sufficient and appropriate to support the unmodified opinion given. This is contrary to the guidance given in ISA 500 Audit Evidence. The standard states that the objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

  It appears the auditor was under pressure either within and/or without to issue an opinion. This is also has ethical implications. The International Ethics Standards Board for Accountants (IESBA) code. The code is very clear on objectivity. It requires that the member to not allow bias, conflicts of interest or undue influence of others to override professional or business judgements. This also requires review of the audit and serious independent investigation before action is taken.

[Award marks as follows:

½ mark for reference to ISA 500

½ mark for reference to IESBA code

1 mark for review/investigation

1 mark for action taken]

(2) Mweru Plc

(a) Main enquiries

ISRE 2410 Review of Interim Financial Information Performed by the Independent Auditor gives detailed guidance in this area. The main enquiries include:

- Whether the interim financial information has been prepared and presented in accordance with IFRSs?
- Whether there have been changes in accounting policies?
- Whether there have been unusual or complex transactions, e.g. disposal of a business segment?
- Significant assumptions relevant to fair values.
- Whether related party transactions have been accounted for and disclosed correctly?
- Significant changes in commitments and contractual obligations.
- Significant changes in contingent liabilities including litigation or claims.
- Compliance with debt covenants.
- Significant transactions occurring in the last days of the interim period or the first days of the next.
- Knowledge of any actual or possible non-compliance with laws and regulations that could have a material effect on the interim financial information.
- Whether all events up to the date of the review report that might result in adjustment in the interim financial information have been identified?
- Whether management has changed its assessment of the entity being a going concern?

[Award 1 mark for each valid enquiry – Maximum 5 marks]

(b) Importance of ethics

A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Ethical conduct in the review of interim financial information therefore ensures the public interest requirement is met and interim financial information can reasonably be considered reliable. Various stakeholders rely on auditors and their expertise.

ISRE 2410 Review of interim financial information performed by the independent auditor of the entity states that the auditor should comply with ethical principles relevant to the audit when carrying out an interim review.

[Award marks as follows:

1 mark for public interest

1 mark for reliability

1 mark for reference to ISRE 2410]

(c) Ethical threats and recommended safeguards

Ethical threats	Explanations	Recommended Safeguards
(1) A qualified auditor of Sitali Accountants was seconded to the client for five (5) months	It is possible that auditor could have prepared a significant proportion of the interim financial information to be reviewed; this creates a self-review threat as he will review his own work during the review.	The auditor should be removed from the assignment to avoid the threat to independence.
(2) Engagement Partner and the Human Resources Director are related in marriage	The relationship could create a familiarity threat. The Engagement Partner may want to impress the Human Resources Director in order to maintain the relationship. This will impair objectivity.	The Human Resources Director may not be too close to the Engagement Partner. In fact, he cannot exert direct and significant influence over the preparation of the interim financial information. Hence, no safeguard is recommended.
(3) Promise to engage Sitali Accountants to assist with the provision of internal audit services	This will at the moment create self-interest as Sitali Accountants would want to impress Mweru Plc in order to be given the assignment. Later on, this could result in a self-review threat. There is also a possibility of	Given that Mweru Plc is a public interest entity, it advisable to decline this offer.

	assuming management responsibility. This could have a serious negative impact on independence.	
(4) Audit Supervisor owns a few shares in Mweru Plc	The financial interest could create a self-interest threat since the Auditor may not question misstatements which could impact positively on the dividend and share price. He is unlikely to exercise appropriate levels of professional skepticism.	Ideally the Audit Supervisor should be replaced.
(5) Fee for the review of interim financial information to be based on a percentage of profit after taxation	The proposed fee represents a contingent fee. This is prohibited.	Sitali Accountants must refuse the proposal. The fee must be based on the time spent and the level of work performed.
(6) Engagement Partner would like his son, Wesley to be part of the audit team	This will give rise to familiarity threat because his father could be sympathetic when reviewing his work. This may impair objectivity.	In the interest of protecting objectivity, the son should not be part of the review team.
(7) The Audit Committee for Mweru Plc has decided that Sitali Accountants will continue reviewing the interim financial statements for the next ten (10) years	This will give rise to a serious familiarity threat. The long association could impair objectivity and independence.	Advise Mweru Plc's Audit Committee to consider the guidance given in IESBA code.
(8) The audit team members will receive free COVID-19 vaccine, which	This will create a self-interest threat in the form of gifts and hospitality. The	It would be advisable to decline the COVID-19 vaccine, unless the value is

the company had organized.	audit team may want to reciprocate the good gesture. This may impair objective.	trivial and inconsequential and all employees have access to the COVID-19 vaccine.

[Award marks as follows:

½ mark for each identified ethical threat – Maximum 4 marks

Up to 1 ½ marks for each valid explanation – Maximum 12 marks

1 mark for each recommended safeguard – Maximum 8 marks]

<u>SOLUTION ONE</u>

<u>SECTION B</u>

(3) Kariba Ltd

(a) Business risks

Business risks	Explanations	Effect on the financial statements
(1) Changes in tax legislation, adjusting the tax rates upwards	The increased taxes will have a huge negative impact on cash flows and this could affect the operations of the company.	The changes could therefore impact on the following: • Going concern • Provisions • Contingencies
(2) High cost of mining	The company's profitability will decline and investors may consider taking their	The high cost of mining will impact on the following: • Going concern • Disclosures e.g. regarding

	investment to other profitable ventures.	compliance with loan covenants
(3) New Management	This may affect the entire business processes.	New management will affect a number of areas in the financial statements.
(4) Deteriorating exchange rate	This will increase the cost of doing business and this could have a negative impact on liquidity and profitability.	In addition to impact on going concern, this may also impact on the valuation of payables and recognition of revenue.

[Award marks as follows:

1 mark for each valid explanation – Maximum 4 marks

Up to 1 ½ marks for effects on financial statements]

(b) Evaluation of audit responses and suggested amendments

Audit risks	Audit responses	Evaluations and suggested amendments
(1) Additional overheads have been included in the valuation of inventory. This follows a change in accounting policy which was approved by the board. There is a risk that inventory could be overstated.	Discuss the change in the inventory policy with management and check relevant board minutes for approval. In addition, review additional overheads included to ensure that these are of a production nature.	The responses are appropriate, and therefore no amendments are suggested.

(2) A generous revenue-related bonus scheme has been introduced in the year. This may lead to fraudulent accounting in the recognition of revenue.	Management should be advised to stop this generous revenue-related bonus scheme in order to eliminate the material misstatements which will result from fraudulent accounting.	The response is inappropriate since it is a management response not an audit response. The appropriate audit responses could be performance of increased revenue cut-off testing along with a review of post year-end sales returns as they may indicate cut-off errors or fraudulent financial reporting.
(3) The working capital ratios have significantly deteriorated despite the increase of revenue. This could be evidence of overtrading which could result in going concern difficulties.	Prepare detailed 12 months' forecasts and discuss with management the assumptions used.	The response is inappropriate since it is a management response not an audit response. The appropriate audit responses could be to request management to prepare the forecast and then as auditors we review the forecasts for reasonableness, accuracy etc.
(4) There is a risk that Kariba Ltd may fail to comply with the loan covenants, resulting in the loan being recalled. This could then possibly lead to going concern issues.	The audit team must maintain professional skepticism.	Maintaining professional skepticism will be an appropriate response especially if experienced auditors will be used.

(5) 20% of the receivables included in the financial statements could be irrecoverable. Hence, there is a risky that the receivables are understated.	Carry out appropriate confirmation of receivables, using positive confirmation.	The audit response is appropriate. However, the risk is not understatement of receivables but overstatement of receivables.

[Award up to 2 marks for each valid evaluation and amendment if any necessary – Maximum 8 marks]

(4) Chambishi Plc

(a) Convertible securities and why they are used

Convertible securities are securities that give the holder the right to convert to other securities, normally ordinary shares, at a pre-determined price/rate and time. Most companies issuing convertible securities (e.g. convertible bonds) expect them to be converted. They view the bonds as delayed equity. They are often used either because the company's ordinary share price is considered to be particularly depressed at time of issue or because the issue of equity shares would result in an immediate and significant drop in earnings per share (EPS).

[Award marks as follows:

1 mark for definition

1 mark for depressed price

1 mark drop in EPS]

(c) Procedures when issuing convertible securities

Section 155 (1) of Companies Act states that the board of directors shall, before issuing any securities that are convertible into shares in the company or any options to acquire shares in the company—

(a) determine the consideration payable with respect to the convertible securities or options and, in either case, the shares and the terms on which the shares shall be issued;

(b) if the shares are to be issued for consideration, other than cash, determine the reasonable present cash value of the consideration; Companies [No. 10 of 2017 487

(c) resolve that the consideration payable and the terms of the issue of the convertible securities or options and, in either case, the shares are fair and reasonable to the company and to all existing shareholders; and

(d) if the shares are to be issued, other than for cash, resolve that the present cash value of the consideration to be provided is not less than the amount to be credited for the issue of the shares.

Section (2) states that the directors who vote in favour of a resolution, required by subsections (1)(c) and (d), shall make a declaration—

(a)stating the consideration for, and the terms of the issue of, the convertible securities or options and, in either case, the shares;

(b) describing the consideration in sufficient detail to identify it;

(c) where a present cash value has been determined, in accordance with subsection (1) (b), stating that value and the basis for assessing it;

(d) stating that the consideration for and terms of issue of the convertible securities or options and, in either case, the shares are fair and reasonable to the company and to all existing shareholders; and

(e) if the shares are to be issued, other than for cash, stating that the present cash value of the consideration to be provided is not less than the amount to be credited for the issue of the shares. (3) The board of directors shall within ten days of the declarations being signed, deliver copies of the declarations, made in accordance with subsections (2) (d) and (e), to the Registrar, in the prescribed form, for registration.

[Award 1 mark for each valid procedure – Maximum 6 marks]

[Award 1 mark for each valid procedure – Maximum 6 marks]

(d) Recommended audit procedures

The audit procedures include the following:

- Test how management made the accounting estimate and the data used. Check that fair value is arrived at in accordance with IFRS 13, using the fair value hierarchy.
- Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures.
- Develop a point estimate or a range to evaluate management's point estimate, e.g. the auditor can make their own estimate of the fair value.
- Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate, e.g. are there any indicators of impairment?

[Award 2 marks for each correct recommended audit procedure – Maximum 8 marks]

(5) Zambezi Ltd

(a) Relevant procedures

The relevant procedures include the following:

- Verify projected income figures to suitable evidence e.g. price list, current market prices etc.
- Verify expected demand to estimates (e.g. budgets) and previous patterns.
- Verify the following projected expenditure to suitable evidence:
    - Cost of sales against quotations from suppliers, contracts etc.
    - Depreciation against company policy and projected capital expenditure.
    - Administration against current bills, rental agreements etc.
    - Distribution cost against current quotations, market rates etc.
    - Finance costs against current rates from banks and other financial institutions.
    - Income tax against the actual income tax rates.

[Award up to 2 marks for each relevant procedure – Maximum 12 marks]

(b) Action(s) to take

If the prospective financial information (PFI) contains unrealistic assumptions, the auditor must not accept or should withdraw from an engagement. This is a more risky assignment compared to the annual financial audit. The annual financial audit deals mainly with historical events while PFI deals with future events.

[Award marks as follows:

Up to 2 marks for not accept/withdraw

1 mark for risky assignment]

SOLUTION TWO

SECTION A

(1) Ministry of Health guidelines

(a) & (b) Main risks and recommended appropriate controls

Main risks	Explanations	Recommended appropriate controls
(1) Receipt of cash by unemployed parents	Cash is risky and the parents may not use it for the intended purpose. It can also be misappropriated by the responsible officials.	Use exchangeable certificates like those used for working parents.
(2) Definition of lower income	This may be questionable, and discretion may be used in some cases. Abuse may go unnoticed.	Use experts to determine the lower threshold.
(3) Approval of providers	The procedures may be open to abuse.	Appoint a committee to scrutinize all applications before approval. Only those who are able to exercise a high level of care should be approved.
(4) Lack of inspection	Abuse may go unnoticed.	Periodic inspection of hospitals by relevant regulators, including unannounced visits by senior officials.
(5) Use of volunteers	Some could have poor attitudes towards work, resent formal procedures and lack the required competence.	Conduct proper background checks.

(6) Lack of segregation of duties	Internal check may be absent and will mean fraudulent activities may go unnoticed.	Appoint a finance committee to oversee the operations.
(7) Lack of ethical behaviour	Regulators may be bribed so that wrongdoing is not acted upon.	At least two inspectors should be involved in the inspections and there should a deliberate policy of rotation.

[Award marks as follows:

Up to 2 marks for each main risk – Maximum 12 marks

1 mark for each appropriate control – Maximum 6 marks]

(2) Tiger Ltd

(a) Problems and possible solutions

Problems	Solutions
(1) First year audit costs – the relative costs of an audit in the first year at a client tend to be greatest due to additional work of ascertaining client systems. This means Serenje Associates may have a limited budget to document systems including computer systems.	This can be alleviated to some extent again by good audit planning. The audit manager must also monitor the audit process carefully, ensuring that any additional work caused by the client not providing access to systems information including computer systems is identified and added to the total billing cost of the audit.
(2) Timescale – the audit report is due to be signed six weeks after the year end. This means that there will be considerable pressure on the auditor to complete audit work without compromising standards by rushing procedures.	This can be overcome by careful planning of the audit, use of experienced staff and ensuring other issues such as second partner reviews are booked in advance.
(3) Software issues – it seems there will be little time to write and test audit software, let alone use the software and evaluate the results of testing.	Specialist computer audit staff with suitable knowledge relating to computer assisted audit techniques (CAATs) should be used.

(4) Live testing – this increases the risk of accidental amendment or deletion of client data systems.	Consider testing when system is not in use e.g. over the weekends or use copies of backups for testing.
(5) Staff exams – there is likely to be a shortage of staff as most them will be writing exams.	Book staff as soon as possible any shortages can be filled using suitably experienced temporal workers.

[Award marks as follows:

1 mark for each problem explained – 5 marks

1 mark for each solution – 5 marks]

(b) Bank report

The procedures are as follows:

- Consider if a bank letter is required. For the audit of Tiger Ltd, the bank letter will be required as the company has significant cash and bank transactions.
- Produce a bank letter in accordance with local audit regulations and practices.
- Send the bank letter to Tiger Ltd to sign and authorize disclosure and then it will be forwarded on to Tiger Ltd's the bank.
- The bank will complete the letter and send it back directly to Serenje Associates.

[Award 1 mark for each procedure – Maximum 4 marks]

(c) Audit procedures

The audit procedures in respect of existence of non-current assets will include the following:

- Confirm that the company physically inspects all items in the non-current asset register each year.
- Inspect assets, concentrating on high value items and additions in the year under review. Confirm that items inspected exist, are in use, are in good condition etc.

[Award up to 2 marks for each audit procedure – Maximum 4 marks]

(3) Briefing notes

To: Managing Partner

From: Audit Manager

Subject: **Risk management systems and offer to be auditor**

Introduction

As requested, these briefing notes state the risk management systems requirements for reporting entities under the Finance Intelligence Centre (FIC) Act, and how the offer from the company owned by a senior government official should be handled.

Risk management systems requirements

The Financial Intelligence Centre (FIC) Act states that a reporting entity shall identify, assess, and understand the money laundering and financing of terrorism or proliferation or any other serious offence relating to money laundering, financing of terrorism or proliferation risks with regard to its products, services, delivery channels and its customers, geographical locations and country risk. A reporting entity shall, based on the assessment above:

- Apply a risk based approach to ensure that measures to prevent or mitigate money laundering and financing of terrorism or proliferation or any other serious offence relating to money laundering, financing of terrorism or proliferation are commensurate with the risks identified.
- A reporting entity shall, in relation to the above—
  (a) prior to the launch or use of a new product and new business practices, including a new delivery mechanism, and the use of a new or developing technology for both new and pre existing products, identify, assess, manage and mitigate the risks that may arise in relation to the development and use thereof;
  (b) document its risk assessments;
  (c) consider all the relevant risk factors before determining the level of overall risk and the appropriate level and type of mitigation to be applied; and
  (d) keep the assessments up to date.

Where a reporting entity identifies customers whose activities may pose a high risk of money laundering and financing of terrorism or proliferation or any other serious offence relating to money laundering, financing of terrorism or proliferation, the reporting entity shall exercise enhanced identification, verification and ongoing due diligence procedures with respect to those customers and shall—

(a) obtain approval from senior management of the reporting entity before establishing a business relationship with the customer, or later, as soon as an existing customer is identified as a high risk customer;

(b) take all reasonable measures to verify the source of wealth and funds and other assets of the customer;

(c) provide increased and ongoing monitoring of the customer and the business relationship to prevent money laundering, financing of terrorism or proliferation or the commission of any other serious offence related to money laundering, financing of terrorismor proliferation and to permit the reporting entity to fulfil its obligations under this Act, including all of its due diligence and reporting requirements

Offer to be auditor

The senior government official is considered to a politically exposed person (PEPs). Great care should be taken by Serenje Associates when dealing with such people. To establish a relationship with a company owned by a politically exposed person the firm should at a senior level evaluate the relationship and such relationship should be approved at this high level.

Among the matters to seriously consider before acceptance include the source of the wealth of the senior government official. At the moment, since we do not even have proper risk management systems, it may appropriate to decline the offer as being too risky.

[Award marks as follows:

Up to 4 marks for presentation

2 marks for each valid requirement – Maximum 8 marks

Up to 2 marks on offer to be auditor]

SOLUTION TWO

SECTION B

(4) Chongwe Zambia Bank

Evaluation of the governance structures for Chongwe Zambia Bank

- Appointment of board members – the board members are appointed by the majority shareholder of Chongwe Zambia Bank. This contrary to the Bank of Zambia Corporate Governance Directives, which requires that directors should be appointed through a formal, rigorous and transparent process.
- Independence and objectivity – there is no doubt that the former bank managers could possess wide knowledge of the industry from which Chongwe Zambia Bank be benefiting significantly. However, it is likely that the majority shareholder and the former bank managers are friends or even related. Hence, their independence and objectivity could be questioned and this is not good for corporate governance. This is also not in line with the Bank of Zambia Corporate Governance Directives.
- Skills, knowledge and experience – the board consists only of former bank managers and this may mean that skills, knowledge and experience in other areas are definitely lacking. This is contrary to the Bank of Zambia Corporate Governance Directives which requires that there shall be a balance of skills, knowledge and relevant experience among directors in order to enhance the board's effectiveness.
- No induction is conducted – an induction process should mainly give the incoming director:
    - An understanding of the nature of Chongwe Zambia Bank, its business and the market in which it operates. This will enable new directors, especially the non-executive directors (NEDs) to participate in strategy more effectively.
    - A link with Chongwe Zambia Bank's various stakeholders especially the employees below board level.
    - An understanding of Chongwe Zambia Bank's main relationships (including meeting Chongwe Zambia Bank's auditors).

  Not conducting an induction is not in line with the Bank of Zambia Corporate Governance Directives.

- Committees – the existence of committees generally enables boards to discharge their duties more effectively. This is in line with the Bank of Zambia Corporate Governance Directives.

[Award marks as follows:

1 mark for appointment

Up to 2 marks for independence and objectivity

Up to 2 marks for skills, knowledge and experience

Up to 3 marks for induction

1 mark for committees]

(5) Mwandi Ltd

Issue one – Allowance for doubtful accounts

(a) Matters to consider

- Materiality – the potential overstatement in the valuation of investment property represents 0.5% (K250,000/K52,000,000 X 100%) of profit before tax and 0.1% (K250,000/K255,000,000 X 100%) of total assets. This is immaterial to both the statement of profit or loss and the statement of financial position.
- Risk – there is a risk that both profits and assets could be overstated.
- Relevant accounting standard – IFRS 13 *Fair value measurement* and IAS 40 *Investment property* gives detailed guidance on the valuations.
- Impact on audit opinion – Since the potential overstatement is immaterial, the audit opinion will be unmodified.

(b) Evidence

- Workings for the valuation of investment property
- Copy of company policy

Issue two – Provision of K7 million has been treated as a contingent liability

(a) Matters to consider

- Materiality – The misstatement of K7 million represents 13% (K7/K52 X 100%) of profit before tax and 2.7% (K7/K255 X 100%) of total assets. This is material to both the statement profit or loss and the statement of financial position.
- Risk – There is a risk that profits are overstated and liabilities are understated.
- Relevant accounting standard – IAS 37 *Provisions, contingent liabilities and contingent assets* requires that a provision must be recognized in the financial statements while a contingent liability may disclosed if it material. The accounting treatment is therefore incorrect.
- Impact on audit opinion – The audit opinion will be modified in the form of a qualified opinion, since the issue is unlikely to be pervasive.

(b) Evidence

- Specific details on the issue
- Correspondence with experts e.g. Lawyers

Issue three – Impairment loss

(a) Matters to consider

- Materiality - the impairment loss of K1 million represents 1.9% (K1/K52 X 100%) of profit before tax and 0.4% (1/255 X 100%). This is immaterial to both the statement of profit or loss and the statement of financial position.
- Risk – there is a risk that profits and assets are both overstated.
- Relevant accounting standard – IAS 36 *Impairment of assets* requires that impairment loss on non-current assets should be written off against profit or loss for the year. The accounting treatment is therefore correct.
- Impact on audit opinion – Since the accounting treatment is correct, the audit opinion will be unmodified.

(b) Evidence

- Copy of relevant impairment loss computation
- Copy of relevant board minutes

[Award marks as follows:

1 mark for materiality for each issue – Maximum 3 marks

1 mark for risk for each issue – Maximum 3 marks

1 mark for relevant accounting standard and treatment for each issue – Maximum 3 marks

1 mark for impact on audit opinion for each issue – Maximum 3 marks

1 mark for each audit evidence – Maximum 6]

(6) Suggested audit opinions

(a) Critically appraising an audit opinion

When critically appraising an audit opinion, it is important for the auditor appraising the audit opinion to first form his own opinion on the basis of the facts and then evaluate the original opinion in the light of his own opinion. As this a matter of judgement, it is possible that two (2) different, yet reasonable conclusions could be drawn. If this is the case, further judgements and risk assessments would have to be made.

Audit opinions will generally be appraised in the following contexts:

- Engagement Partner reviewing the audit work and conclusions drawn
- Auditor asked for second opinion about an audit opinion
- Second partner required to review an audit file.

[Award marks as follows:

Up to 2 marks for forming own audit opinion first

1 mark for evaluation of original audit opinion

Up to 2 marks for further judgements and risk assessments

1 mark for each valid context – Maximum 3 marks]

(c) Suitability or otherwise of suggested audit opinions

- **Client one** – The reclassification seem justified on the basis of the information given. Hence, the Audit Senior's suggestion of a modified audit report containing an unmodified opinion with an emphasis of matter paragraph is correct. The audit report will be modified because of the inclusion of the emphasis of matter paragraph since this is not part of the standard report given in ISA 700 (Revised) *Forming an opinion and reporting on financial statements).* The audit opinion will be unmodified because there is apparently nothing wrong with the accounting treatment.

- **Client two** – It is sometimes the case that a component, when considered in isolation, does not appear to be a going concern, even though the group as a whole is a going concern. In such a case, it is appropriate that the auditor obtains a comfort letter (also known as support letter). The suggestion by the Audit Senior is suitable provided that any material uncertainty relating to going concern is appropriately disclosed under the section in the audit report headed, "Material Uncertainty Related to Going Concern".
- **Client three** – The understatement is considered immaterial and as such a modification of either the audit report or the audit opinion is grossly misplaced. The suitable alternative will be to give unmodified audit report with an unmodified opinion. The Audit Senior could consider including the issues in the management report (management letter).
- **Client four** – Since the risk of material misstatement is considered as low and the Audit Senior has obtained sufficient appropriate audit evidence, it may be suitable to give unmodified audit report and unmodified audit opinion. The Audit Senior's suggestion of an unmodified report containing a modified opinion in the form of a disclaimer of opinion is not only incorrect but is also technically wrong. A modified audit opinion cannot be in an unmodified audit report.
- **Client five** – The audit team was unable to obtain sufficient appropriate audit evidence. The issue is with a related party and therefore could be material by nature. The Audit Senior has proposed a modified audit report containing a modified opinion in the form of an adverse audit opinion. The modifications of the audit report and the audit opinion are suitable. However, the adverse audit opinion seems inappropriate since the issue is unlikely to be pervasive. It will be suitable to give a qualified audit opinion.

[Award up to 3 marks for each client – Maximum 15 marks]

END OF SOLUTIONS