

# AUDITING BOOK

## ACCOUNTING PROFESSION OPTION for Rwandan Schools

Senior

6

Teacher's Guide

EXPERIMENTAL VERSION

Kigali, 2023

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## FOREWORD

Dear Teachers,

Rwanda Basic Education Board is honoured to present the teacher's guide for Auditing in the Accounting Profession Option. This book serves as a guide to competence-based teaching and learning to ensure consistency and coherence in the learning of the Auditing Subject. The Rwandan educational philosophy is to ensure that students achieve full potential at every level of education which will prepare them to be well integrated in society and exploit employment opportunities.

Specifically, the curriculum for Accounting Profession Option was reviewed to train quality Accountants Technicians who are qualified, confident and efficient for job opportunities and further study in Higher Education in different programs under accounting career advancement.

In line with efforts to improve the quality of education, the government of Rwanda emphasizes the importance of aligning teaching and learning materials with the syllabus to facilitate their learning process. Many factors influence what students learn, how well they learn and the competences they acquire. Those factors include the relevance of the specific content, the quality of teachers' pedagogical approaches, the assessment strategies and the instructional materials.

High Quality Technician Accounting program is an important component of Finance and Economic development of the Rwanda Vision 2050, "**The Rwanda We Want**" that aims at transforming the country's socioeconomic status. The qualified Technicians accountants will significantly play a major role in the mentioned socioeconomic transformation journey. Auditing textbooks and teacher's guide were elaborated to provide the mathematical operations, algebraic functions and equations, and basic statistics that are necessary to train a Technician Accountant capable of successfully perform his/her duties.

The ambition to develop a knowledge-based society and the growth of regional and global competition in the jobs market have necessitated the shift to a competence-based curriculum.

The Auditing teacher's guide provides active teaching and learning techniques that engage students to develop competences. In view of this, your role as an auditing teacher is to:

- Plan your lessons and prepare appropriate teaching materials.
- Organize group discussions for students considering the importance of social constructivism suggesting that learning occurs more effectively

when the students work collaboratively with more knowledgeable and experienced people.

- Engage students through active learning methods such as inquiry methods, group discussions, research, investigative activities and group or individual work activities.
- Provide supervised opportunities for students to develop different competences by giving tasks which enhance critical thinking, problems solving, research, creativity and innovation, communication and cooperation.
- Support and facilitate the learning process by valuing students' contributions in the class activities.
- Guide students towards the harmonization of their findings.
- Encourage individual, pair and group evaluation of the work done in the classroom and use appropriate competence-based assessment approaches and methods.

To facilitate you in your teaching activities, the content of this book is self-explanatory so that you can easily use it. It is divided in 3 parts:

The part I explains the structure of this book and gives you the methodological guidance;

The part II gives a sample lesson plan;

The part III details the teaching guidance for each concept given in the student book.

Even though this Teacher's guide contains the guidance on solutions for all activities given in the student's book, you are requested to work through each question before judging student's findings.

I wish to sincerely express my appreciation to the people who contributed towards the development of this book, particularly, REB staff, Office of Auditor General, UR Lecturers, Teachers from TTC and General Education and experts from different Education partners for their technical support. A word of gratitude goes also to the administration of Universities, Head Teachers and TTCs principals who availed their staff for various activities.

**Dr. MBARUSHIMANA Nelson**  
**Director General, REB.**

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# **PART I. GENERAL INTRODUCTION**

## **1.1. The structure of the guide**

The teacher's guide of Auditing is composed of three parts:

The Part I concerns general introduction that discusses methodological guidance on how best to teach and learn Auditing, developing competences in teaching and learning, addressing cross-cutting issues in teaching and learning and Guidance on assessment.

Part II presents a sample lesson plan. This lesson plan serves to guide the teacher on how to prepare a lesson in Auditing.

The Part III is about the structure of a unit and the structure of a lesson. This includes information related to the different components of the unit and these components are the same for all units. This part provides information and guidelines on how to facilitate students while working on learning activities. More over, all application activities from the textbook have answers in this part.

## **1.2. Methodological guidance**

### ***1.2.1. Developing competences***

Since 2015 Rwanda shifted from a knowledge based to a competence-based curriculum for pre-primary, primary, secondary education and recently the curriculum for profession options such as TTC, Associate Nurse and Accounting programs. This called for changing the way of learning by shifting from teacher centred to a student-centred approach. Teachers are not only responsible for knowledge transfer but also for fostering students' learning achievement and creating safe and supportive learning environment. It implies also that students have to demonstrate what they are able to transfer the acquired knowledge, skills, values and attitudes to new situations.

The competence-based curriculum employs an approach of teaching and learning based on discrete skills rather than dwelling on only knowledge or the cognitive domain of learning. It focuses on what student can do rather than what student knows. Students develop competences through subject unit with specific learning objectives broken down into knowledge, skills and attitudes/values through learning activities.

In addition to the competences related to Auditing, students also develop generic competences which should promote the development of the higher order thinking skills and professional skills in Auditing teaching. Generic competences are developed throughout all units of Auditing as follows:

Generic competences	Ways of developing generic competences
Critical thinking	All activities that require students to calculate, convert, interpret, analyse, compare and contrast, etc. have a common factor of developing critical thinking into students
Creativity and innovation	All activities that require students to plot a graph of a given algebraic data, to organize and interpret statistical data collected and to apply skills in solving problems of production/ finance/ economic have a common character of developing creativity into students
Research and problem solving	All activities that require students to make research and apply their knowledge to solve problems from the real-life situation have a character of developing research and problem solving into students.
Communication	During Auditing class, all activities that require students to discuss either in groups or in the whole class, present findings, debate ...have a common character of developing communication skills into students.
Co-operation, interpersonal relations and life skills	All activities that require students to work in pairs or in groups have character of developing cooperation and life skills among students.
Lifelong learning	All activities that are connected with research have a common character of developing into students a curiosity of applying the knowledge learnt in a range of situations. The purpose of such kind of activities is for enabling students to become life-long students who can adapt to the fast-changing world and the uncertain future by taking initiative to update knowledge and skills with minimum external support.
Professional skills	Specific instructional activities and procedures that a teacher may use in the class room to facilitate, directly or indirectly, students to be engaged in learning activities. These include a range of teaching skills: the skill of questioning, reinforcement, probing, explaining, stimulus variation, introducing a lesson; illustrating with examples, using blackboard, silence and non-verbal cues, using audio – visual aids, recognizing attending behaviour and the skill of achieving closure.

The generic competences help students deepen their understanding of Auditing and apply their knowledge in a range of situations. As students develop generic competences, they also acquire the set of skills that employers look for in their employees, and so the generic competences prepare students for the world of work.

### **1.2.2. Addressing cross cutting issues**

Among the changes brought by the competence-based curriculum is the integration of cross cutting issues as an integral part of the teaching learning process-as they relate to and must be considered within all subjects to be appropriately addressed. The eight cross cutting issues identified in the national curriculum framework are: Comprehensive Sexuality Education, Environment and Sustainability, Financial Education, Genocide studies, Gender, Inclusive Education, Peace and Values Education, and Standardization Culture.

Some cross-cutting issues may seem specific to particular learning areas/ subjects but the teacher need to address all of them whenever an opportunity arises. In addition, students should always be given an opportunity during the learning process to address these cross-cutting issues both within and out of the classroom.

**Below are examples of how crosscutting issues can be addressed:**

<b>Cross-Cutting Issue</b>	<b>Ways of addressing cross-cutting issues</b>
<p><b>Comprehensive Sexuality Education:</b> the primary goal of introducing Comprehensive Sexuality Education program in schools is to equip children, adolescents, and young people with knowledge, skills and values in an age appropriate and culturally gender sensitive manner so as to enable them to make responsible choices about their sexual and social relationships, explain and clarify feelings, values and attitudes, and promote and sustain risk reducing behaviour.</p>	<p>Using different charts and their interpretations, Auditing's teacher should lead students to discuss the following situations: "Alcohol abuse and unwanted pregnancies" and advise students on how they can fight against them.</p> <p>Some examples can be given when learning statistics, powers, logarithms and the related graphical interpretation.</p>



**Environment and Sustainability:**

integration of Environment, Climate Change and Sustainability in the curriculum focuses on and advocates for the need to balance economic growth, society well-being and ecological systems. Students need basic knowledge from the natural sciences, social sciences, and humanities to understand to interpret principles of sustainability.

Using Real life models or students' experience, Auditing Teachers should lead students to illustrate the situation of "population growth" and discuss its effects on the environment and sustainability.

**Financial Education:**

the integration of Financial Education into the curriculum is aimed at a comprehensive Financial Education program as a precondition for achieving financial inclusion targets and improving the financial capability of Rwandans so that they can make appropriate financial decisions that best fit the circumstances of one's life.

Through different examples and calculations on interest (simple and compound interests), interest rate problems, total revenue functions and total cost functions, supply and demand functions, Auditing Teachers can lead students to discuss how to make appropriate financial decisions.

**Gender:** at school, gender will be understood as family complementarities, gender roles and responsibilities, the need for gender equality and equity, gender stereotypes, gender sensitivity, etc.

Auditing Teachers should address gender as cross-cutting issue through assigning leading roles in the management of groups to both girls and boys and providing equal opportunity in the lesson participation and avoid any gender stereotype in the whole teaching and learning process.

**Inclusive Education:** inclusion is based on the right of all students to a quality and equitable education that meets their basic learning needs and understands the diversity of backgrounds and abilities as a learning opportunity.

Firstly, Auditing Teachers need to identify/recognize students with special needs. Then by using adapted teaching and learning resources while conducting a lesson and setting appropriate tasks to the level of students, they can cater for students with special education needs. They must create opportunity where students can discuss how to cater for students with special educational needs.

**Peace and Values Education:** Peace and Values Education (PVE) is defined as education that promotes social cohesion, positive values, including pluralism and personal responsibility, empathy, critical thinking and action in order to build a more peaceful society.

Through a given lesson, a teacher should:

- Set a learning objective which is addressing positive attitudes and values,
- Encourage students to develop the culture of tolerance during discussion and to be able to instil it in colleagues and cohabitants;
- Encourage students to respect ideas from others.

**Standardization Culture:** Standardization Culture in Rwanda will be promoted through formal education and plays a vital role in terms of health improvement, economic growth, industrialization, trade and general welfare of the people through the effective implementation of Standardization, Quality Assurance, Metrology and Testing.

With different word problems related to the effective implementation of Standardization, Quality Assurance, Metrology and Testing, students can be motivated to be aware of health improvement, economic growth, industrialization, trade and general welfare of the people.



### **1.2.3. Guidance on how to help students with special education needs in classroom**

In the classroom, students learn in different way depending to their learning pace, needs or any other special problem they might have. However, the teacher has the responsibility to know how to adopt his/her methodologies and approaches in order to meet the learning need of each student in the classroom. Also, teachers need to understand that student with special needs, need to be taught differently or need some accommodations to enhance the learning environment. This will be done depending to the subject and the nature of the lesson.

In order to create a well-rounded learning atmosphere, teachers need to:

- Remember that students learn in different ways so they have to offer a variety of activities (e.g. role-play, music and singing, word games and quizzes, and outdoor activities);
- Maintain an organized classroom and limits distraction. This will help students with special needs to stay on track during lesson and follow instruction easily;
- Vary the pace of teaching to meet the needs of each student. Some students process information and learn more slowly than others;
- Break down instructions into smaller, manageable tasks. Students with special needs often have difficulty understanding long-winded or several instructions at once. It is better to use simple, concrete sentences in order to facilitate them understand what you are asking.
- Use clear consistent language to explain the meaning (and demonstrate or show pictures) if you introduce new words or concepts;
- Make full use of facial expressions, gestures and body language;
- Pair a student who has a disability with a friend. Let them do things together and learn from each other. Make sure the friend is not over protective and does not do everything for the one with disability. Both students will benefit from this strategy;
- Use multi-sensory strategies. As all students learn in different ways, it is important to make every lesson as multi-sensory as possible. Students with learning disabilities might have difficulty in one area, while they might excel in another. For example, use both visual and auditory cues.
- Below are general strategies related to each main category of disabilities and how to deal with every situation that may arise in the classroom. However, the list is not exhaustive because each student is unique with different needs and that should be handled differently.

### **Strategy to help students with developmental impairment:**

- Use simple words and sentences when giving instructions;
- Use real objects that students can feel and handle. Rather than just working abstractly with pen and paper;
- Break a task down into small steps or learning objectives. The student should start with an activity that she/he can do already before moving on to something that is more difficult;
- Gradually give the student less help;
- Let the student with disability work in the same group with those without disability.

### **Strategy to help students with visual impairment:**

- Help students to use their other senses (hearing, touch, smell and taste) and carry out activities that will promote their learning and development;
- Use simple, clear and consistent language;
- Use tactile objects to help explain a concept;
- If the student has some sight, ask him/her what he/she can see;
- Make sure the student has a group of friends who are helpful and who allow him/her to be as independent as possible;
- Plan activities so that students work in pairs or groups whenever possible.

### **Strategy to help students with hearing disabilities or communication difficulties**

- Always get the student's attention before you begin to speak;
- Encourage the student to look at your face;
- Use gestures, body language and facial expressions;
- Use pictures and objects as much as possible.
- Keep background noise to a minimum.

### **Strategies to help students with physical disabilities or mobility difficulties:**

- Adapt activities so that students, who use wheelchairs or other mobility aids, can participate.
- Ask parents/caregivers to assist with adapting furniture e.g. the height of a table may need to be changed to make it easier for a student to reach it or fit their legs or wheelchair under;
- Encourage peer support when needed;
- Get advice from parents or a health professional about assistive devices if the student has one.

### **Adaptation of assessment strategies:**

At the end of each unit, the teacher is advised to provide additional activities to help students achieve the key unit competence. These assessment activities are for remedial, consolidation and extension designed to cater for the needs of all categories of students; slow, average and gifted students respectively. Therefore, the teacher is expected to do assessment that fits individual students.

Remedial activities	After evaluation, slow students are provided with lower order thinking activities related to the concepts learnt to facilitate them in their learning.  These activities can also be given to assist deepening knowledge acquired through the learning activities for slow students.
Consolidation activities	After introduction of any concept, a range number of activities can be provided to all students to enhance/ reinforce learning.
Extended activities	After evaluation, gifted and talented students can be provided with high order thinking activities related to the concepts learnt to make them think deeply and critically. These activities can be assigned to gifted and talented students to keep them working while other students are getting up to required level of knowledge through the learning activity.

#### **1.2.4. Guidance on assessment**

Assessment is an integral part of teaching and learning process. The main purpose of assessment is for improvement of learning outcomes. Assessment for learning/Continuous/ formative assessment intends to improve students' learning and teacher's teaching whereas assessment of learning/summative assessment intends to improve the entire school's performance and education system in general.

#### **Continuous/ formative assessment**

It is an on-going process that arises during the teaching and learning process. It includes lesson evaluation and end of sub unit assessment. This formative assessment should play a big role in teaching and learning process. The teacher should encourage individual, pair and group evaluation of the work done in the

classroom and uses appropriate competence-based assessment approaches and methods.

### **Formative assessment is used to:**

- Determine the extent to which learning objectives are being achieved and competences are being acquired and to identify which students need remedial interventions, reinforcement as well as extended activities. The application activities are developed in the student
- book and they are designed to be given as remedial, reinforcement, end lesson assessment, homework or assignment
- Motivate students to learn and succeed by encouraging students to read, or learn more, revise, etc.
- Check effectiveness of teaching methods in terms of variety, appropriateness, relevance, or need for new approaches and strategies. Auditing teachers need to consider various aspects of the instructional process including appropriate language levels, meaningful examples, suitable methods and teaching aids/ materials, etc.
- Help students to take control of their own learning.

In teaching Auditing, formative or continuous assessment should compare performance against instructional objectives. Formative assessment should measure the student's ability with respect to a criterion or standard. For this reason, it is used to determine what students can do, rather than how much they know.

### **Summative assessment**

The assessment can serve as summative and informative depending to its purpose. The end unit assessment will be considered summative when it is done at end of unit and want to start a new one.

It will be formative assessment, when it is done in order to give information on the progress of students and from there decide what adjustments need to be done.

The assessment done at the end of the term, end of year, is considered as summative assessment so that the teacher, school and parents are informed of the achievement of educational objective and think of improvement strategies. There is also end of level/ cycle assessment in form of national examinations.

## When carrying out assessment?

Assessment should be clearly visible in lesson, unit, term and yearly plans.

- Before learning (diagnostic): at the beginning of a new unit or a section of work; assessment can be organized to find out what students already know / can do, and to check whether the students are at the same level.
- During learning (formative/continuous): when students appear to be having difficulty with some of the work, by using on-going assessment (continuous). The assessment aims at giving students support and feedback.
- After learning (summative): at the end of a section of work or a learning unit, the Auditing Teacher has to assess after the learning. This is also known as Assessment of Learning to establish and record overall progress of students towards full achievement. Summative assessment in Rwandan schools mainly takes the form of written tests at the end of a learning unit or end of the month, and examinations at the end of a term, school year or cycle.

## Instruments used in assessment.

- **Observation:** this is where the Auditing teacher gathers information by watching students interacting, conversing, working, playing, etc. A teacher can use observations to collect data on behaviours that are difficult to assess by other methods such as attitudes, values, and generic competences and intellectual skills. It is very important because it is used before the lesson begins and throughout the lesson since the teacher has to continue observing each and every activity.
- **Questioning**
  - a) Oral questioning: a process which requires a student to respond verbally to questions
  - b) Class activities/ exercise: tasks that are given during the learning/ teaching process
  - c) Short and informal questions usually asked during a lesson
  - d) Homework and assignments: tasks assigned to students by their teachers to be completed outside of class.

Homework assignments, portfolio, project work, interview, debate, science fair, Auditing's projects and Auditing competitions are also the different forms/ instruments of assessment.



### **1.2.5. Teaching methods and techniques that promote active learning**

The different learning styles for students can be catered for, if the teacher uses active learning whereby students are really engaged in the learning process.

The main teaching methods used in Auditing are the following:

- **Dogmatic method** (the teacher tells the students what to do, what to observe, how to attempt, how to conclude)
- **Inductive-deductive method:** Inductive method is to move from specific examples to generalization and deductive method is to move from generalization to specific examples.
- **Analytic-synthetic method:** Analytic method proceeds from unknown to known, 'Analysis' means 'breaking up' of the problem in hand so that it ultimately gets connected with something obvious or already known. Synthetic method is the opposite of the analytic method. Here one proceeds from known to unknown.
- **Skills lab method:** Skills lab method is based on the maxim "learning by doing." It is a procedure for stimulating the activities of the students and to encourage them to make discoveries through practical activities.
- Problem solving method, Project method and Seminar Method.

The following are some active techniques to be used in Auditing:

- Group work
- Research
- Probing questions
- Practical activities (drawing, plotting, interpreting graphs)
- Modelling
- Brainstorming
- Quiz Technique
- Discussion Technique
- Scenario building Technique

#### **What is Active learning?**

Active learning is a pedagogical approach that engages students in doing things and thinking about the things they are doing. Students play the key role in the active learning process. They are not empty vessels to fill but people with ideas, capacity and skills to build on for effective learning. Thus, in active learning, students are encouraged to bring their own experience and knowledge into the learning process.

### The role of the teacher in active learning

- The teacher engages students through active learning methods such as inquiry methods, group discussions, research, investigative activities, group and individual work activities.
- He/she encourages individual, peer and group evaluation of the work done in the classroom and uses appropriate competence-based assessment approaches and methods.
- He provides supervised opportunities for students to develop different competences by giving tasks which enhance critical thinking, problem solving, research, creativity and innovation, communication and cooperation.
- Teacher supports and facilitates the learning process by valuing students' contributions in the class activities.

### The role of students in active learning

- A student engaged in active learning:
- Communicates and shares relevant information with fellow students through presentations, discussions, group work and other student-centred activities (role play, case studies, project work, research and investigation);
  - Actively participates and takes responsibility for his/her own learning;
  - Develops knowledge and skills in active ways;
  - Carries out research/investigation by consulting print/online documents and resourceful people, and presents their findings;
  - Ensures the effective contribution of each group member in assigned tasks through clear explanation and arguments, critical thinking, responsibility and confidence in public speaking
  - Draws conclusions based on the findings from the learning activities.

### Main steps for a lesson in active learning approach

All the principles and characteristics of the active learning process highlighted above are reflected in steps of a lesson as displayed below. Generally, the lesson is divided into three main parts whereby each one is divided into smaller steps to make sure that students are involved in the learning process. Below are those main part and their small steps:

## 1. Introduction

Introduction is a part where the teacher makes connection between the current and previous lesson through appropriate technique. The teacher opens short discussions to encourage students to think about the previous learning experience and connect it with the current instructional objective. The teacher reviews the prior knowledge, skills and attitudes which have a link with the new concepts to create good foundation and logical sequencings.

## 2. Development of the new lesson

The development of a lesson that introduces a new concept will go through the following small steps: discovery activities, presentation of students' findings, exploitation, synthesis/summary and exercises/application activities.

### ▪ **Discovery activity**

#### **Step 1:**

- The teacher discusses convincingly with students to take responsibility of their learning
- He/she distributes the task/activity and gives instructions related to the tasks (working in groups, pairs, or individual to prompt / instigate collaborative learning, to discover knowledge to be learned).

#### **Step 2:**

- The teacher let students work collaboratively on the task;
- During this period the teacher refrains to intervene directly on the knowledge;
- He/she then monitors how the students are progressing towards the knowledge to be learned and boosts those who are still behind (but without communicating to them the knowledge).

### ▪ **Presentation of students' findings/productions**

- In this part, the teacher invites representatives of groups to present their productions/findings.
- After three/four or an acceptable number of presentations, the teacher decides to engage the class into exploitation of students' productions.

### ▪ **Exploitation of students' findings/ productions**

- The teacher asks students to evaluate the productions: which ones are correct, incomplete or false.



- Then the teacher judges the logic of the students' products, corrects those which are false, completes those which are incomplete, and confirms those which are correct.
- **Institutionalization or harmonization (summary/conclusion/ and examples)**
  - The teacher summarizes the learned knowledge and gives examples which illustrate the learned content.
- **Application activities**
  - Exercises of applying processes and products/objects related to learned unit/sub-unit
  - Exercises in real life contexts
  - Teacher guides students to make the connection of what they learnt to real life situations.
  - At this level, the role of teacher is to monitor the fixation of process and product/object being learned.

### **3. Assessment**

In this step the teacher asks some questions to assess achievement of instructional objective. During assessment activity, students work individually on the task/activity. The teacher avoids intervening directly. In fact, results from this assessment inform the teacher on next steps for the whole class and individuals. In some cases, the teacher can end with a homework/ assignment. Doing this will allow students to relay their understanding on the concepts covered that day. Teacher leads them not to wait until the last minute for doing the homework as this often results in an incomplete homework set and/or an incomplete understanding of the concept.

## PART II: SAMPLE LESSON PLANS

Term	Date	Subject	Class	Unit N°	Lesson N°	Duration	Class size
1	23 /09/ 2024	Auditing	S 6	1	3 of 5	80 Min	35
<b>Type of Special Educational Needs to be catered for in this lesson and number of learners in each category</b>				One student with visual impairment			
<b>Unit title</b>		Fundamental concepts in audit					
<b>Key Unit Competence:</b>		To be able to explain the fundamental concepts in audit					
<b>Title of the lesson</b>		Types of Audit according to the different classification					
<b>Instructional Objective</b>		Given a written scenario of types of audit, student will be able to explain the types of audit according to the form of organisation. The teacher will read for the student with visual impairment and allow him/her to answer verbally or use Braille documents.					
<b>Plan for this Class (location: in / outside)</b>		Inside the classroom in a U shape arrangement or outside the classroom					
<b>Learning Materials (for all learners)</b>		The learning material will depend on what is available (example: scenario, field visit, etc.)					
<b>References</b>		Auditing Senior 6					
<b>Timing for each step</b>		Description of teaching and learning activity				Generic competences and cross cutting issues to be addressed + a short explanation	
	Think-pair-share; small group discussion on types of audit according to the form of organisation, gallery walk, and content harmonization from different group presentations						
	Teacher activities	Learner activities					

<p><b>1. Introduction</b></p> <p><b>10 minutes</b></p>	<p>Revision on the previous lesson on the meaning of auditing</p> <p>Explain the form of organization</p> <p>Handle any homework or assignments,</p> <p>Ensure a conducive learning environment.</p> <p>Show learners the relationship between the previous lesson and new lesson</p> <p>Guide students to discover the lesson of the day.</p> <p>Share the objectives of the lesson with the learners</p> <p>Ask students to show the link between learning objective and Key unit competence</p>	<p>Answer the questions on the meaning of auditing and form of organization</p> <p>Correct homework with the teacher</p> <p>Discover the title of today's lesson:</p> <p><b>Types of audit according to the form of organisation</b></p>	<p>Communication:</p> <p>Through answering questions and peer discussion.</p>
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<p><b>2. Development of the lesson : 70min</b></p>			
<p><b>a) Discovery activity</b></p> <p><b>15 Minutes</b></p>	<p>Ask student to play Water Melon Game:</p> <p>Put students into groups &amp; have them sit together.</p>	<p>Listen carefully to instructions</p> <p>Forming groups:</p> <p>Students arrange themselves in teams and sit together.</p>	<p>Cooperation, interpersonal management and life</p>

	<p>Ask student to look in student book S6 Auditing unit 1.</p> <p>This activity will be done first individually, shared in pairs then in a big group according to students sitting arrangement</p> <p>Tell students that this activity will be done in 35 minutes and the presentation will be done using gallery work.</p> <p>Teacher moves around in groups to guide them as they attempt to answer the questions.</p> <p>The teacher pays a special attention to student with disability</p>	<p>Work individually or in pairs to explain types of audit according to the form of organisation.</p> <p>In their groups, they share and agree on the types of audit according to the form of organisation</p>	<p>Skills: Students share ideas in pairs and in groups.</p> <p>Critical thinking:</p> <p>Student analyse situation of form of organisation in their community and come up with types of audit according to form of organization.</p> <p>Communication:</p> <p>Students discuss in groups and answer questions.</p> <p>Research and problem solving:</p> <p>Through discussion and research, students explain the types of audit according to the form of organisation</p> <p>Peace and values education:</p>
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			<p>Trough games and group discussions, students socialize and develop some values like sharing, honesty, cooperation, respect, team work, etc.</p>
<p><b>b) Presentation and exploitation of learner's productions</b></p> <p><b>30 Minutes</b></p>	<p>Invite the student to hang their work on the Present Boards.</p> <p>Allow students to do gallery work</p> <p>To ask other groups if they agree on what other groups have presented and comment on each presentation.</p> <p>Invite the representative of each group to come with types of audit according to the form of organisation.</p>	<p>Groups present about the types of audit according to the form of organisation</p> <p>Each team hangs its answers on Present Board.</p> <p>Each team moves around to read presentations of other teams while taking notes and asking for clarification where they do not understand.</p> <p>Harmonize their findings and come up with types of audit according to the form of organisation.</p>	<p>Inclusive Education:</p> <p>Taking into account student with visual impairment during gallery walk and also read for him/her.</p> <p>Communication:</p> <p>Student discusses and communicates verbally while presenting their work and commenting on other groups work.</p> <p>Critical thinking:</p> <p>Learners use critical thinking in answering questions.</p>

**c) Summary/  
conclusion  
10 Minutes**

Help the students to come up with a summary on types of audit according to the form of organisation.

Read the summary loudly for the student with visual impairment to allow him/her to take notes.

**1. Form of organization  
a. Audit of a sole proprietorship**

Audit of the accounts of a private individual or sole trader

When an auditor is asked to audit the accounts of a private individual or a sole trader, he must get clear instructions in writing from his client as to what he is expected to do. His duties, nature of work, scope of his work etc. will have to be defined in agreement.

**Advantages of audit of the accounts of sole trader are:**

1. Assured that his/her accounts are properly kept and no fraud
2. Audited accounts are helpful in the determination of death duty accounts by administrators
3. Sole trader agents are kept vigilant (in the case of consignment)
4. Taxes are assessed and paid very well
5. Audited accounts are basis for obtaining bank loans and public markets

Inclusive Education:

Taking into account of students with visual impairment by reading for them note written on board and giving more time to take note.

### **b. Audit of partnership**

Audit conducted for partnership business. Audit conducted for partnership business. The scope and conduct of audit and rights and duties of the auditors are determined on the basis of the agreement between the firm and auditor. While conducting audit of partnership firm the auditor must refer to the Deed of partnership.

#### **Advantages of audit of partnership firm are:**

1. Avoid any financial dispute among partners
2. Third parties are assured that there are no frauds
3. Helps in the valuation of goodwill of a dead partner and incoming partner
4. Expertise of audit avail profit for better management and taxation

### **c. Audit of limited liability company**

An audit is an examination of the financial statements of a company, such as the income statement, cash flow statement, and balance sheet. Audits provide investors and regulators with confidence in the accuracy of a corporation's financial reporting.



		<p>During the public limited audit, it is clarified whether the financial statements are fairly presented and free from material misstatements</p> <p>The auditor's role is to assess annual reports of the company and make sure they are correct and reliable. The auditor's role is not to manage the accounts.</p>	
<p><b>3. Assessment</b> <b>15 Minutes</b></p>	<p>What are the Advantages of audit of the accounts of sole trader?</p> <p>Differentiate of audit of partnership firm and audit of a limited company</p>	<p><b>Expected Answers:</b></p> <p><b>1.</b></p> <ul style="list-style-type: none"> <li>▪ Assured that his/her accounts are properly kept and no fraud</li> <li>▪ Audited accounts are helpful in the determination of death duty accounts by administrators</li> <li>▪ Sole trader agents are kept vigilant (in the case of consignment)</li> <li>▪ Taxes are assessed and paid very well</li> <li>▪ Audited accounts are basis for obtaining bank loans and public markets</li> </ul> <p><b>2. Audit of partnership</b></p> <ol style="list-style-type: none"> <li>1. Is not compulsory and is purely voluntary</li> <li>2. An auditor does need to be certified unless the firm requires</li> <li>3. Scope of audit depends on agreement between auditor and firm</li> <li>4. Rights and duties, powers and responsibilities are contractual</li> </ol>	



		<ol style="list-style-type: none"> <li>5. Auditor reports to the partners of the firm</li> <li>6. Extent of work of an auditor depends on the agreement between auditor and partners of the firm</li> </ol> <p><b>Audit of limited liability company</b></p> <ol style="list-style-type: none"> <li>1. Is compulsory under the provisions of the company's act</li> <li>2. An auditor must be a qualified, practicing certified accountant.</li> <li>3. Scope of audit is defined by companies Act</li> <li>4. Rights and duties, powers and responsibilities are statutory</li> <li>5. Auditor reports to the shareholders or members of the firm</li> <li>6. Extent of work of an auditor is as per the provisions of the Company Act</li> </ol>	<p>Critical thinking:</p> <p>Students develop critical thinking and reasoning skills while answering questions from other groups.</p> <p>Research and problem solving</p> <p>Imagination and application of this lesson to real business world.</p>
<b>Teacher self-evaluation</b>	For example: 3 students need remedial activities (they are given)		

### **PART III: UNIT DEVELOPMENT**

# UNIT 1 | FUNDAMENTAL CONCEPTS IN AUDITING

## 1.1. Key unit competence

To be able to explain the fundamental concepts in auditing

## 1.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in senior 4 (unit 2 and 3) in financial accounting, the introduction to books of prime entry and in unit 2 in management accounting they have studied source documents. The books of prime entry are among important documents on which the audit is applied and source documents are examined as evidence of transactions which took place in the organisation. So, with this prior knowledge, skills, attitudes and values should help them to appreciate the role of auditing in the development of the country.

## 1.3 Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection

**Gender education:** emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the meaning of the fundamental concepts applied in audit. Being citizens of Rwanda, males and females are encouraged to start businesses; they should know the importance of audit for them as owners of the business.

**Inclusive education:** in addition to all having equal opportunities to carry out business activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan system that do not discriminate.

**Peace and Values:** you need to emphasize to students the benefit of living in peace and harmony with others. Students need to appreciate the role played by auditors in promoting peace and patriotism in the community avoiding activities that are illegal e.g., frauds, fraudulent manipulations of accounts and make sure that every business they plan to have is legal and contributes to national development goals.

**Standardization culture:** you need to emphasize to students why adhering to ethics and integrity requirements at workplace and their respective community is very crucial for a self-reliance national development. This will help them to abide to international auditing and Assurance Standards Board.

## 1.4. Guidance on introductory activity

### Introductory activity

MUKESHIMANA decided to set up a business for selling flowers after S6 Accounting. She got up early in the morning, visited the market, and then set up a stall by the side of the road. She started selling different kinds of flowers. She was able to sell and gain some income from the business. For the first year, everything went well.

However, MUKESHIMANA thought that she could sell more flowers if she was able to transport more to the place where she would sell them. She also knew that there were several other roads nearby where she could sell flowers. To achieve her ambition of selling more flowers, she needed to buy a van and recruit more employees to transport flowers to different selling points.

MUKESHIMANA realized the need for more money to expand her business. Therefore, she requested her rich friend Alex to invest in the business.

Alex found out the potential of MUKESHIMANA's business and decided to invest, but he did not want to be involved in the management of the business and also bear liabilities in case of failure of the business (bankruptcy). He therefore suggested the following to MUKESHIMANA:

- To establish a limited liability company
- To be major shareholders (over 51%) and be entitled for more dividends
- Mukeshimana to be the managing director of the company

At the end of the first year of trading as a limited liability company, Alex received a copy of the financial statements. He noticed that the profit of the company was lower than expected, and this lowered significantly his dividends.

He knew that MUKESHIMANA is paid a salary and might not give much attention to the performance of the company (making profit for the company).

To have proper understanding of the performance of the business, there was a strong need of Alex to engage the third parties (auditors) to provide annual assurance services on financial statements of the company.

### Answers for introductory activity (case study)

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

1. The work done by the third person appointed Alex is Audit.
2. There is a difference between the work done by MUKESHIMANA and which is performed by the third person.
3. Alex gets assurance and he will be sure that the financial statements presented to him by MUKESHIMANA are true and fair.
4. The difference between work done by MUKESHIMANA and third person is that MUKESHIMANA performs accounting activity while the third person performs audit activity.

## 1.5 .List of lessons/sub-heading

Headings	Lesson title/ sub-headings		Learning objectives	Number of periods
1.1. Key terms applied in auditing	Introductory activity		Arouse the curiosity of students on the content of unit 1	1
	1	Definition of key terms	Explain the meaning of key terms in audit	2
1.2. Objectives, advantages and disadvantages of audit	1	Objectives of auditing	Explain objectives of auditing	1
	2	Advantages and disadvantages of audit	Identify the advantages and disadvantages of audit	2

1.3. Types of audits	1	Form of organisation	Explain the types of audit according to the form of organisation	1
	2	Nature of work	Explain the types of audit according to the nature of work	1
	3	Time factor (interval of time)	Explain the types of audit according to the time factor	1
	4	Methods of approach	Explain the types of audit according to the methods of approach	2
	5	Public sector's audit	Explain the public sector audit	2
1.4. Investigation	1	Difference between audit and investigation	Explain the meaning and difference between audit and investigation	2
	2	Characteristics and reasons of investigation	Explain characteristics, reasons of investigation, steps of investigation, report of investigation	2
1.5. Auditing and accounting	1	Difference between auditing and accounting	Explain the difference between auditing and accounting	2
	2	Benefits and limitations of an audit	Explain the benefits and limitations of an audit	1
<b>End Unit Assessment</b>				<b>1</b>
Total number of periods				<b>21</b>

## Lesson 1 Key terms applied in auditing

### a) Learning objective

Explain the meaning of key terms in auditing

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, flipchart, computer resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

Read the Key unit competence in the syllabus to determine what students will know and be able to do by the end of the unit. Look at the action verb, concept and context of learning objective. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objective link to the key unit competence.

### d) Learning activities

#### Activity 1.1

Exploit and use appropriate learning methods that can foster collaborative learning (for example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity, ensure that students have understood the instructions, prompt and probe them through question and answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the teams' presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:



### Answers to Learning Activity 1.1

1. An auditor is a person who conducts an audit
2. The work performed by an auditor is the audit which is an official independent examination of the books of the accounts (or accounting systems) of an entity (by an auditor)
3. The main principles of audit are Integrity, Objectivity, Professional Independence, Professional competence and due care and Confidentiality

### e) Application activity 1.1

Students analyse and discuss about the questions either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess students' findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

### Answers to application activity 1.1

1. Assurance is one in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria." 'Assurance' means confidence. In an assurance, an 'assurance firm' is engaged by one party to give an opinion on a piece of information that has been prepared by another party.
2. The meaning of integrity and objectivity
  - a. **Integrity:** an auditor should be straightforward, honest and sincere in his/her approach to his/her professional work.
  - b. **Objectivity:** is not to allow bias, conflict of interest or undue influence of others to override professional or business judgments

## **Lesson 2: Objectives, advantages and disadvantages of auditing**

### **a) Learning objectives**

Describe objectives, advantages and disadvantages of auditing

### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, flipchart, computer, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In previous lesson, lesson 1 Students studied for meaning of key terms applied in auditing that will help to discuss the objectives, advantages and disadvantages of audit in this lesson.

### **d) Learning activities**

#### **Activity 1.2**

- Put students in small groups and give clear instructions about the activity
- Ask them to observe the pictures in student's book and answer the questions provided in the activity.
- Guide students' discussions and make sure that everyone is participating
- Invite students to share their findings.
- Harmonize their findings or answers, and link the findings to the learning objectives,
- Help them draw conclusions/summary on objectives, advantages and disadvantages of auditing.
- Listen all answers to asked questions give solutions to challenges from the activity.
- Guide them to make notes in referring in their student's book.



## Answer to Learning Activity 1.2

1. Yes
2. Objectives of audit
  - To check/verify the accuracy of financial statements or accounts;
  - To prove the true and fair view of the company's financial state of affairs;
  - To confirm that the proper books of accounts are being kept or not;
  - To prepare audit report;
  - To confirm the accuracy of final accounts

### e) Application activities 1.2

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

## Answers to application activity 1.2

1. The advantages of audited accounts for the shareholders are:
  - Shareholders are assured that directors and management are acting to the best of their interests;
  - They use audited accounts to determine amount to be paid to dead partner;
  - They use audit to admit a new partner by examining his/her business;
  - Audit ensures that regulations and statutory requirements are followed.
2. The primary or main objectives of an audit are:
  - To check/verify the accuracy of financial statements or accounts;
  - To prove the true and fair view of the company's financial state of affairs;
  - To confirm that the proper books of accounts are being kept or not;
  - To prepare audit report;
  - To confirm the exactitude of final accounts.

## Lesson 3: Types of audits

### a) Learning objectives

Describe the types of audits according to different classifications.

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, flipchart, computer resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson 2, Students studied for objectives, advantages and disadvantages of auditing that will help them to discuss on the types of audits according to the different classifications in this lesson. Remember the learning objectives are linked to the key unit competence.

### d) Learning activities

#### Activity 1.3

- Put students in small groups and give clear instructions about the activity.
- Ask them to show the pictures in student's book and answer the questions provided in the activity.
- Guide students' discussions and make sure that everyone is participating.
- Invite students to share their findings.
- Harmonize their findings or answers, and link the findings to the learning objectives, and help them to draw conclusions/summary on the various types of audits according to different classifications.
- Answers are addressed to any questions or challenges that are obtained from the activity.
- Guide them to make notes in referring to their student book.

#### Answer to Learning Activity 1.3

- Continuous audit
- Final audit
- Public sector's audit

### e) Application activities 1.3

This activity can be given as a normal individual or group activity, where students describe various types of audits according to the different classifications and give advantages and disadvantages of procedural audit. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### Answers to application activity 1.3

##### 1. a. Final Audit (periodic/Detailed/Complete Audits)

It is conducted at the end of the financial period when accounts have been balanced off, and profit and loss account and balance sheet have been prepared and approved.

##### b. Interim Audit.

Interim audit is conducted to a particular date within the accounting period.

It is conducted within the accounting period usually half yearly.

It is a kind of audit which is conducted between the two periods or during transitional period.

It is aimed at assessing the company's performance in order to pay interim dividends.

##### c. Continuous Audit.

It is that audit which involves detailed examination of the books of accounts at regular intervals of 1, 2 or 3 months.

##### 2. Advantages of procedural audit

- This audit will provide a feedback to the management.
- The audit will reveal which procedures are out of dated and uneconomical and which calls for replacement.
- It will identify the strength or weakness in ICS.
- It will reveal the management weakness in supervising the company's operations.
- It will ensure co-ordination of the company's operations which may boost its profitability.
- It will reveal whether procedures in accounting department are working properly or not.

### **Disadvantages of procedural audit**

- It may be a very expensive audit.
- It may be frustrated for the management.
- It may mean duplication of effort if the same procedures are examined in the final audit.
- This type of audit may be tedious in particular if the company has numerous procedures.

## **Lesson 4: Investigation**

### **a) Learning objectives**

Describe investigation

### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, flipchart, computer resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In previous lesson, lesson3, Students studied for the types of audits that will help them to discuss the difference between auditing and investigation in this lesson. Remember the learning objectives are linked to the key unit competence.

### **d) Learning activities**

#### **Activity 1.4**

- Put students in small groups and give clear instructions about the activity
- Ask them to show the pictures in student's book and answer the questions provided in the activity
- Guide students' discussions and make sure that everyone is participating
- Invite students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objectives, help them draw conclusions/summary on the description of investigation. Answers addressed to any questions or challenges are obtained from the activity. Guide them to make notes in referring in their students' book.

### Answer to Learning activity 1.4

1. I see two people
2. The first one is a person having the position of an auditor and another is an official investigator from the Rwanda investigation Bureau (R.I.B)

### e) Application activities 1.4

This activity can be given as a normal individual or group activity, where students describe the concepts of investigation. Monitor the activity to ensure students are on track and actively participating. Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

### Answers to Application Activity 1.4

1. The areas in which investigation should be applied are:
  - a. Financial
  - b. Economic
  - c. Business
  - d. Social
  - e. Technical
2. The steps of investigation are:
  - a. Determine the scope/objectives of investigation.
  - b. Planning the investigation (Formulate investigation program).
  - c. Establishment of the fields of application (by examining or studying various records).
  - d. Analysis and interpretation of findings/results.
  - e. Preparation of investigation's report/writing of the report.

## Lesson 5: Auditing and accounting

### a) Learning objectives

Explain the difference between audit and accounting, benefits and limitations of audit.

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, flipchart, computer resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson, lesson, Students studied for the difference between audit and investigation. That will help them to discuss the difference between audit and accounting, limitation of audit in this lesson. Remember the learning objectives are linked to the key unit competence.

### d) Learning activities

#### Activity 1.5

- Put students in small groups and give clear instruction about the activity
- Ask them to show the pictures in student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on the difference between audit and accounting, benefits and limitations. Answers addressed to any questions or challenges are obtained from the activity. Guide them to make notes in referring in their students' book.

#### Answer to Learning activity 1.5

The picture no 1 illustrates the activities of accounting and the picture no 2 shows the activities of auditing.



### e) Application activity 1.5

This activity can be given as a normal individual or group activity, where students establish the difference between audit and accounting and provide benefits and limitations of audit.

Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### Answers to Application Activity 1.5

##### 1. The benefits of the auditing are the following:

- The shareholders of a company are given an independent opinion as to the true and fair view of the accounts that have been prepared by management.
- The use made by third parties such as suppliers and banks adds confidence in the performance of a company.
- While not responsible for detecting fraud, the very fact that an auditing is carried out and may uncover evidence of fraud, can help to mitigate against such risks.

##### 2. The limitations of the auditing are explained as follows:

- Every item is not checked. In fact, only test checks are carried out by auditors. It would be impractical to examine all items within a class of transactions or accounts balances. Hence, it is not really possible to give absolute assurance.
- Auditors depend on representations from management and staff. Collusion can mitigate some good controls such as division of duties. There is always the possibility of collusion or misrepresentation for fraudulent purposes.
- Evidence gathered is persuasive rather than conclusive. It often indicates what is probable rather than what is certain.
- Auditing is not purely an objective exercise. Judgments have to be made in a number of areas. The view in financial statements is itself based on a combination of fact and judgment.
- The timing of an audit.
- An unqualified audit opinion is not a guarantee of a company's future viability, the effectiveness and efficiency of management, nor that fraud has not occurred in the company.

## Skills lab activity 1

### Guidance on the skills lab activity:

In conducting this skills lab activity, you can either put students in two learning groups; one group plays the role of accountant another playing the role of an auditor then they will exchange the roles and finally students express their views on similarities between auditing and accounting.

#### i. Build

Given that students visit the library,

- Remind students on the expected objectives for the library's attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team has the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understandings of the assignment
- Remind them that everybody's full participation is mandatory.

#### ii. Practice

During research on internet, care about the following concerns:

- Guide students on accessing the real audit books and accounting
- Ensure that books are available for all
- Respond to any questions for clarification and support accordingly

For the visit to the library, a concept note is needed to describe what has been covered during the class lesson and state what are students and teacher's expectations.

#### iii. Present

During the group presentation, the teacher must assess whether the student's participation in the skills lab activity was effective by:

- Selecting randomly anyone in all groups to present the report on behalf of team members.
- Allow students to ask questions to their fellows.

All teams' members' presentation is expected to contribute to the plenary by answering some questions that the presenter is not covering as well as expected

## iv. Conclusion

The teacher emphasizes on the objective of the research reminding students that they were expected to understand and express their views on similarities between auditing and accounting.

### 1.6. Summary of the unit

#### 1. Definition of key terms applied in auditing, assurance, Auditor and Auditing

##### 1.1. Definition of key terms

- a. **Audit: an audit** is an official independent examination of the accounts (or accounting systems) of an entity (by an auditor).
- b. **Assurance:** the International Standards on Auditing (ISA) give a definition of an assurance engagement as "one in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria."
- c. **Auditor: an auditor** is a person who conducts an audit

An auditor is a person authorized to examine and verify the books of accounts of an organization.

- d. **Auditing:** auditing may be defined as the examination of financial statements covering the transactions over a period and ascertaining the financial position of an organization on a certain date in order that the auditor may issue a report on them. It means auditing is the application of auditing principles and methods as may be considered as necessary by an auditor.

The main principles and processes of auditing are classified as under:

##### a. Principles of the auditing.

- Integrity
- Objectivity
- Professional Independence.
- Professional competence and due care.
- Confidentiality
- Professional behavior

##### b. Processes of the auditing

- Planning
- Detailed audit( audit execution)
- Reporting
- Follow up of audit recommendations

## 2. Objectives, advantages and disadvantages of auditing

### 2.1. Objectives of auditing

The objectives of auditing may be classified as under:

- Primary or principal objectives
- Secondary or subsidiary objectives

#### a) Primary or principal objectives of auditing

- To determine the accuracy of financial statements or accounts.
- To prove the true and fair view of the company's financial state of affairs.
- To confirm that the proper books of account are being kept or not.
- To prepare audit report.
- To confirm the exactitude of final accounts.

#### b) Secondary or subsidiary objectives of auditing

- To detect errors.
- To detect frauds
- To prevent errors.
- To prevent frauds .
- To assist the client to improve their accounting systems.
- To find out whether the internal control system is working properly or not.
- To advise the management.

### 2.2. Advantages and disadvantages of auditing

#### A. Advantages of auditing

##### For the shareholders:

- a) Shareholders are assured that directors and management are acting to the best of their interests.
- b) They use audited accounts to determine amount to be paid to dead partner.
- c) They use audit to admit a new partner by examining his/her business.
- d) Audit ensures that regulations and statutory requirements are followed.

##### For the employees:

- a) Audit keeps accounting staff vigilant and careful in their work.
- b) Employees ensure their job security and continuity of good remuneration by the audited company.

- c) Auditing acts as a detective and preventive measure against errors and frauds.

**For the state:**

- a) Audited companies ensure the accomplishment of fiscal duties regarding companies (payment of taxes and social contributions).
- b) The government is assured that public funds are being well paid and used.
- c) The government ensures continuity of business for the purpose of general interest of the people.
- d) The state ensures that books of accounts are maintained according to legal requirements and companies' Act.

**For the management of an enterprise and third parties in general:**

- a) Audit provides assurance and credibility to the accounts for interested parties.
- b) Third parties not taking active part in the organization are protected.
- c) Audited accounts minimize disputes between parties.
- d) Audited accounts are acceptable as the basis of ascertaining tax liability.
- e) The auditor promotes general management efficiency by advising management.

**B. Disadvantages of audit**

- a) If the auditor has many clients, planning and personnel problems lead to inefficient audit leaving errors and frauds undetected. Thus, increasing auditor's liability to third parties
- b) It is expensive and third parties may not be able to afford it
- c) The audit report provides information that may otherwise be confidential to competitors
- d) A qualified report may affect the company's credibility with third parties
- e) An audit can disrupt the client's (audited company) work
- f) Audited figures may be altered (changed) leading to inaccurate opinion
- g) May prompt trade unions to demand for higher wages for their employees e.g. in cases of unreasonable reserves
- h) An audit can lead to conflict between the internal auditor and management in cases where the internal auditor co-operates with the external auditor
- i) Revelations of weaknesses in the management letter or letter of weaknesses may make managers to resign. Thus, leading to apathy in the organization.

### **3. Types of audits according to the different classifications**

#### **3.1. Types of audits according to the forms of organizations**

- Audit of a sole proprietor
- Audit of partnership
- Audit of Limited liability company
- Audit of cooperatives

Various types of audits according to nature of work:

- Private audit
- Statutory audit
- Internal audit
- External audit

Various types of audits according to the time factor

- Final audit
- Interim audit
- Continuous audit

Various types of audits according to the method of approach are the following:

- Procedural audit
- Management audit
- Balance sheet audit
- Vouching audit
- Standard audit

#### **Public sector's audit**

Types of public sector's audit

- Financial audit
- Performance audit
- Compliance audit

### **4. Investigation**

#### **1.The meaning of investigation**

Investigation is an enquiry commissioned by a client for some purpose.

Investigation means an inquiry into the accounts of a business for a special purpose.



Investigating is a kind of special audit with a limited or extended scope according to the purpose for which it is conducted.

## **2. Difference between auditing and investigation**

### **a. Characteristics of investigation**

- Investigation is an enquiry.
- Investigation implies systematic and critical examination of accounts and record of a business enterprise for a specific purpose.
- It is conducted for a specific purpose (suspicion in mind).
- Its specific purpose may be evaluated by the state of affairs or establishment of a fact.
- Conducted for a non-fixed period (any time) and any person (police, lawyers, consultants, etc.) and describes a fact not an opinion.

### **b. Reasons of investigation**

Investigation is carried out due to the following reasons. These reasons of investigation become types and are the followings:

- Purchase of a company
- Admission of a new partner
- Fusion of the companies (Acquisition of a Merger).
- Prospecting of the investments (Prospective investment)
- Prospecting of a loan or investigations on request for loans (Prospective lending)
- Suspicion of fraud or fraud investigation (Fraud)
- Legal or statutory investigation

### **c. Steps of investigation**

- Step 1. Determine the scope/objectives of investigation
- Step 2. Planning the investigation (Formulate investigation program)
- Step 3. Establishment of the fields of application (by examining or studying various records)
- Step 4. Analysis and interpretation of findings/results
- Step 5. Preparation of report/writing of the report

### **d. Report of investigation.**

On the completion of investigation, the report is submitted to concerned parties. The report submitted in respect of an investigation should cover the following points:

- Reference to instruction given by the client
- Reference to basic documents covering information obtained

- General outline of the work done
- Summary of information obtained
- Recommendations in accordance with information obtained.

## 5. Auditing and accounting

### 1. Difference between auditing and accounting

Accounting	Auditing
<ul style="list-style-type: none"> <li>▪ It is a preparation of books of accounts</li> <li>▪ It is a continuous process during the financial period.</li> <li>▪ It is not conditioned</li> <li>▪ It is conducted without vigilance</li> <li>▪ In accounting, the work is conducted without independence.</li> <li>▪ It is essential to all businesses</li> <li>▪ It is conducted by an accountant</li> <li>▪ It involves a tedious process of preparing the accounts.</li> </ul>	<ul style="list-style-type: none"> <li>▪ 1 It is an independent examination of books of accounts.</li> <li>▪ It is conducted usually at the end of the period or at the end of the year.</li> <li>▪ It is conditioned on prepared books of accounts.</li> <li>▪ It is conducted with vigilance.</li> <li>▪ It is conducted independently</li> <li>▪ It is a statutory requirement for all limited liability companies</li> <li>▪ It is conducted by a qualified auditor.</li> <li>▪ It is conducted in form of final touches to what has been prepared by the accountant.</li> </ul>

### 2. Benefits and limitations of the auditing

#### a. Benefits of the auditing

1. The shareholders of a company are given an independent opinion as to the true and fair view of the accounts that have been prepared by management.
2. The use made by third parties such as suppliers and banks of the accounts adds confidence in the performance of a company.
3. While not responsible for detecting fraud, the very fact that an audit is carried out and may uncover evidence of fraud, can help to mitigate against such risks.

#### b. Limitations of the auditing

1. Every item is not checked. In fact, only test checks are carried out by auditors.
2. Auditors depend on representations from management and staff.

3. Evidence gathered is persuasive rather than conclusive.
4. Auditing is not purely an objective exercise. Judgments have to be made in a number of areas.
5. The timing of an audit.
6. An unqualified audit opinion is not a guarantee of a company's future viability, the effectiveness and efficiency of management, nor that fraud has not occurred in the company.

## **1.7. Additional information for teachers**

### **Reasons of investigation**

Investigation is carried out due to the following reasons. These reasons of investigation become types and are the followings:

#### **1. Purchase of a company**

When an individual is interested to purchase a business, he can appoint an accountant of his choice to carry out investigation in respect of business which he wants to purchase.

The main purpose of this investigation is to find out the details about this purchase. If the investigation report is in favour of this business, then it can be purchased.

#### **2. Admission of a new partner**

An investigation may arise, either on behalf of a person intending to bring capital in order to become a partner, or for the existing proprietors who intend to take in a partner. If the investigation is arranged by the prospective partner the main purpose will be to ascertain whether to become a partner is beneficial or not. In this case, investigation will be similar as in the case of a purchase of a business.

#### **3. Fusion of the companies (Acquisition of a Merger)**

Mergers mean to convert two or more business enterprises into one unit. In this case, one business enterprise can acquire the assets or shares of another enterprise. The most important term that must be negotiated in a merger arrangement is the price the acquiring firm will pay for the acquired business. In mergers or acquisitions a larger firm generally takes over a small one and assumes all management control.

Before the merger of two or more business enterprises, investigations are carried out through some accountants by the firm which intends to acquire other firms.

The main purpose of these investigations is to find out the details about financial position of the other businesses.

#### **4. Prospecting of the investments (Prospective investment)**

Some individuals or firms might be interested to make some investments in the form of shares or debentures of other companies. In order to make their decisions, they want to know the details about the financial standing of those companies.

For this purpose, they can arrange some investigations through some accountants.

#### **5. Prospecting of a loan or investigations on request for loans (Prospective lending)**

Some banks carry out some investigation before advancing loans to some business enterprises. Similarly, some suppliers need independent investigation reports before granting credit facilities to their clients.

#### **6. Suspicion of fraud or fraud investigation (Fraud)**

Investigations are carried out on the instructions of management to detect fraud if the behaviour of some employee is suspicious. If the fraud is concerned only with the a section of the work e.g. the entry of dummy workmen on a wages sheet by one clerk, the extent of the investigation should be restricted to that one section.

On the other hand, if misapplication of cash is the result of collusion between two or more employees then the investigation can be extended to various sections or departments of the organization.

#### **7. Legal or statutory investigation**

Investigation conducted to satisfy some legal requirements. The following cases indicate when a legal investigation can be conducted:

An investigation by the liquidator of a company where directors are suspected of fraud regarding the affairs of the company

## 1.8. End unit assessment

### Answers to end unit assessment

#### 1. Write short notes on the following:

- a. **Statutory audit** is that which is conducted under the provisions of the law of the country. This is an audit performed according to the law or the companies Act.
- b. **Private or voluntary audit** is that audit which is not legally required.
- c. Is conducted according to the agreement between the auditor and the client (audited company) and are not governed by any particular law.
- d. **Interim audit** is conducted to a particular date within the accounting period.
- e. It is conducted within the accounting period usually half yearly.
- f. It is a kind of audit which is conducted between the two periodical or finals.
- g. **Continuous audit** it is that audit which involves detailed examination of the books of accounts at regular intervals of 1, 2 or 3 months.

#### 2. Explain the term 'continuous audit' and outline its advantages and the disadvantages

Continuous audit is a kind of audit which involves the detailed examination of books of accounts at regular intervals such: 1, 2 or 3 months

##### Advantages of continuous audit

- Easy and quick discovery of errors;
- Quick presentation of accounts
- Moral check on staff;
- Keeps client's staff regular
- Audit staff can be kept regular
- Efficient audit.

##### Disadvantages of continuous audit

- Alteration of figures;
- Altered by dishonest clerk;
- Dislocation of client's work;
- This method is expensive;
- It involves extensive note taking so as to avoid alteration of figures.

### 3. The types of audits according to the time factor are :

- Final audit
- Interim audit
- Continuous audit

### 4. Difference between auditing and accounting

Accounting	Auditing
<ul style="list-style-type: none"><li>▪ It is a preparation of books of accounts</li><li>▪ It is a continuous process during the financial period.</li><li>▪ It is not conditioned</li><li>▪ It is conducted without vigilance</li><li>▪ In accounting the work is conducted without independence.</li><li>▪ It is essential to all businesses</li><li>▪ It is conducted by an accountant</li><li>▪ It involves a tedious process of preparing the accounts.</li></ul>	<ul style="list-style-type: none"><li>▪ It is an independent examination of books of accounts.</li><li>▪ It is conducted usually at the end of the period or the year.</li><li>▪ It is conditioned on prepared books of accounts.</li><li>▪ It is conducted with vigilance.</li><li>▪ It is conducted independently</li><li>▪ It is a statutory requirement for all limited companies</li><li>▪ It is conducted by a qualified auditor.</li><li>▪ It is conducted in form of final touches to what has been prepared by the accountant.</li></ul>

### 5. Explain the following principles of auditing:

- Objectivity** is to not allow bias, conflict of interest or undue influence of others to override professional or business judgments
- Professional Independence

The auditor is an agent/watchdog for the shareholders and must be independent of directors and management who look after the interests of shareholders in a company.

The profession requires the auditor to be independent so as to be able to express a balanced opinion on the accounts presented by the directors to the shareholders whose company he/she has audited.



## 6. The elements of the investigation's report are the following:

- Reference to instruction given by the client
- Reference to basic documents covering information obtained
- General outline of the work done
- Summary of information obtained
- Recommendations in accordance with information obtained.

## 1.9. Additional activities (Questions and answers)

### 1.9.1. Remedial activities (Questions and answers)

**Question 1.** Define the term Audit

**Answer 1.** An audit is an official independent examination of the accounts of an entity by an auditor.

An audit is defined as: the independent examination and expression of opinion on the financial statements of an entity by an auditor

**Question 2.** State four (4) Secondary or subsidiary objectives of an audit

**Answer 2.** Secondary objectives of audit are:

- To detect errors;
- To detect frauds;
- To prevent errors;
- To prevent frauds ;
- To assist the client to improve their accounting systems;
- To find out whether the internal control system is working properly or not;
- To advise the management.

**Question3.** What are the types of audits according to the method of approach?

**Answer3.** According to the method of approach ,various types of audit are:

- Procedural audit
- Management audit
- Balance sheet audit
- Vouching audit
- Standard audit

### **1.9.2. Consolidation activities (Questions and answers)**

**Question 1.** Describe the similarities between statutory and private audits

**Answer 1.** Similarities between statutory and private audits

1. In both audits, the auditor's duties and scope of work can be increased by the client.
2. In both audits, the auditor earns the audit fee
3. Both audits are conducted at the end of the year when the records have been balanced and closed down
4. In both audits, the auditors apply similar techniques and audit tests
5. Both auditors might be the members of RAB (Registration of Accountants Board)
6. In both audits, valuable advice is provided to the client at the end of audit
7. Both audits are used as basis for decision making
8. Both safeguard company's fixed assets
9. In both audits the auditors write the report
10. Both audits are concerned with the review of the activities of the company
11. They are concerned with the preventive measures against errors and frauds
12. They are concerned with the strength of the ICS.

**Question 2.** Explain the characteristics of an investigation

**Answer 2.** Characteristics of investigation are:

1. Investigation is an enquiry.
2. Investigation implies systematic and critical examination of accounts and record of a business enterprise for a specific purpose.
3. It is conducted for a specific purpose (suspicious).
4. Its specific purpose may be evaluated of state of affairs or establishment of a fact.
5. Conducted for a non- fixed period (any time) and any person (police, lawyers, consultants, etc.) and describes a fact not an opinion.

**Question 3.** Explain the types of public sector's audit

**Answer 3.** Types of public sector's audit

### a) Financial audit

Focuses on determining whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.

### b) Performance audit

Focuses on whether interventions, programs and institutions are performing in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement.

### c) Compliance audit

Focuses on whether a particular subject matter is in compliance with authorities identified as criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the audited entity.

## 1.9.3. Extended activities (Questions and answers)

**Question 1.** Distinguish Auditing from investigation

**Answer1.** Difference between auditing and investigation

Auditing	Investigation
<ul style="list-style-type: none"><li>▪ It is an examination of the books of accounts and vouchers of a business</li><li>▪ It covers one financial period</li><li>▪ It is conducted for the owners of the business (shareholders)</li><li>▪ It is usually restricted to the books of accounts</li><li>▪ It is conducted to prove the true and fair view</li><li>▪ It is conducted by a qualified auditor according to the companies Act.</li><li>▪ It is conducted without suspicion</li><li>▪ It is a legal requirement for all limited companies</li></ul>	<ul style="list-style-type: none"><li>▪ It involves a searching enquiry into the company's affairs.</li><li>▪ It may cover more than one financial period.</li><li>▪ It may be conducted on behalf of shareholders, but generally it is conducted on behalf of outsiders.</li><li>▪ It is not limited to any area.</li><li>▪ It is conducted to investigate the extent of a fraud</li><li>▪ It is conducted by any competent professional e.g. Lawyer, tax assessors.</li><li>▪ It is conducted where there is suspicion of a fraud</li><li>▪ It is not a legal requirement for the business</li></ul>

**Question 2.** Explain and distinguish continuous audit from Interim audit

**Answer 2.** Distinction between continuous audit and Interim audit.

Continuous audit	Interim audit
<ul style="list-style-type: none"><li>▪ The work of audit is carried on up to any date according to the convenience of the auditor and his/her client.</li><li>▪ The verification of assets and liabilities is done after the balance sheet has been prepared at the end of the accounting period.</li><li>▪ No trial balance is prepared .</li><li>▪ The object is not to know the profit and loss.</li></ul>	<ul style="list-style-type: none"><li>▪ The work of audit is up to a definite date according to the instruction of the client.</li><li>▪ The assets and liabilities are verified when such audit is conducted.</li><li>▪ The trial balance has to be prepared and checked.</li><li>▪ The interim audit is conducted with the object of finding the profit or loss.</li></ul>

**Question 3.** Explain the advantages and disadvantages of final audit.

**Answer 3. Advantages of final Audit**

- a. Chances of figures being changed are minimal;
- b. It is flexible as the auditor can prepare good programme to cover all areas well;
- c. It is very ideal for small business whose transactions are few and can be audited at one sitting;
- d. It is not expensive;
- e. This audit does not interrupt the client's work;
- f. It eliminates notes taking which is a phenomenon of other audits.

**Disadvantages of Final audit.**

- a. The delays may occur if there is large volume of work;
- b. The frauds and errors are discovered after the close of the year. Sometime, it is too late to rectify or take preventive measures;

As the financial periods of most of the clients end on the same date , it becomes difficult for the auditor to deploy audit staff adequately.

# UNIT 2

## LEGAL AND PROFESSIONAL REQUIREMENTS

### 2.1. Key Unit competence

To be able to describe the legal and professional standards required for an auditor

### 2.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in senior 6 Financial accounting course (unit 1) to the Regulatory framework and also in auditing (unit 1) to the fundamental auditing concepts. So, with this prior knowledge, skills, attitudes and values, it should help them to appreciate the role of international standards in the development of professional auditors in the country.

### 2.3. Cross-cutting issues to be addressed

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection and the importance of auditors in reducing using printed documents.

**Gender education:** emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the legal and professional requirements of an auditor in Rwanda. So that this will encourage people to take the first step in being professional auditors.

**Inclusive education:** in addition to all having equal opportunities to carry out business activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical

understanding of Rwandan system that do not discriminate. Students need to understand that the International Standards on Auditing should not discriminate but promote inclusiveness of all etc.

**Peace and Values:** you need to emphasize to learners the need to live in peace and harmony with others. Students need to appreciate the role of international standards in promoting peace and patriotism in the community avoiding activities that are illegal and make sure that every audit's activities they plan to have is legal and contributes to national development goals.

**Standardization culture:** you need to emphasize to students the need for standard in audit work. This will help them to abide by standards of legal and professional requirement to an auditor.

## 2.4 Guidance on introductory activity

Follow the guidance about the introductory activity:

Students in small groups, pairs or individual read and analyse the case study and identify the necessity of issuing the International Standards on Auditing, different areas these standards are applied and the exceptional circumstances of not complying with them.

During the activity, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair-share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Appreciate the teams' presentations and remind them that this activity was not meant come to the very right answers but to help them become aware of what to expect in the unit. Answers to the activity will be got as the unit progresses. Guide them to take notes in their books referring to learners' book.

You can support students' answers by referring to possible answers to the introductory activity below:



### Possible answers for introductory activity (case study)

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

1. It is necessary to every business or company to comply with national and international regulations/standards because the last ones improve the degree of conformity and uniformity of audit practices.
2. When there is exceptional circumstances, the auditor can depart from an auditing standard in order to achieve the objective of an audit.

## 2.5. List of lessons/sub-heading

Heading	Lesson title/ sub-heading	Learning objectives	Number of periods	
2.1. Audit standards	Introductory activity	Arouse the curiosity of students on the content of unit 2	1	
	1	International standards on auditing	Identify international standards on auditing	1
	2	Ethical duties of auditors according to international standards on auditing	Explain the ethical duties of auditors according to international standards on auditing	1
2.2. Auditor of the company	1	Duties, obligations and rights of an auditor	Explain duties, obligations and rights of an auditor	2
	2	Auditor's liability	Describe auditor's liability	1
<b>End Unit Assessment</b>			1	
<b>Total number of periods</b>			<b>7</b>	

## Lesson 1: Audit standards

### a) Learning objectives

Explain the audit standards and ethical duties of auditors according to International Standards on Auditing

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In S6, Unit 1 consists of Regulatory framework, students studied the international standards in accounting. Given this background, learners should be able to appreciate that recording financial transactions basing on these standards leads to professional competences. Learners should also realize that there are different standards they can comply with. In this unit, they will be able to describe the legal and professional standards required for an auditor which may encourage them to perform well company activities and they intend to exercise well auditing activities in their communities.

### d) Learning activities

#### Activity 2.1

Exploit and use appropriate learning methods that can foster collaborative learning (for example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question and answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come

to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

### Answers to Learning activity 2.1

1. The organisations have in charge to control and evaluate the execution of International standards/regulations are:
  - International Auditing and Assurance or guarantee Standards Board (IAASB).
  - International Ethics Standards Board for Accountants (IESBA).
  - International Federation of Accountants (IFAC).
2. Being a member of the above organisations requires to comply with the following fundamental principles of ethics: integrity, objectivity, Professional competence and due care, confidentiality and professional behaviour.

### e) Application activity 2.1

Students analyse and discuss about the questions either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

### Answers to application activity 2.1

1. INEZA BAKERY needs the International Standards on Auditing.

Two examples of international standards:

- IAS 230: Deals with the auditor's responsibility to prepare the audit documentation for an audit of financial statements
  - IAS 300: Planning an audit of financial statements
2. The fundamental principles of ethics that you observe are the following:

**Integrity:** to be straightforward and honest in all professional and business relationships.

**Objectivity:** not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.

**Professional competence and due care:**

- To attain and maintain professional knowledge or skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation.
- To act diligently and in accordance with applicable technical and professional standards.

**Confidentiality:** to respect the confidentiality of information acquired as a result of professional and business relationships.

**Professional behaviour:** to comply with relevant laws and regulations and avoid any action that the professional accountant knows or should might discredit the profession.

## **Lesson 2: Auditor of the company**

### **a) Learning objectives**

- Explain duties, obligations and rights of an auditor
- Describe the auditor's liability

### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In previous lesson, lesson 1 Students studied the meaning of international standards, fundamental

principles on audit and ethical duties of auditors according to International standards on auditing.

That will help to discuss about auditor's duties, obligations and rights in exercising the audit work learnt in this lesson.

## d) Learning activities

### Activity 2.2

- Put students in small groups and give clear instructions about the activity
- Ask them to read carefully the case study in student book and answer the question provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invite students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on auditor's duties, obligations and rights. Answer or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### Answers to Learning activity 2.2

1. An auditor has the following responsibilities or duties:
  - Make a report to shareholders or owners as external auditors.
  - Make a report to the management as internal auditors.
  - Assist in investigation.
  - Make income statement.
  - Provide clear report and clear evidence.
  - Certify that whether loans are properly secured and not at terms prejudicial to the interest of shareholders.

## e) Application activity 2.2

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

## Answers to application activity 2.2

1. The auditor can take the following ways/ steps in order to minimise the dangers of any claims against him/her for negligence work:
  - Gather conclusive evidence and supporting documents before passing any entries and drawing an opinion.
  - Review the risky audit areas before releasing the final audit report to the shareholders.
  - Withdraw his consent and give a public notice to this effect after registration of prospectus but before allotment of shares.
  - Use well trained and experienced staff during the audit who will carry out their duties completely.
  - He should obtain supporting evidence e.g. letters of representation to prove his competences.
  - Withdraw his consent in writing before such a prospectus has been registered and before it is for public use.

## Skills lab activity 2

### Guidance on the skills lab activity:

In conducting this skills lab activity, you can arrange for students accompanied to attend a presentation on the different cases that can lead the auditor to criminal liabilities and civil liabilities, then visit the computer laboratory and search the audit books in order to find useful cases. Besides, encourage student to visit ICPAR website for further research.

#### i. Build

Given that students visit the ICPAR website,

- Remind students on the expected objective for the computer lab attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have notebooks where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understanding of the assignment
- Remind them that everybody full participation is mandatory.



## ii. Practice

During research on internet, care about the following concerns:

- Guide students on accessing the real website
- Ensure that internet is connected for all
- Respond to any questions for clarification and support accordingly

For the internet research, a concept note is needed to describe what has been covered during the class lesson and state what are students and teacher's expectations.

## iii. Present

During the group presentation, the teacher must assess whether the student participation in the skills lab activity was effective by:

- Selecting randomly anyone in all groups to present the report on behalf of team members.
- Allow students to ask question to their fellows.

All team members being presenting are expected to contribute to the plenary by answering some questions that the presenter is not covering as well as expected.

## iv. Conclusion

The teacher emphasizes on the objective of the research reminding students that they were expected to discover and understand all the types of auditor's liabilities. After this discovery, students should be able to differentiate criminal liabilities from civil liabilities to an auditor.

## 2.6. Summary of the unit

### 1. Meaning and structure of International Standards on Auditing

#### Meaning of international standards

International Standards on Auditing are professional standards for the performance of financial audit of financial statements.

#### 1.1. Structure of International Standards on Auditing

International standards are structured as follows:

- Introduction
- Objective
- Definition

- Requirements and
- Application and other explanatory material

## **1.2. Process of setting the standards**

The following are the steps of setting the standards:

- Identification of new development
- Appointment of task force to draft a standard
- Consultation
- Consideration of comments by task force and making amendments

Five (5) fundamental principles of ethical duties of auditors are:

- Objectivity,
- Integrity,
- Professional competence and due care,
- confidentiality,
- Professional behaviour.

## **2. Duties, obligations and rights of an auditor**

### **2.1. Duties of an auditor**

- Make a report to shareholders or owners as external auditors
- Make a report to the management as internal auditors
- Assist in investigation
- Make income statement
- Provide clear report and clear evidence
- Certify that whether loans are properly secured and not at terms prejudicial to the interest of shareholders
- Certify that whether transactions conducted by the company are not prejudicial to the interest of shareholders
- Certify that whether securities have been sold at a price lower than cost

### **2.2. The auditor's obligations are:**

- To pass an approved set of professional examinations
- To become a member (and stay member) of a Recognised Supervisory Body (RSB) e.g. ACCA
- Not to be a director or employee of the company, or of any associated companies
- Not be an employee or business partner of a director or employee of the company or of any associated companies.

### 2.3. Rights of being an auditor are as follows:

- Access to all records they require (the books of the organisation at any time)
- Receive information and explanations of all transactions
- Call for information and explanations from employees, managing agents, company secretaries, etc.
- Attend and receive notice (within 21 days) about general meetings and they have right to speak at general meetings on relevant matters
- Visit the company's branches
- Take a legal and technical advice
- Remuneration
- Sign the audit report

### 3. Auditor's liability

Difference between civil liability and criminal liability

**Civil liability of Auditor for negligence:** refers to the liability of auditor to pay damages while

**Criminal liability:** refers to the responsibility for any illegal behaviour that causes harm or damage to someone or something which means open to punishment for a crime.

### 2.7. Additional information for teachers

#### Working procedures of the IAASB

A rigorous due process is followed by the IAASB to ensure that the views of all those affected by its guidance are taken into account. The following diagram summarises the process followed in the development of IAASB standards.

#### Research and consultation

A project task force is established to develop a draft standard or practice statement



#### Transparent debate

A proposed standards is discussed at a meeting, open to the public

### **Exposure for the public comments**

Exposure drafts are put on the IAASB's website and widely distributed for comment for a minimum of 120 days.



### **Consideration of comments**

Any comments as a result of the exposure draft are considered at an open meeting of the IAASB, and it is revised as necessary.



### **Affirmative approval**

Approval is made by the affirmative vote of at least 2/3 of IAASB members.

## **2.8. End unit assessment**

### **Answers to end unit assessment**

1. The components of International Standards on Auditing are the following :

**Introduction:** includes the purpose, scope and subject matter of the ISA plus the responsibility of the auditor.

**Objective:** consists of a clear statement of the ISA's objective in relation to the audit area that the ISA addresses.

**Definitions:** of applicable terms used in the text.

**Requirements:** clearly stated as 'the auditor **shall...**'

**Application and other explanatory material:** more precise explanations of what requirements mean or are meant to cover.

2. International Standards on Quality Control and International Auditing Practice Statements are not engagement standards issued by the IAASB. The others are all classed as engagement standards.
3. An auditor may be held liable to third party for negligence work in the following circumstances:
  - Where the auditor has been proved negligence and any third party has suffered a financial loss due to negligence of the auditor.

- Where the auditor did not attach a disclaimer to this report to the effect that the report was not intended to be relied upon by third parties.
  - Where the auditor was made fully aware that third parties were going to rely on his/her report.
  - Where the third parties can prove that no other external factors influenced their decision making except the auditor's report
  - Where the auditor owed a duty of care to the third parties.
  - Where the auditor gives reference regarding his/her client's creditworthiness.
4. In order to hold the auditor criminally liable, the following cases must be proved:
- That the statement made was false in material facts.
  - That the auditor wilfully made such a false statement, and
  - That the statement complained of has been made in any return report, balance sheet, certificate or any other document required to be made under any provision of the Companies Act.

## 2.9. Additional activities (Questions and answers)

### 2.9.1. Remedial activities

1. Write in full words the following abbreviations:
  - a) IAASB: International Auditing and Assurance or guarantee Standards Board
  - b) IAS: International Audit Standards
  - c) RQB: Recognised Qualifying Body
2. Write down three (3) duties and rights of an auditor.

An auditor has to:

- Make a report to shareholders or owners as external auditors
- Make a report to the management as internal auditors
- Assist in investigation

The auditor's rights are:

- Access to all records they require (the books of the organisation at any time)
- Receive information and explanations of all transactions
- Call for information and explanations from employees, managing agents, company secretaries, etc.

### **2.9.2. Consolidation activities**

1. Write down the sources of legal liability for an auditor.

#### **Sources of legal liability for an auditor are the following:**

- The Legal Liability of Auditors to Third parties
  - Unjustified/unfair Lawsuits
  - Successful Lawsuits Against Auditors
2. When an auditor can be held liable for negligence of his/her duty?

An auditor can be held liable for negligence of his/her duty if it is proved that:

- Negligence in the performance of his/her duty
- A loss or damage as a result of his/her negligence
- The loss was suffered by his/her client.

### **2.9.3. Extended activities**

#### **a) Extended activities (Questions and answers)**

##### **Question**

1. Consider whether providing the following additional services to audit, clients may compromise your independence as an auditor. If they do, consider how the risk to your independence could be safeguarded.
  - a. Taxation, preparing a client's corporation tax computation and negotiating with the tax authorities
  - b. Preparing a client's annual financial statements
  - c. Attending meetings of a client's board of directors

##### **Answer**

- a. Preparing a taxation computation is unlikely to impair auditor independence, since a company's tax liability would generally be reviewed as part of the audit. Routine negotiations with the taxation authorities should not normally impair independence.

There may however be a problem if a significant tax liability is under dispute, since the auditor may believe the accounts should disclose details of the dispute, but the directors may disagree.

In these circumstances, the auditor may find it impossible to act as both auditor and tax adviser.



- b. The major risk with the auditor preparing the financial statements is that the auditor may not be objective when he/she reviews the financial statements. In addition, the audit files may not demonstrate sufficiently how the accounting work has been used as a source of audit assurance. If the client is a public interest entity (PIE), the provision of this service would not be allowed the audit firm can counter the risk to independence by having different staff members prepare the financial statements and audit them. Alternatively, the audit work should be reviewed by someone unconnected with the preparation of the financial statements. Audit firms' internal guidance can also help, by clearly demonstrating how much audit assurance can be gained from accounting work, and what extra work will be required to give sufficient audit assurance.
- c. Attendance at meetings of the board of directors imposes a clear threat to auditor's independence as the auditor may become involved in management decisions on which he/she subsequently has to report. Legislation often also regards as a director anyone who carries out the functions of a director; an auditor would be exposed to this provision if he/she regularly attended board meetings and hence would be ineligible under legislation to act as auditor.

The best way to preserve auditor's independence would be for an auditor only to attend the board meetings at which the annual accounts are discussed.

# UNIT 3 | AUDITOR'S APPOINTMENT

## 3.1. Key unit competence

To be able to describe the procedures for auditor's appointment.

## 3.2. Prerequisite (knowledge, skills, attitudes and values)

In Unit2, you have analysed duties, obligations and rights of an auditor under the legal and professional requirements. This prior knowledge, skills or competences should help the students to understand duties, obligations and rights of an auditor as well as the contribution of audit profession to business activities in their locality and be able to realize their contributions as students towards business activities.

## 3.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address crosscutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the crosscutting issues where possible taking consideration of their environment or community around them.

**Genocide studies:** genocide studies provide young people with an understanding of the circumstances leading to the genocide and the remarkable story of recovery and re-establishing national unity. Genocide studies help students to comprehend the role of every individual in ensuring nothing of the sort ever happens again.

**Gender education:** emphasis throughout this unit has to be put on how both males and females have same rights and obligations to do business activities which can generate an income in their local community. So as to promote better standard of living of business activities and their community in the creation of business based employment opportunities and the country complying with appropriate and required audit standards leading to business progress and socioeconomic development.

**Environment and sustainability:** the greatest source of business practices is the environment and the society. Auditing in business or any other business concept related to business activities cannot be applied without the environment. Therefore, great care has to be taken for environment and society. Therefore, it is important to elaborate measures to protect the environment so that it can be safe from harm.

**Inclusive education:** in addition to all having equal opportunities to become businesses, attention will be made on how we all regardless of our background have right to generate ideas that do not discriminate as our needs are the same. Students need to understand that business law should not discriminate but promote inclusiveness of all. Throughout the business activities, students should be able to evaluate the contribution of auditing in socio-economic development of the community.

**Peace and Values:** you need to emphasize on students need to live in peace and harmony with others. Students need to identify potential contributions of all aspects towards the promotion of peace and value in the society. Students also need to develop positive attitudes towards the society, customers, shareholders, environment, business and government, among others in order to contribute to the socio-economic development. They need also to know that the security is important for people to live in high standard of living.

**Standardization culture:** you need to emphasize to students, the need for standards even in business activities to ensure that these activities bring in enough income to the economy and to maintain order in business environment.

**Financial education:** teacher and students should know that resources and materials used in teaching and learning activities must not be mismanaged. This issue will also be addressed when studying practice related to business activities. Students will learn what is permitted and what is prohibited to manage learning resources and materials well. They will put in mind that misusing materials is wasting money.

### **3.4. Guidance on introductory activity**

**NOTE:** The students won't be able to answer all the questions at this stage; they can answer one question. The most important thing is that you want to challenge students to be expectant and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide interest and motivation for students to be able to identify laws related to business activities as opportunity of fighting against illegal business activities in the community.

The introductory activity will also evoke students' interests about what to expect in this unit as they answer the questions that follow in the activity. Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content.

Use an appropriate method such as small groups or pairs and provide students with Unit 3 introductory activity, give clear instructions to the activity.

They read the case study and discuss what activities may have carried out. They read a scenario about business in Rwanda and discuss about a professional name of a person who examines financial statements and other financial documents on behalf of shareholders, appropriate procedures for appointing an auditor and things to consider by the auditor before accepting the assignment of auditing.

During grouping or pairing, mix boys and girls and students with different abilities.

During the discussion, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud/congratulate the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Harmonize their findings or answers, and help them draw conclusions/summary to questions. Answer or address any questions or challenges about the activity. Guide them to make notes in their books referring to students' book.

Students present their findings, results, answers through presentations on the introductory activity.

Appreciate the teams' presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the unit.

You can support students' answers by referring to possible answers to the introductory activity below:

## Answers to introductory activity

1. Auditor
2. Procedures for auditor's appointment
  - Advertising
  - Tender
  - Practical issues
  - submitting an audit proposal
  - Use of logos
  - Fees
  - Evaluating the tender
3. Before accepting the assignment, the auditor should consider the following:
  - Make sure there are no ethical issues which would prevent you from accepting this assignment.
  - Make sure that you are professionally qualified to carry out the work requested and that your firm has the resources available in terms of staff, expertise and time.
  - Check out references for the directors of the client firm especially if they are unknown to the audit firm.
  - Consult previous auditors as a matter of professional courtesy and establish from them whether there is anything that you ought to know about this vacancy.

### 3.5. List of lessons/sub-heading

Heading	Lesson title/sub-heading	Learning objectives	Number of periods
3.1. Auditor's appointment procedures	Introductory activity	Arouse the curiosity of students on the content of unit 3	1
	1 Appointment of an auditor	Explain appointment procedures of an auditor	2
	2 Acceptance procedures	Explain the acceptance procedures	2
	3 Agreeing the terms of engagement	Identify the terms of engagement	1
<b>End Unit Assessment</b>			1
Total number of periods			7

## Lesson 1: Auditor's appointment procedures

### a) Learning objectives

Describe auditor's appointment procedures

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction

In Unit 2 you have analysed duties, obligations and rights of an auditor under the legal and professional requirements. This prior knowledge, skills or competences should help the students to understand auditor's appointment procedures as well as the contribution of audit profession to business activities in their locality and be able to realize their contribution as students towards business activities.

### d) Learning activities

- Invite students to read individually the question in the student's book and work in pairs to share with the classmates.
- Have some pairs and make the presentations
- Provide constructive feedback in terms of supplements

### Answers to Learning activity 3.1

1. The ICPAR code of ethics lays out the fundamental principles of ethics as follows:
  - **Integrity:** a member should be straightforward and honest in all professional and business relationships.
  - **Objectivity:** a member should not allow bias, conflict of interest or undue influence of others to override professional or business judgements.
  - **Professional competence and due care:** a member has a continuing duty to maintain professional knowledge and skills at the level required to ensure that a client or employer receives competent professional service.
  - **Confidentiality:** a member should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Any information acquired should not be used for the personal advantage of the member or third parties.



- **Professional behaviour:** a member should comply with relevant laws and regulations and should avoid any action that discredits the profession.

## 2. Rights of an auditor

- Right to access to the books of accounts of the organization at all times.
- Right to call for information and explanations.
- Right to receive a notice of 21 days to attend the Annual General Meeting .
- Right to make a statement at the Annual General Meeting.
- Right to be indemnified.
- Right to visit the company's branches.
- Rights to take legal and technical advice.
- Right to Remuneration.
- Right to sign the audit report.
- Right to receive notices of meetings.

During his/her removal, he/she has the following rights:

- Right to speak at the every meeting discussing his/her removal.
- Right to send his/her representations to the company this will then be circulated to all shareholders.
- Right to receive notice of the Annual General Meeting that will discuss the auditor's removal (28 days' notice)
- Right to read the representations in the annual general meeting in the case they were not sent in a reasonable time to shareholders.
- His/her is removal is reserved to shareholders. Thus he/she has the right to withstand other forms of removals.

## 3. Auditor's liabilities

- The client to whom he/she owes the primary duty of care.
- Third parties who have not privacy of contract but have relied on his/her opinion to arrive at a decision.

In general, the auditor's liability may arise due to:

- His/her failure to detect fraud
- His/her failure to detect errors in the accounts
- Carelessness or dishonesty

The liability of an auditor may arise in the following capacities:

- In his/her capacity as an auditor in private audits.
- In his/her capacity as an auditor as a statutory audit

### e) Application activities 3.1:

Invite students to read the application activities in student's book and answer them.

#### Answers to Application Activity 3.1

1. Matters to be considered:

- Identity and business reputation of owners, key management and those charged with governance.
- Nature of the client's operations and its business practices.
- Attitude of the owners, key management and those charged with governance towards matters such as aggressive interpretation of accounting standards and the internal control environment.
- Client's attitude to fees.
- Indications of inappropriate limitation in the scope of work.
- Indications that client may be involved in money laundering or other criminal activities.
- Reasons given for non-reappointment of previous auditors.

#### Skills lab activity 3

Through the search in audit books from the library, make a summary to be presented in the class on the procedures of recruiting an auditor in order to make sure that you have understood the whole process.

Guidance on the skills lab activity.

In conducting this skills lab activity, you can either accompany the students to the library to make a search on the auditor's recruitment. Facilitate them to make presentation of findings in the class.

i. **Build**

Given that students make search about auditor's recruitment

- Remind students on the expected objective for recruiting an auditor
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research

## ii. Practice

- Guide students on accessing the real materials
- Ensure that books in the library are available for all
- Respond to any questions for clarification and support accordingly

## iii. Present

- Choose randomly any two teams to present their findings
- Allow students to ask question to their fellows

## iv. Conclusion

The teacher emphasizes on the objective of the research reminding students that they have to follow those identified procedures to recruit an auditor.

The following are key areas for reference:

Requirements for appointing an auditor:

How to appoint an auditor?

## 3.6. Summary of the unit

### 3. Auditor's appointment procedures

#### 3.1. Appointment of an auditor

##### Procedures for appointing an auditor

A. Advertising

B. Tendering

C. Acceptance

#### 3.2. Acceptance procedures

##### Conditions before accepting the assignment

- Make sure there are no ethical issues which would prevent you from accepting this assignment.
- Make sure that you are professionally qualified to carry out the work requested and that your firm has the resources available in terms of staff, expertise and time.
- Check out references for the directors of the client firm especially if they are unknown to the audit firm.

- Consult previous auditors as a matter of professional courtesy and establish from them whether there is anything that you ought to know about this vacancy.

### **Conditions after accepting the assignment**

- Make sure the resignation of the previous auditors has been properly carried out and that the new appointment is valid. A resolution by shareholders of the company is required.
- Submit a letter of engagement to the directors of the client company and ensure it is accepted and signed before any audit work is carried out.

### **Integrity of the client**

### **Competence of the audit firm**

## **3.3. Agreeing the terms of engagement**

### **ISA 210: terms of audit engagements**

#### **Other points to be included:**

- Arrangements regarding the planning and performance of the audit.
- The expectation of receiving from management written confirmation regarding
- Representations made in connection with the audit.
- Request for the client to confirm in writing the terms of the letter.
- The fee to be charged and the credit terms.
- The form of any reports or other communication of results of the engagement.
- On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.
- An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Where the terms are changed, both parties should agree on the new terms.

### **Books and documents**

ISQC1 states that the firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.

Unless otherwise specified by law or regulation, engagement documentation is the property of the audit firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Audit working papers belong to the auditor and cannot be taken over by another set of auditors taking over the audit assignment. In practice, the previous auditors provide the new auditors with enough carry over information such as the lead schedules behind the makeup of the financial statements.

**There are strict conditions when this can be enforced:**

- The books and documents must actually belong to the client
- The auditor must have got them by proper means
- The actual work must have been done and a fee note raised and given to the client
- The fee must relate to the held documents. Financial statements and tax compliance work belong to the client, even if the auditor/ accountant has prepared them.

**Change in auditors**

Companies do actually change their auditors. It is important that auditors understand why a company may seek to change their auditor in a bid to prevent this from happening to them.

**Audit firm may not seek re-election**

**Problems related to the size of the company**

- The company may be growing at such a rate that the audit firm no longer has the necessary resources, staff, time, and expertise, to allow it to retain the audit.
- It is important to apply the principle of professional competence and due care.
- Alternatively, the company may be constricting and it now finds that it can avail of the
- Audit exemption specified under relevant jurisdiction regulations.
- There is very little that the auditor can do in each of these cases.
- With small companies, the audit is almost a personal service.
- As part of the safeguards against the threats to independence, audit rotation was put forward. This is where the audit moves to another firm although in the previous point, rotating to another engagement partner within the same firm will mean the same thing.

### 3.4. Additional information for the teacher

#### Other factors relating to the tender

##### Practical issues

It is important that the auditor also considers a number of other issues: ▪ Can the audit assignment be fitted in to the audit firm current work plan?

- Is there suitable audit staff available?
- Will any specialist skills be required?
- What are the future plans for the company?
- Is there any training required for current staff and what will be the cost of that training?
- What work does the client actually want? Audit and/or tax.
- Is this the first time the company has been audited.
- Whether the client is seeking to change its auditors and if so what is the reason behind it.

##### Submitting an audit proposal

There is no set format. In fact, the client may dictate the format whether it be a written submission or a presentation to the board of directors. Whatever the form of the tender submission, the following matters should be included in the proposal:

- The audit fee and the basis for its calculation
- An assessment of the needs of the client
- How the firm means to meet the needs of the client
- Any assumptions made to support the proposal
- The audit approach to be adopted by the firm
- A brief outline of the firm ▪ Details and background of the key audit staff on the proposed engagement.

##### Evaluating the tender

Different clients will have different ways of evaluating a tender. Some of the more general points are listed below. It is important to bear these in mind when preparing a proposal:

- Fee. This can be the most vital point. Some clients go straight to this figure and don't even bother with the rest of the document.
- Professionalism. Auditors are expected to be professional. Remember, the audit team and the tender documents are often the first factors on which a prospective client forms an impression.



- Proposed audit approach. Clients are always looking for the least amount of disruption to their already busy schedules, so the shortest number of days on-site may be the key to winning a tender.
- Personal service. Fostering relationships is vital. Client should always feel he is getting value for money.

### 3.7. End unit assessment

#### Answers to end unit assessment activities

1. Auditor's appointment procedures are the following:
  - Advertising
  - Tender
  - Practical issues
  - submitting an audit proposal
  - Use of logos
  - Fees
  - Evaluating the tender
2. The main terms of engagement as per ISA 210 are the following:
  - Agreeing the terms of an engagement with the client and;
  - The auditor's response to a request by a client to change those terms to one that provides a lower level of assurance.
3. The conditions for setting the remuneration of the auditor are the following:
  - If appointed by directors, they will fix his fees and expenses.
  - If appointed by the Registrar, he fixes his remuneration in liaison with Directors.
  - If appointed by shareholders, the same fix his fees or can delegate the powers to the Directors.
  - A retiring auditor who is automatically re-appointed at the AGM, unless a resolution is passes re-fixing his fees is entitled the same remuneration as in the previous periods.
  - If the auditor is required to do any other work other than his normal work, e.g. to prepare tax return, he is entitled to extra remuneration for that.
  - If an auditor is removed in the way prejudicial to his interest, e.g. unlawfully, he is entitled to a full year fees.
  - Any sum paid in respect of expenses to the auditor is part of his remuneration and should be reflected in the P&L Account

4. Conditions for accepting the audit assignments are the following:

**a. Conditions before accepting the assignment**

- Make sure there are no ethical issues which would prevent you from accepting this assignment.
- Make sure that you are professionally qualified to carry out the work requested and that your firm has the resources available in terms of staff, expertise and time.
- Check out references for the directors of the client firm especially if they are unknown to the audit firm.

Consult previous auditors as a matter of professional courtesy and establish from them whether there is anything that you ought to know about this vacancy

**b. Conditions after accepting the assignment**

- Make sure the resignation of the previous auditors has been properly carried out and that the new appointment is valid. A resolution by shareholders of the company is required.
- Submit a letter of engagement to the directors of the client company and ensure it is accepted and signed before any audit work is carried out.

ISQC1 states that a firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it:

- Has considered the integrity of the client and does not have any information that would lead it to conclude that the client lacks integrity,
- Is competent to perform the engagement and has the capabilities, time and resources to do so and
- Can comply with the ethical requirements.

5. The following conditions of engagement client must respect:

- Confirmation of the auditor's acceptance of the appointment.
- The auditor is responsible for reporting on the accounts to the shareholders
- The directors of the company have a statutory duty to maintain the books of the company and are responsible for the preparation of the financial statements.
- The directors are responsible for the prevention and detection of fraud.

- The fact that because of the test nature and other inherent limitations of an audit, there is the unavoidable risk that some material misstatements may remain undiscovered.
  - The scope of the audit including reference to appropriate legislation and standards.
  - There should be unrestricted access to whatever books and records the auditor needs in the performance of his duties.
6. The main points to be clarified in the letter of engagement would include:
- Confirmation of the auditor's acceptance of the appointment.
  - The auditor is responsible for reporting on the accounts to the shareholders
  - The directors of the company have a statutory duty to maintain the books of the company and are responsible for the preparation of the financial statements.
  - The directors are responsible for the prevention and detection of fraud.
  - The fact that because of the test nature and other inherent limitations of an audit, there is the unavoidable risk that some material misstatements may remain undiscovered.
  - The scope of the audit including reference to appropriate legislation and standards.
  - There should be unrestricted access to whatever books and records the auditor needs in the performance of his duties.

### ***3.7. 1. Consolidation activities (Questions and answers)***

#### **Questions:**

1. Describe the process of appointing an auditor

#### **2. Answers:**

#### **A. Advertising**

Auditors are like anyone else in business and in business it is necessary to advertise. But this advertising should be aimed at informing the public in an objective manner and should be in good taste.

## B. Tendering

Client companies can change auditors. In this regard a firm may be approached to submit a tender for an audit. When approached to tender, an audit firm must consider whether they want to do the work and they must have regard for the ethical considerations, such as independence and professional competence. In addition, they need to consider fees and some other practical issues.

## C. Acceptance

You have submitted a tender. You have been successful and the client has offered you the audit. Before you accept and commence the audit you should carry out a number of procedures in order to comply with the provisions in ISQC1 quality control.

**Question 2:** Describe the conditions required on behalf of the auditor before accepting assignments.

**Answer:** Before he accepts assignments the auditor should be sure about the following:

- Make sure there are no ethical issues which would prevent you from accepting this assignment.
- Make sure that you are professionally qualified to carry out the work requested and that your firm has the resources available in terms of staff, expertise and time.
- Check out references for the directors of the client firm especially if they are unknown to the audit firm.
- Consult previous auditors as a matter of professional courtesy and establish from them whether there is anything that you ought to know about this vacancy.

### 3.7.2. Extended activities (Questions and answers)

#### Question:

1. Describe the competence matters related to the audit firm.

#### Answer:

1. Matters to be considered:

- Has the firm got sufficient knowledge of the relevant industry and the relevant regulatory environment?
- Are there sufficient personnel within the firm having the necessary capabilities and competence and are experts/specialists available when needed?

- Are competent individuals available to perform engagement quality control reviews?
- Will the firm be able to complete the engagement within the reporting deadline?
- Where a potential conflict of interest is identified, the firm should consider whether it is appropriate to accept the engagement.
- Need to consider any significant matters that may have arisen during the current or previous engagements of whatever description.
- ISQC1 goes on to state that where the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures (on the continuance of the engagement and the client relationship) should include consideration of: The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities, and can comply with the ethical requirement.
- The possibility of withdrawing from the engagement or from both the engagement and the client relationship.

### **3.8. Additional activities (Questions and answers)**

#### ***3.8.1. Remedial questions (Questions and answers)***

**Question1:** Among the appointment procedures mention two of them.

**Answer1:** Advertising, Tendering, Acceptance

**Question2:** What do you understand by the term acceptance in the process of audit appointment?

**Answer2:** You have submitted a tender. You have been successful and the client has offered you the audit. Before you accept and commence the audit you should carry out a number of procedures in order to comply with the provisions in ISQC1 quality control.

**Question 3:** Elements to be clarified in the letter of engagement.

**Answer3:** Elements to include in the engagement letter are:

- Confirmation of the auditor's acceptance of the appointment.
- The auditor is responsible for reporting on the accounts to the shareholders.

- The directors of the company have a statutory duty to maintain the books of the company and are responsible for the preparation of the financial statements.
- The directors are responsible for the prevention and detection of fraud.
- The fact that because of the test nature and other inherent limitations of an audit, there is the unavoidable risk that some material misstatements may remain undiscovered.
- The scope of the audit including reference to appropriate legislation and standards.
- There should be unrestricted access to whatever books and records the auditor needs in the performance of his duties.



# UNIT 4 | AUDITORS REQUIREMENTS

## 4.1. Key unit competence

To be able to describe the auditor's requirements

## 4.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in unit 2 the legal and professional requirements of an auditor on his second lesson, and in unit 5 the legal responsibilities and duties of an auditor on his lesson one in which they have learnt legal responsibilities, duties, obligation and rights of an auditor. So, with this prior knowledge, skills, attitudes and values it should help them to appreciate the auditor requirement.

## 4.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** Environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection and the importance of audit procedures in reducing errors and frauds while promoting other environmentally friendly businesses e.g. use of renewable energies (solar energy).

**Gender education:** Emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the process of auditing procedures. So that this will encourage student to take the first step in understanding the requirements of an auditor.

**Inclusive education:** all students need to realize that universal laws do not discriminate as they do apply to all regardless of social, economic, political, physical background. Emphasis should be put on how we all have the same rights. During auditor requirement unit, student may discuss and appreciate need to qualification, disqualification, rights, and duties of an auditor during the audit work.

**Peace and Values:** right before the lesson begins; there are quite a lot of opportunities for the teacher to promote peace and values. Being punctual for activities (time management), involvement in various activities (team work), keeping their school environment clean (responsibility), greeting one another are among such opportunities (empathy).

**Standardization culture:** in every lesson take an opportunity to share with learners that standards should be respected since they are part and parcel of our lives. From school uniform, to class size, to lesson duration, language of instruction, among others. So always, create opportunities to discuss about the standards with learners during their everyday and audit activities.

#### **4.4. Guidance on introductory activity**

**NOTE:** Follow the guidance about the introductory activity:

Students in small groups, pairs or individual observe and analyse the image and identify the major qualifications, disqualification, rights, and duties of an auditor.

During the activity, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair-share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Appreciate the team's presentations and remind them that this activity was not meant come to the very right answers but to help them become aware of what to expect in the unit. Answers to the activity will be got as the unit progresses. Guide them to take notes in their books referring to learners' book.

You can support student's answers by referring to possible answers to the introductory activity below:

### Possible answers for introductory activity

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

1. Auditors must have certain rights to enable them to carry out their duties effectively.
2. He/she can be removed
3. They are called qualifications of an auditor.
4. They are called disqualifications of an auditor.

#### 4.5. List of lessons/sub-heading

Heading		Lesson title/ sub-heading	Learning objectives	Number of periods
4.1 Qualification and disqualification of an auditor		Introductory activity	Arouse the curiosity of students on the content of unit 4	1
	1	Qualification of an auditor	Explain the qualification of an auditor	1
	2	Disqualification of an auditor	Explain the reasons for disqualification of an auditor.	1
4.2 Rights and removal of an auditor	1	Rights and duties of an auditor	Identify the rights and duties of an auditor.	4
	2	Resignation and removal of an auditor	Explain the procedures of resignation and removal of an auditor	3
<b>End Unit Assessment</b>				1
<b>Total number of periods</b>				<b>11</b>

## **Lesson 1: Qualifications and disqualifications of an auditor**

### **a) Learning objective**

Describe the auditor's qualification and disqualification

### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, internet, computer, projector, text books, chalk or marker pen, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

Read the Key unit competence in the syllabus to determine what students will know and be able to do by the end of the unit. Look at the action verb, concept and context of learning objective. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objective link to the key unit competence.

### **d) Learning activities**

#### **Activity 4.1**

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question and answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

### Answers to Learning Activity 4.1

1. They are discussing about candidates who applied to be auditors.
2. No, because being a wife of the manager is one of auditor's disqualification.
3. If the manager's wife is selected as an auditor, she can't work independently, she may issue an appropriate audit opinion.
4. Yes.

#### e) Application activities 4.1

Students analyse and discuss about the scenario either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

### Answers to application activity 4.1

This refers to the question of who cannot be an auditor. The nephew (TOTO) is a relative of the manager of KBC Ltd, and this can't allow him to work independently. The prescription about the disqualification says that **"The spouse or any other relative of a director of the company are disqualified to be auditors of the company"**.

## Lesson 2: Rights and removal of an auditor

### a) Learning objective

Describe the rights of an auditor, and the process of his removal

### b) Teaching resource basic materials for a class/ lesson to be conducted:

Students books, teacher guide internet, computer, projector, chalk or marker pen, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In previous lesson, lesson 1 Students studied for meaning of taxation , tax and duty

That will help to discuss current legislation and tax period relating to taxation in Rwanda

Leant in this lesson.

### **d) Learning activities**

#### **Activity 4.2**

- Put students in small groups and give clear instruction about the activity.
- Ask them to observe the pictures in student book and answer the questions provided in the activity.
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings.
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on when to discuss rights, duties, resign and removal of an auditor according to the company act. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

#### **Answer to Learning Activity 4.2**

1. Yes, because his/her rights bind him/her to his duties.
2. The auditor can declare the lack of independence to the person who appointed him/her, and the companies act make it an offense for a company's officer knowingly or reckless to make a statement in any form to an auditor which:
  - Conveys or purports to convey any information or explanation required by the auditor, and
  - Is misleading, false or deceptive in a material particular.
3. He can be removed.

### **e) Application activities 4.2**

This activity can be given as a normal individual activity, where students can answer questions by write the letter corresponding to the right answer only. Monitor the activity to ensure students are not collaborating.



Students share their findings to the teacher. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

### Answers to Application Activity 4.2

1. A
2. D
3. D
4. C

### Skills lab activity 4

Guidance on the skills lab activity.

To do this skills lab activity, students can either visit library or request students to make a research on the internet where need be.

#### **i. Build**

Given that students visit the required website,

- Remind students on the expected objective for the computer lab attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research

#### **ii. Practice**

Guide students on accessing the real website

Ensure that internet is connected for all

Respond to any questions for clarification and support accordingly

#### **iii. Present**

Choose randomly any two teams to present their findings

Allow students to ask question to their fellows

#### **iv. Conclusion**

The teacher emphasizes on the objective of the research reminding students that they have to follow those rights auditor has.

The following are key areas for reference:

Rights of auditor

#### **4.6. Summary of the unit**

##### **Qualification and disqualification of an auditor**

- Qualification of an auditor
- Disqualification of an auditor

##### **Rights, duties and removal of an auditor**

##### **Rights, and duties of an auditor**

Right to sign the Auditor Report

Right to Remuneration

Rights to take legal and technical advice

Right to visit the company's branches

Right to be indemnified

Rights to make a statement at the Annual General Meeting

Right to receive a notice of 21 days to attend the Annual General Meeting

Rights to call for information and explanation

Rights of access to the books of accounts of the organization at all times

##### **Duties of an auditor**

Duties to make a report

Duty to state the following in the report:

Duty to call for information as to:

Duty to assist in investigations

To certify statutory report

Duty to certify profit and loss Account in prospectus

Duty to certify profit and loss account when Managing Agents resign

## **Resignation and removal of an auditor**

### **Steps of auditors' resignation**

Resignation procedures

Notice of resignation

Statement of circumstances

Convening of general meeting

Statement prior to general meeting

Other rights of auditor during resignation

### **Steps of auditors' removal**

Notice of removal

Representations

Notification of regulatory authority

Deposit of statement of circumstances

Auditors' rights during removal

## **4.7. Additional information for the teachers**

Beyond the basic education requirement, all auditors are expected to exhibit a positive professional behaviour, demonstrate good communication skills and possess the ability to work well with people.

The auditor's office is exempt from the state's merit system administered by the department of administrative services. Therefore, it is not necessary for candidates to complete the certification process that is required for state offices under the merit system.

## 4.8. End unit assessment

### Answers to end unit assessment activities

1. The auditor is entitled to access, at all times to the books of accounts including all statutory records such as minute books, fixed assets register, etc.
2. The auditor has the following rights under the company's Act:
  - Right to access to the books of accounts of the organization at all times
  - Right to request necessary information
  - Right to receive a notice of 21 days to attend the Annual General Meeting
  - Right to make a statement at the Annual General Meeting
  - Right to be indemnified
  - Right to Remuneration
  - Right to sign the Auditor Report
  - Right to written resolutions
  - Right to be heard at any general meeting

## 4.9. Additional activities (Questions and answers)

### 4.9.1. Remedial activities (Questions and answers)

1. Who among the following can be appointed as an auditor of a company:
  - A. A partner or a director of the company
  - B. A person of unsound mind
  - C. Mr GAGA who owe a large amount of money to the company
  - D. Mr Z the holder of C.A certificate
  - E. All of the above

**Answer: D**

**2. The retiring auditor does not have right to:**

- A. Make written representations
- B. Get his representation circulated
- C. Be heard at the meeting
- D. Speak as a member of the company
- E. No one of the above

**Answer: D**

**3. Which of the following statement is not correct regarding removal of first auditor before expiry of the term?**

- A. He is removed at a general meeting
- B. The shareholders are authorized to do so
- C. The approval of the central government is required for such removal
- D. The board of directors is authorized
- E. A and C are correct answers
- F. No one of the above

**Answer: C**

**4. A remuneration of a company auditor is fixed by the:**

- A. Shareholders
- B. Board of directors
- C. Central government
- D. Appointing authority
- E. All of the above

**Answer: D**

**5. Which one of the following is not a duty of an auditor:**

- A. Duty to report company's banker
- B. Duty to report to the member
- C. Duty to sign the audit report
- D. Duty to report on any violation of law
- E. No one of the above

**Answer: A**

### **4.9.2. Consolidation activities (Questions and answers)**

**1. The Vacancy caused by resignation of an auditor is filled by:**

- A. Board of directors
- B. At the general meeting of shareholders
- C. By the central government
- D. By the company low board
- E. A and B are correct answers
- F. All of the above

**Answer: B**

**2. If at an annual general meeting, no auditors are appointed or reappointed:**

- A. The board of directors appoint a person to fill the vacancy
- B. The union government appoints an auditor
- C. The managing director appoint an auditor
- D. An extra-ordinary meeting is called
- E. No auditor will work for the whole year
- F. All of the above

**Answer: A**

**3. According to the company act an auditor has a right to attend any general meeting:**

- A. By himself or through his authorized representative who is not qualified to be an auditor
- B. By him self
- C. Auditor has no duty to attend any general meeting
- D. By himself or through his authorized representative who is qualified to be an auditor.
- E. All of the above

**Answer: D**



**4. Which of the following persons is qualified to be a company auditor?**

- A. An employee of the company
- B. A body corporate
- C. A person who is indebted to the company for a large amount of money
- D. A practicing chartered accountant
- E. No one of the above.

**Answer: D**

**5. What makes a person ineligible for appointment as a company auditor?**

- A. An officer or employee of the company
- B. A partner or employee of such a person
- C. A partnership in which such a person is a partner
- D. The person who is indebted to the company quite large sum of money, etc.
- E. A and D are correct answers
- F. All of the above.

**Answer: E**

### ***4.9.3. Extended activities (Questions and answers)***

1. Mr. KARARA, a chartered accountant, was appointed as an auditor of ABC Ltd. In the 12<sup>th</sup> Annual general meeting of the company in September, 2019. In June 2020 the company removed him through a resolution in general meeting and appointed GAGA as its auditor.

**Required:**

Specify the provisions about removal of auditor before the expiry of the term.

**Answer:**

- Auditor may be removed from his office before the expiry of his term, by the company only in a general meeting plus prior central government approval (except for removal of first auditor).
- Since prior approval of the central government has not been obtained, the removal of KARARA is not valid and, therefore, KARARA continues to be the auditor. The appointment of GAGA in his place is void because it is not follow rules and regulations.

# UNIT 5 | AUDITOR RESPONSIBILITIES

## 5.1. Key Unit competence

To be able to exhibit the auditor's responsibilities

## 5.2. Prerequisite (knowledge, skills, attitudes and values)

In unit have taught the in Unit 2 you have analysed duties, obligations and rights of an auditor under the legal and professional requirements. This prior knowledge, skills or competences should help the students to understand duties, obligations and rights of an auditor as well as contribution of audit profession to business activities in their locality and be able to realize their contribution as students towards business activities.

## 5.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address crosscutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the crosscutting issues where possible taking consideration of their environment or community around them.

**Genocide Studies:** Genocide Studies provides young people with an understanding of the circumstances leading to the genocide and the remarkable story of recovery and re-establishing national unity. Genocide Studies helps student to comprehend the role of every individual in ensuring nothing of the sort ever happens again.

**Gender education:** Emphasis throughout this unit has to be put on how both males and females have same rights and obligations to do business activities which can generate an income in their local community. So as to promote better standard of living of business activities and their community in the creation of business based employment opportunities and the country complying with appropriate and required audit standards leading to business progress and socioeconomic development.

**Environment and sustainability:** The greatest source of business practices is the environment and the society. Auditing in Business or any other business concept related to business activities cannot be applied without the environment. Therefore, great care has to be taken for environment and society. Therefore, it is important to elaborate measures to protect the environment so that it can be safe from harm.

**Inclusive education:** In addition to all having equal opportunities to become businesses, attention will be made on how we all regardless of our background have right to generate ideas that do not discriminate as our needs are the same. Students need to understand that business law should not discriminate but promote inclusiveness of all. Throughout the business activities students should be able to evaluate the contribution of auditing in socio-economic development of the community.

**Peace and Values:** You need to emphasize on students need to live in peace and harmony with others. Students need to identify potential contributions of all aspects towards the promotion of peace and value in the society. Students also need to develop positive attitude towards the society, customers, shareholders, environment, business and government, among others in order to contribute to the socio-economic development. They need also to know that the security is important for people to live in high standard of living.

**Standardization culture:** You need to emphasize to students, the need for standards even in business activities to ensure that these activities bring in enough income to the economy and to maintain order in business environment.

**Financial education:** Teacher and students should know that resources and materials used in teaching and learning activities must not be mismanaged. This issue will also be addressed when studying practice related to business activities. Students will learn what is permitted and what is prohibited to manage learning resources and materials well. They will put in mind that misusing materials is wasting money.

#### **5.4. Guidance on introductory activity**

**NOTE:** The students won't be able to answer all the questions at this stage; they can answer one question. The most important thing is that you want to challenge students to be expectant and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide interest and motivation for students to be able to identify laws related to business activities as opportunity of fighting against illegal business activities in the community.

The introductory activity will also evoke students' interests about what to expect in this unit as they answer the questions that follow in the activity. Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content.

Use an appropriate method such as small groups or pairs and provide students with Unit 3 introductory activity, give clear instructions to the activity.

They read the case study and discuss what activities may have carried out. They read a scenario about business in Rwanda and discuss about a professional name of a person who examines financial statements and other financial documents on behalf of shareholders, appropriate procedures for appointing an auditor and things to consider by the auditor before accepting the assignment of auditing.

During grouping or pairing, mix boys and girls and students with different abilities.

During the discussion, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud/congratulate the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Harmonize their findings or answers, and help them draw conclusions/summary to questions. Answer or address any questions or challenges about the activity. Guide them to make notes in their books referring to students' book.

Students present their findings, results, answers through presentations on the introductory activity.

Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the unit.

You can support student's answers by referring to possible answers to the introductory activity below:

## Answers to the introductory activity

1. Duties of an auditor
  - Duty to make a report to shareholders or owners.
  - Duty to call for information
  - Duty to assist in investigations especially in audited area.
2. In general the auditor's liability may rise due to:
  - His failure to detect fraud
  - His failure to detect errors in the accounts
  - Carelessness or dishonesty
3. Liabilities to third parties are under the following conditions:
  - Where the party has suffered a financial loss as a result or by relying on the report made by the auditor.
  - Where it can be proved that the auditor did not use his/her professional skills and judgement during the audits.
  - Where the auditor made report when he or she is aware that such a report should be used by the third parties to make investment decisions.
  - Where the auditor didn't attach the disclaimer on his report that such a report was not included to be relied upon by third parties.
  - Where it can be proved that the third parties relied on the report.
  - Where the parties can prove that no external factors whatever influenced their decision but just the audit report
  - Where the third parties were not warned not to rely on the audit report

## 5.5. List of lessons/sub-heading

Heading	Lesson title/sub-heading		Learning objectives	Number of periods
5.1. Legal responsibilities and duties of an auditor	Introductory activity		Arouse the curiosity of students on the content of unit 5	1
	1	Legal responsibilities of an auditor	Explain legal responsibilities of an auditor	3
	2	Duties of an auditor	Explain the duties of an auditor	4
5.2. Error and fraud	1	Types of errors and frauds	Describe the types of errors and frauds	4
	2	Auditor's responsibilities in relation to fraud	Identify the auditor's responsibilities in relation to fraud	4
<b>End Unit Assessment</b>				<b>1</b>
<b>Total number of periods</b>				<b>17</b>

### Lesson 1: Legal responsibilities and duties of an auditor

#### i..Learning objective

Explain legal responsibilities and duties of an auditor

#### ii. Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.

#### iii. Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In Unit 3 you have analysed the auditor's appointment. This prior knowledge, skills or competences should help the students to understand the auditor's responsibilities as well as the contribution of audit profession to business activities in their locality and be able to realize their contribution as students towards business activities.



#### iv. Learning activities

##### Activity 5.1

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and students' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question-and-answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the learning activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

##### Answers to learning activity 5.1

###### 1. Auditor's duties:

- a) Duty to make a report to shareholders or owners and duty to state the following in his/her report:
  - Whether in his/her opinion, he/she has received all information and explanations necessary for his/her opinion.
  - Whether in his/her opinion, the trading, profit and loss account exhibits the true and fair view of the profit or loss of the period.
  - Whether in his/her opinion, the balance sheet is properly drawn and exhibits a true and fair view of the company's financial position.
  - Whether proper books of accounts have been kept properly or not.
- b) Duty to call for information:
  - Whether loans have been properly secured except lands and building.
  - Whether securities have been sold below the purchase price.

- Whether personal expenses have been debited to the profit and loss account and if so to debit the personal accounts of the employees concerned.

c) Duty to assist in investigations .

2. In general, the auditor's liabilities may rise due to:

- His failure to detect fraud.
- His failure to detect errors in the accounts.
- Carelessness or dishonesty.

## v. Application activities 5.1

Students analyse and discuss about the questions either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

### Answers to application activity 5.1

1. In order to minimize his/her liabilities, the auditor must:
  - Be diligent and honest to reduce negligence.
  - Use disclaimers on his/her report to minimize liabilities resulting from his/her report.
2. A guideline showing how the auditor's liabilities should be assessed under private audit:
  - That he/she was actually negligent with reference to the agreement.
  - That out of negligence the client suffered loss.
  - That a person who has explicit contractual obligation with him has/ her suffered the loss defined by the contract.

## Lesson 2: Error and fraud

### i. Learning objective

Describe the types of errors, frauds and the auditor's responsibilities in relation to fraud

## ii. Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.

## iii. Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson, lesson 1 Students discussed the legal responsibilities and duties of an auditor. This will help them to understand the auditor's responsibilities in relation to fraud.

## iv. Learning activities

### Activity 5.2

- Put students in small groups and give clear instruction about the activity
- Ask them to read carefully the questions and answer them
- Guide students' discussions and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary. Answer or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### Answers to learning activity 5.2

#### 1. a) Errors detected/disclosed by the Trial Balance

- Single entry.
- Overcast (over debit or over credit of accounts) or under cast (under credit or under debit of accounts).
- Two credits or two debits on the same side.
- Transfiguration or transposition.
- summation error

#### b) Errors not detected/disclosed by the trial balance

- Errors of original entry.
- Errors of Omission.
- Errors of commission.
- Errors of Principle.
- Compensating errors.

- Errors of complete reversal of entries.
- Material error.
- Immaterial error.

## 2. Procedures to discover errors and fraud

- Control of source documents and its likely (documentation).
- Physical observation.
- Direct confirmation.
- Analytical examination.
- Examination of the annual accounts.

### v. Application activities 5.2

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups for both gender and capability. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answer below as you assess their work.

### Answers to Application Activity 5.2

1. Measures an organisation should use in order to prevent errors are the following:
  - Employ a strong internal control system and efficient internal check system.
  - Award employees reasonable salaries according to their qualifications and experiences to reduce chances of committing errors and raise their morale to work.
  - Employment of qualified staff to prevent errors of principle.
  - Institute an internal audit department where possible.
  - Encourage clerks/staff to take their annual leave periodically so that their work performance can be assessed in their absence and any errors they had made revealed.
  - Encourage inter-department transfers and rotation of duties at a surprise moment so as to cut down the continuity of an error.

- There should be a close supervision of duties, particularly in sensitive areas of the business e.g. cash receipts and payments.
- Use specific reviews of what has taken place in any one given area.
- Use machines to record transactions e.g. adding machines, check writing machines, etc.
- Management should insist on referees when engaging employees especially the accounting staff.

2. In order to hold the auditor liable, the following should be proved:

- That the auditor made a statement that proved false in material facts.
- That the auditor wilfully made a statement, which was actually false knowing it.
- That the statement made was in any report, prospectus, balance sheet, certificate or any other document, which under the company's Act, the auditor is required to authenticate.
- That the auditor made a statement as a statutory officer of the company.

In general, an auditor can be held liable under the companies Act for criminal acts under the following circumstances:

- If he/she fails to disclose material facts in the financial statements, knowing that they are material and that such non-disclosure will make the statement misleading.
- If the auditor does not use reasonable care and skills during the course of his/her audit.
- If the auditor wilfully contravenes any provisions of the act which under normal circumstances is supposed to follow during the course of his/her auditing e.g. If he/she fails to request returns from the branches.
- If he/she destroys secrets mutilates vouchers, documents, books of accounts, certificates with the aim to destroy someone's opinion.
- If he/she falsifies or is privy to falsification of any document, prospectus, books of accounts or vouchers of the company with to deceive or defraud.
- If he/she knows that a material has been omitted in the report or financial statements and does not reveal such fact.

## Skills lab activity 5

### Guidance on the skills lab activity:

In conducting this skills lab activity, you give to students accounting documents containing errors, ask them to make corrections and discuss how to prevent them.

#### i. Build

Given that students work on correction of errors,

- Remind students on the expected objective for correcting errors
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understanding of the assignment
- Remind them that everybody full participation is mandatory.

#### ii. Practice

During the work in the learning group, care about the following concerns:

- Guide students on accessing the real documents
- Ensure that documents are available for all
- Respond to any questions for clarification and support accordingly

To facilitate the presenter to prepare his presentation, send him a concept note describing what has been covered during the class lesson and state what are students and teacher's expectations.

#### iii. Present

During the group presentation, the teacher must assess whether the student participation in the skills lab activity was effective by:

- Selecting randomly anyone in all groups to present the report on behalf of team members.
- Allowing students to ask question to their fellows.

All team members being presenting are expected to contribute to the plenary by answering some questions that the presenter is not covering as well as expected.



## iv. Conclusion

The teacher emphasizes on the objective of the research reminding students that they were expected to be able to describe errors, fraud and the auditor's responsibilities in relation to fraud.

## 5.6. Summary of the unit

### 1. Legal responsibilities and duties of an auditor

#### 1.1. Legal responsibilities of an auditor

Under the company's act, an auditor may be liable to the following parties:

1. The client to whom he owes the primary duty of care.
2. Third parties who have not privacy of contract but have relied on his opinion to arrive at a

#### a. Liabilities of an Auditor under Private Audits

In such audits, the auditor's liabilities depend on the agreement between the auditor and the client. It is for that reason that an auditor insists that the agreement be in writing clearly defining his duties, powers and responsibilities.

In order to minimize his liabilities, the auditor must:

- Be diligent and honest to reduce negligence
- Should never sign a balance sheet he doesn't believe to be correct
- Use disclaimers on his report to minimize liabilities resulting from his report

In assessing the auditor's liabilities under private audit the following should be assessed:

- That he was actually negligent with reference to the agreement
- That out of negligence the client suffered loss
- That a person who has explicit contractual obligation with him has suffered the loss defined by the contract.

#### b. Liabilities of an Auditor under Statutory Audits (Company's Act)

Under the Company's Act, auditors' liabilities cannot be limited by any agreement. The act defines his duties, powers and responsibilities. Under the Company's Act, the auditors' liabilities can arise out of:

- Civil law
- Criminal law

## **Civil liability of the Auditor**

These are liabilities that arise out of negligence. Under civil law the auditor has the duty to care about the following:

1. The client (in contract)
2. Third parties whether he has contractual obligations or not.

### **1.2. Duties of an auditor**

1. Duty to make a report to shareholders or owners and duty to state the following in his report
2. Duty to call for information
3. Duty to assist in investigations
4. To certify statutory report in order to assure the owners about the number of shares allocated to promoters and whether such issue was conducted properly.
5. Duty to certify the profit and loss account in the prospectus.
6. Duty to certify the profit and loss accounts when managing agents resign, balance sheet and funds flow statement.
7. Other duties:
  - Whether loans are properly secured and not at terms prejudicial to the interest of the shareholders
  - Whether transactions conducted by the company are not prejudicial to the interest of the shareholders.
  - Whether securities have been sold at the price lower than cost

## **2. Errors and frauds**

### **2.1. Types of errors and frauds**

#### **Types of errors**

##### **a) Errors detected/ disclosed by the Trial Balance**

The purpose of the T/B is to check the accuracy and validity of the books. It specifically detects the following errors:

- Single entry
- Overcast
- Two credits or two debits on the same side

- Transfiguration or transposition
- Summation or addition error

### **b) Errors not detected/disclosed by the trial balance**

When a T/B balances or agrees, it is not a guarantee that no errors were committed. Errors which cannot be detected by the T/B include

- Errors of original entry
- Errors of Omission
- Errors of commission
- Errors of Principle
- Compensating errors
- Errors of complete reversal entries
- **Material error:** to help you decide whether a particular item/transaction is material, you may consider looking at the following:
  - The percentage of the possible error.
  - Recurring or non-recurring error.
  - Statutory requirement

### **Immaterial error.**

Measurements of prevention of the errors

Methods of detection of errors

1. Trial balance checking
2. Short cut method
3. Extensive checking

### **Measures to prevent errors**

- Employ a strong internal control system and efficient internal check system
- Award employees' reasonable salaries according to their qualifications and experience to reduce chance of errors and raise their morale to work
- Employment of qualified staff to prevent errors of principle
- Institute an internal audit department where possible
- Encourage clerks/staff to take their annual leave periodically so that their work performance can be assessed in their absence and any errors they had made revealed.

- Encourage inter-department transfers and rotation of duties at a surprise moment so as to cut down the continuity of an error.
- There should a close supervision of duties; particularly in sensitive areas of the business e.g. cash receipts and payments.
- Use specific reviews of what has taken place in any one given area.
- Use machines to record transactions e.g. adding machines, check writing machines, etc.
- Management should insist on referees when engaging employees especially the accounting staff.

## Fraud

**Definition of fraud:** fraud is an intentional misrepresentation of financial information by one or more individual among the management, employees or third party collaboration in order to defraud the business of financial resources and assets. Example:

### Types of the frauds

- Embezzlement of cash
- Misappropriation of goods
- Fraudulent manipulation of accounts

### Difference between error and fraud

Errors	Frauds
▪ These are unintentional.	▪ These are intentional.
▪ It is easier to detect errors by checking the posting.	▪ It is difficult to detect frauds because they cross all the posting.
▪ Errors are committed by lower level staff.	▪ Frauds are committed by the management staff.

### ▪ Procedure of detecting errors and fraud

1. Control of source documents and its likely (documentation):
  - a) Types of Documents: internal and external Examination of documents that support a recorded transaction or amount.
    - The direction of testing must be from the recorded item to the supporting document.
    - Tests existence or occurrence

### Documents

- b) Document Vouching (from recorded item to supporting document)
- c) Document Tracing (from supporting document to recorded item)

2. Physical observation
3. Direct confirmation
4. Analytical examination
5. Examination of the annual accounts.

## **2.2. Auditor's responsibilities in relation to fraud**

The auditor can relieve himself of such liabilities under the following:

- i) If he/she withdraws his/her consent in writing before such prospectus has been registered and circulated for the public use.
- ii) That after registration of prospectus and before the allotment of shares, he on knowing the misleading statement in the prospectus, withdrawn his consent and give a public notice to this effect.
- iii) That it was important to give such statement and that he has reasonable grounds which he can substantiate e.g. letters of representation for proving that the statement was true.

In general, the auditor's liabilities to the third parties and client give rise to claims against the auditor on such grounds as:

- i) Failure to detect embezzlement by employees.
- ii) Negligence on the part of the auditor or his staff.
- iii) Improper accounts procedures, which may lead to fraud.
- iv) Errors in the financial statement he is reporting on.

In order to minimize his liabilities to the third parties and the client while compiling his report, an auditor should:

- i. Enter into agreement with his client that another person should not use his report
- ii. Include a disclaimer in his report to the effect that any party to make any decision should not.

## **5.7. Additional information for the teacher**

### **Change in auditors**

Companies do actually change their auditors. It is important that auditors understand why a company may seek to change their auditor in a bid to prevent this from happening to them.

The following sets out the reasons why this can happen:

## Audit fee

- Many companies perceive that an audit has very little value. In turn this makes the audit fee a very sensitive issue.
- The fee may be perceived to be too high. Remember, a lot of audit work may be done off site and the hours charged at the firms office will belong to the managers and partners, so the client might not understand why the fee is so high.
- It may not be seen as good value for money. For example, a client may have important tax work carried out for him. The fee charged may be way lower than that of the audit, probably due to the time involved, yet the client might see the value of this work far greater than that of the audit.
- The current fee might not appear to be very competitive. Other similar firms may be getting audit services for less.
- The client may put the audit out to tender to see whether the price is actually negotiable, even though he may have no intention of changing his auditor.
- The audit fee may breach the recommended level of overall practice fees as laid down by ethics and auditor may have no other alternative but to resign.

## 5.8. End unit assessment

### Answers to end unit assessment activities

1. a) **Definition of fraud:** a fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

**Definition of error:** an error is an unintentional misstatement in the financial statements, including the omission of an amount or a disclosure.

### 2. The auditor's liabilities towards the third parties:

He/she can be liable to the third parties under the following conditions:

- Where the party has suffered a financial loss as a result or by relying on the report made by the auditor.
- Where it can be proved that the auditor did not use his/her professional skills and judgement during the audits.
- Where the auditor made report aware that such a report should be used by the third parties to make investment decisions



- Where the auditor didn't attach the disclaimer on his/her report that such a report was not included to be relied upon by third parties.
- Where it can be proved that actually the third parties relied on the report.
- Where the parties can prove that no external factors whatever influenced their decision but just the audit report
- Where the third parties were not warned not to rely on the audit report.

However, for any action to succeed against the auditor, the auditor must prove the following:

- The auditor was negligent
- Due to negligence the third party suffered loss
- The auditor knew or ought to have known that third parties could rely upon the account.

### **3. Description of five (5) types of errors in audit:**

#### **a) Errors detected/ disclose by the Trial Balance**

The purpose of the T/B is to check the accuracy and validity of the books. It specifically detects the following errors:

- Single entry i.e. failing to complete double entry. E.g. cash sales where sales A/C is credited but cash A/C not posted.
- Overcast (over debit or over credit of accounts) or under cast (under credit or under debit of accounts).
- Two credits or two debits on the same side without the corresponding entries.
- Transfiguration or transposition i.e. changing figures by mistakes when posting e.g. RWF 58, 000 as RWF 85,000.
- Arithmetical error e.g. if the total is RWF 40 000 and you total RWF 50 000.

#### **b) Errors not detected/disclosed by the trial balance**

When a T/B balances or agrees, it is not a guarantee that no errors were committed. Errors which cannot be detected by the T/B include:

- Errors of original entry

These errors originate from source documents e.g. invoices, vouchers, receipts, bank paying slip etc. These errors are carried throughout the accounting process i.e. from the journal to the ledger to the trial balance and eventually to the final accounts.

For example: goods were sold on credit for RWF 95,000, but was recorded in the sales invoice as RWF 59,000 and the same figure is journalized.

- Errors of Omission

These are errors of omitting transactions from all books of accounts. If a transaction occurs and is not recorded anywhere, the T/B cannot detect such an error. If for example goods were bought for cash FRW 65,000 and entries were not made in the cash and purchases account.

- Errors of commission

These errors are committed when an entry is made on wrong person's account or account title but the double entry properly effected. For instance, goods worth FRW 400,000 were sold to Jane on credit but Joan's account was debited instead of the correct account of Jane. The sales account being properly credited.

- Errors of Principle

These are making entries on wrong classes or types of accounts. For instance, if a capital expenditure for say purchase of a motor vehicle is made, and it is debited to the purchases account instead of the correct motor vehicle account. Or if an old fixed asset was disposed off and the proceeds from this disposal or sale is entered in the sales account

- Compensating errors

These are errors that cancel out in the trial balance. They get cancelled because the error on one side of the T/B is compensated by a similar error on the other side of the trial balance. For instance, if an item that appears on the debit side of the T/B

E.g. Purchases is overcast by FRW 280 000 and by coincidence another account that appear on the credit side of the trial balance says the sales account was also overcast by FRW 280 000. These errors will neutralize each other and the TB will agree as if no error was made.

- Errors of complete reversal entries

These are committed when entries are made on wrong sides of the accounts. For instance, if wages totalling FRW 3 500 000 were paid cash and the bookkeeper debits the cash account and credits the wages account

- Material error is an error which has a big effect on the accounting transactions and has effect on the financial statements of a business.

To help you decide whether a particular item/transaction is material, you may consider looking at the following:

The effect on an individual financial statement as well as the whole set of financial statements.

The percentage of the possible error: for profit and loss account items, we usually calculate the percentage with reference to the profit before interest and tax figure. For Balance Sheet items, we usually calculate the percentage with reference to the total share capital and reserves or the total fixed assets. As a general rule, an error less than 5% would be regarded as immaterial.

Recurring or non-recurring error: recurring errors must be investigated no matter how small the percentage is. Recurring errors imply that there is a problem with the accounting system, which should be followed up.

Statutory requirement: In general, if an error does not seriously affect the accounts users' decisions, we do not worry about this minor mistake. However, in the context of law, sometimes there is no room for the materiality concept. For example, if the Companies Act requires that a particular item must be disclosed in financial statements, it must be done even if the amount is only FRW 1.

- Immaterial error

Immaterial error is when an item is immaterial, we do not need to worry about it for both qualitative and quantitative aspects.

#### **4. Auditor's duties:**

- a) Duty to make a report to shareholders or owners and duty to state the following in his/her report:
  - Whether in his/her opinion, he has received all information and explanations necessary for his opinion.
  - Whether in his opinion the trading, profit and loss account exhibits the true and fair view of the profits or loss of the period.
  - Whether in his opinion the balance sheet is properly drawn and exhibits a true and fair view of the company's financial position.
  - Whether proper books of accounts have been kept properly by the company and returns received from company's branches not visited by him.
- b). Duty to call for information:
  - Whether loans have been properly secured except lands and building
  - Whether security have been sold below the purchase price
  - Whether personal expenses have been debited to the profit and loss account and if so to debit the personal accounts of the employees concerned

- c). Duty to assist in investigations, he should give support to the investigators but only if financial matters and to provide his working purpose.

### **5. Types of frauds:**

- Embezzlement of cash.
- Misappropriation of goods.
- Fraudulent manipulation of accounts.

### **6. Auditor's responsibilities in relation to fraud:**

With the prospectus, an auditor has to be extra careful in approving any kind of information because if there is a misleading information which can cause the loss to the company and third parties, they can hold him liable for damages. The auditor can relieve himself of such liabilities under the following:

- i) If he/she withdraws his/her consent in writing before such prospectus has been registered and circulated for the public use.
- ii) That after registration of prospectus and before the allotment of shares, he/she is knowing the misleading statement in the prospectus, withdrawn his/her consent and give a public notice to this effect.
- iii) That it was important to give such statement and that he/she has reasonable grounds which he/she can substantiate e.g. letters of representation for proving that the statement was true.

In general, the auditor's liabilities to the third parties and client give rise to claims against the auditor on such grounds as:

- Failure to detect embezzlement by employees.
- Negligence on the part of the auditor or his/her staff.
- Improper accounts procedures, which may lead to fraud.
- Errors in the financial statement he/she is reporting on.
- In order to minimize his/her liabilities to the third parties and the client while compiling his/her report, an auditor should:
- Enter into agreement with his/her client that another person should not use his/her report.
- Include a disclaimer in his/her report to the effect that any party to make any decision should not.

### **7. Measures to prevent errors are the following:**

- Employ a strong internal control system and efficient internal check system

- Award employees' reasonable salaries according to their qualifications and experience to reduce chance of errors and raise their morale to work
- Employment of qualified staff to prevent errors of principle
- Institute an internal audit department where possible
- Encourage clerks/staff to take their annual leave periodically so that their work performance can be assessed in their absence and any errors they had made revealed.
- Encourage inter-department transfers and rotation of duties at a surprise moment so as to cut down the continuity of an error.
- There should a close supervision of duties; particularly in sensitive areas of the business e.g. cash receipts and payments.
- Use specific reviews of what has taken place in any one given area.
- Use machines to record transactions e.g. adding machines, check writing machines, etc.
- Management should insist on referees when engaging employees especially the accounting staff.

### **8. Procedure of detecting errors and fraud are:**

- **Control of source documents and its likely (documentation):**

a) Types of Documents: internal and external documents

b) Document Vouching (from recorded item to supporting document)

- Examination of documents that support a recorded transaction or amount.
- The direction of testing must be from the recorded item to the supporting document.
- Tests existence or occurrence

c) Document Tracing (from supporting document to recorded item)

- Primary test for unrecorded items and therefore tests the completeness assertion.
- The direction of testing must be from the supporting document to the recorded item.

- **Physical observation:**

- Auditor witnesses the physical activities of the client.
- Differs from physical examination because physical examination counts assets, while observation focuses on client activities.

Direct confirmation:

The receipt of a written or oral response from an independent third party Auditor has client request that the third party respond directly to the auditor. Positive Confirmations asks for response even if balance is correct. Negative Confirmations asks for a response only if balance is incorrect. Examples: Banks – Confirm checking account and loan balances

- **Analytical examination:**

Audits studies relationships among data. Unusual fluctuations occur when significant difference are not expected but do exist or when significant differences are expected but do not exist. Analytical examination is required during the planning and completion phases on all audits.

- **Examination of the annual accounts**

## 5.9. Additional activities (Questions and answers)

### 5.9.1. Remedial activities (Questions and answers)

#### Questions:

1. Differentiate error from fraud.

#### Answers:

**Definition of fraud:** a fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

**Definition of error:** an error is an unintentional misstatement in the financial statements, including the omission of an amount or a disclosure.

#### Questions:

2. What are conditions for the client to sue the auditor?

#### Answer:

The client must prove the following:

- To prove that the auditor was negligence
- To prove that the auditor's negligence caused the client to suffer a financial loss
- Proving that the financial loss is qualified and material



## 5.7.2. Consolidation activities (Questions and answers)

### Question:

1. What are auditor's responsibilities in relation to fraud?

### Answers:

1. Auditor's responsibilities in relation to fraud

With the prospectus, an auditor has to be extra careful in approving any kind of information because if there is a misleading information which can cause the loss to the company and third parties, they can hold him liable for damages. The auditor can relieve himself of such liabilities under the following:

- If he/she withdraws his/her consent in writing before such prospectus has been registered and circulated for the public use.
- That after registration of prospectus and before the allotment of shares, he on knowing the misleading statement in the prospectus, withdrawn his consent and give a public notice to this effect.
- That it was important to give such statement and that he has reasonable grounds which he can substantiate e.g. letters of representation for proving that the statement was true.

In general, the auditor's liabilities to the third parties and client give rise to claims against the auditor on such grounds as:

- Failure to detect embezzlement by employees.
- Negligence on the part of the auditor or his staff.
- Improper accounts procedures, which may lead to fraud.
- Errors in the financial statement he is reporting on.

In order to minimize his liabilities to the third parties and the client while compiling his report, an auditor should:

- Enter into agreement with his client that another person should not use his report
- Include a disclaimer in his report to the effect that any party to make any decision should not

### Question:

2. Give and explain the auditor's duties.

**Answer:** Auditor's duties

a) Duty to make a report to shareholders or owners and duty to state the following in his report:

- Whether in his opinion, he has received all information and explanations necessary for his opinion.
- Whether in his opinion the trading, profit and loss account exhibits the true and fair view of the profits or loss of the period.
- Whether in his opinion the balance sheet is properly drawn and exhibits a true and fair view of the company's financial position.
- Whether proper books of accounts have been kept properly by the company and returns received from company's branches not visited by him.

b) Duty to call for information:

- Whether loans have been properly secured except lands and building
- Whether security have been sold below the purchase price
- Whether personal expenses have been debited to the profit and loss account and if so to debit the personal accounts of the employees concerned

c) Duty to assist in investigations, he should give support to the investigators but only if financial matters and to provide his working purpose.

### ***5.7.3. Extended activities (Questions and answers)***

#### **Questions:**

1. What kinds of measures are to be put in place to prevent errors?

#### **Answers:**

1. Measures to prevent errors

- Employ a strong internal control system and efficient internal check system
- Award employees' reasonable salaries according to their qualifications and experience to reduce chance of errors and raise their morale to work
- Employment of qualified staff to prevent errors of principle
- Institute an internal audit department where possible
- Encourage clerks/staff to take their annual leave periodically so that their work performance can be assessed in their absence and any errors they had made revealed.
- Encourage inter-department transfers and rotation of duties at a surprise moment so as to cut down the continuity of an error.
- There should a close supervision of duties; particularly in sensitive areas of the business e.g. cash receipts and payments.

- Use specific reviews of what has taken place in any one given area.
- Use machines to record transactions e.g. adding machines, check writing machines, etc.
- Management should insist on referees when engaging employees especially the accounting staff.

**Question:**

1. Describe procedures which can be used to detect errors and fraud?

**Answer:** Procedure of detecting errors and fraud

- Control of source documents and its likely (documentation):
- Physical observation
- Direct confirmation
- Analytical examination
- Examination of the annual accounts

# UNIT 6 | AUDITOR REGULATION AND ETHICS

## 6.1. Key unit competence

To be able to comply with auditor's regulation and professional ethics

## 6.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in senior 6 (unit 2) to the legal and professional requirements. So, with this prior knowledge, skills, attitudes and values it should help them to comply with auditor's regulation and professional ethics.

## 6.3. Cross-cutting issues to be addressed:

Note: The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection according to international standards.

**Gender education:** emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the auditing standards. So that this will encourage people to take of international standards in their duties.

**Inclusive education:** in addition to all having equal opportunities to carry out business activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan system that do not discriminate. Students need to understand that the customs procedures should not discriminate but promote inclusiveness of all etc.

**Peace and Values:** you need to emphasize to learners the need to live in peace and harmony with others. Students need to comply auditor's regulation and professional ethics in promoting peace and patriotism in the community avoiding activities that are illegal e.g. unethical behaviour like fraud.

**Standardization culture:** you need to emphasize to students need for standard in auditing. This will help them to abide by standards of auditing as legal aspects

#### **6.4. Guidance on introductory activity**

Follow the guidance about the introductory activity:

Students in small groups, pairs or individual read and analyse the case study and identify the major changes expected by people especially accountant and auditor because help to comply the auditor's regulation and professional ethics needed by an auditor.

During the activity, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair-share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Appreciate the teams' presentations and remind them that this activity was not meant come to the very right answers but to help them become aware of what to expect in the unit. Answers to the activity will be got as the unit progresses. Guide them to take notes in their books referring to learners' book.

You can support student's answers by referring to possible answers to the introductory activity below:

#### **Possible answers for introductory activity (case study)**

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (ISA200), Agreeing the terms of audit engagements (ISA 210), Audit documentation (ISA 230), The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements (ISA 240), Analytical procedures (ISA 520), Audit sampling (ISA 530), Forming an opinion and reporting on financial statements (ISA 700).

## 6.5. List of lessons/sub-heading

Heading	Lesson title/sub-heading	Learning objectives	Number of periods
6.1. International Auditing and Assurance Standards	Introductory activity	Arouse the curiosity of students on the content of unit 6	1
	1 The role of International Auditing and Assurance Standards Board	Identify the role of International Auditing and Assurance Standards Board	1
	2 International Standards on Auditing (ISA)	Describe International Standards on Auditing (ISA)	3
	3 The regulation of auditors	Explain the regulation of auditors	2
6.2. The fundamental principles of auditing	1 IESBA (International Ethics Standards Board for Accountant) code of ethics (the fundamental principles of auditing)	Explain fundamental principles of auditing as per IESBA	3
	2 The professional duty of confidentiality	Explain The professional duty of confidentiality	3
<b>End Unit Assessment</b>			<b>1</b>
<b>Total number of periods</b>			<b>14</b>

### Lesson 1: International Auditing and Assurance Standards

#### a) Learning objective

Describe International Standards on Auditing (ISA)

#### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.



### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

Read the Key unit competence in the syllabus to determine what students will know and be able to do by the end of the unit. Look at the action verb, concept and context of learning objective. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objective link to the key unit competence.

### **d) Learning activities**

#### **Activity 6.1**

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question and answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the learning activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

#### **Answers to learning activity 6.1**

1. Auditing and other elements
2. Independent, statements, planning, etc.

### e) Application activities 6.1

Students analyse and discuss about the questions either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

#### Answers to application activity 6.1

1. International Federation of Accountants (IFAC).
2. Respective responsibilities, Audit planning, Internal control, Audit evidence, Using work of other experts, Audit conclusions and audit report
3. 500: is about audit evidence and 570: is about Going concern

## Lesson 2: The fundamental principles of auditing

### a) Learning objective

Explain fundamental principles of auditing as per IESBA

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson, lesson 1 Students studied international auditing and assurance standards. That will help to comply fundamental principles of auditing as per IESBA Leant in this lesson.

### d) Learning activities

#### Activity 6.2

- Put students in small groups and give clear instruction about the activity
- Ask them to observe the pictures in student book and answer the questions provided in the activity

- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on when to discuss on fundamental principles of auditing as per IESBA. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### Answers to learning activity 6.2

1. The above persons are performing the auditing activities.
2. In a previous role, we worked on a project which required the team to use multiple tools and software packages. My manager provided the required software, but I noticed an issue with one of them immediately after I installed it.

After researching the software application provider, I found we had a pirated version. I struggled with the dilemma of embarrassing or upsetting my employer, but I couldn't stand to use a software package that was illegally pirated. So I reached out to my manager and explained my findings. Since the company couldn't afford the licensed application, I recommended a cheaper alternative for the ongoing project.

### e) Application activities 6.2

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

### Answers to application activity 6.2

1. Integrity implies not only just honesty but also fair dealing and truthfulness.
2. If an auditor discovers or suspects that client has committed **money-laundering**, or **terrorist offences**, he/she is obliged to disclose all the information at his/her disposal to a competent authority.

## Skills lab activity 6

Guidance on the skills lab activity.

To do this skills lab activity, students can either visit library or request students to make a research on the internet where need be.

### **i. Build**

Given that students visit the required website,

- Remind students on the expected objective for the computer lab attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research

### **ii. Practice**

Guide students on accessing the real website

Ensure that internet is connected for all

Respond to any questions for clarification and support accordingly

### **iii. Present**

Choose randomly any two teams to present their findings

Allow students to ask question to their fellows

### **iv. Conclusion**

The teacher emphasizes on the objective of the research reminding students that they have to follow those international auditing standards.

The following are key areas for reference:

International Standards on Auditing (ISA)

fundamental principles of auditing as per IESBA

## **6.6. Summary of the unit**

### **1. International Auditing Standards (ISA)**

#### **1.1. The role of International Auditing and Assurance Standards Board**

The IAASB, is there to serve the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards

#### **1.2. International Standards on Auditing (ISA)**

International Standards on Auditing (ISAs) are set by the International Auditing and Assurance Standards Board (IAASB), a technical committee of the International Federation of Accountants (IFAC). ISAs are produced by IAASB, a technical committee of IFAC. IAASB also produces other items of international guidance, such as the international standard on quality control (ISQC).

#### **The key standards issued by the ISA include:**

Respective responsibilities, Audit planning, Internal control, Audit evidence, Using work of other experts, Audit conclusions and audit report

#### **1.3. The regulation of auditors**

International regulation, however, can play a major part by:

- Setting minimum standards and requirements for auditors
- Providing guidance for those countries without a well-developed national regulatory framework
- Aiding intra-country recognition of professional accountancy qualifications

#### **The audit regulation are:**

1. Statutory regulation
2. Licensing of auditors
3. Delegated regulation by professional bodies within a legal framework (not self- regulation)

## 2. The fundamental principles of auditing

### 2.1. The fundamental principles of auditing as per IESBA

The IESBA Code of Ethics provides ethical guidance. The five fundamental principles of **integrity, objectivity, professional competence and due care, confidentiality** and **professional behaviour**.

### 2.2. The professional duty of confidentiality

**Confidentiality** requires auditors to refrain from disclosing information acquired in the course of professional work except where:

- **Consent has been obtained** from the client, employer or other proper source, or
- There is a **public duty** to disclose, or
- There is a **legal or professional right or duty** to disclose

The auditor agrees to serve a client in a professional capacity both the auditor and the client should be aware that it is an implied term of that agreement that the auditor will not disclose the client's affairs to any other person save with the client's consent or within the terms of certain recognised exceptions, which fall under obligatory and voluntary disclosures.

## 6.7. Additional information for teachers

Additional Information





## 6.8. End unit assessment

### Answers to end unit assessment activities

1. **Objectivity:** means that the auditor must not to allow bias, conflict of interest or the undue influence of others to override professional or business judgments. For external auditors, objectivity is usually hallmarked by 'independence'. The auditor must be, and be seen to be, independent. The IESBA provides a number of guidelines as to how an auditor should maintain his/her independence.

#### Threats to objectivity

The following are all threats to objectivity:

- Personal interest (for example, fear of losing fees or a good relationship with a client).
  - Review of own work (for example, if an auditor audits financial statements he/she has compiled).
  - Disputes (for example, with a client, or where an audit firm advocates for its client).
  - Long association or undue sympathy (for example, through close personal relationships).
  - Intimidation (this is linked to self-interest, for example, fear of losing a client, fear of audit fee being withheld).
2. The principle of objectivity is: "Not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others."
  3. Firms should have a review of machinery, including an annual review to ensure they are acting as auditors in accordance with the IESBA Code of Ethics, to identify situations where independence may be at risk and where the appropriate safeguards should be applied.
  4. a. An auditor is obliged to disclose a client's affairs to an appropriate authority if he/she knows or suspects treason, terrorism or money laundering, for example: where disclosure is compelled by process of law.  
b. An auditor may disclose a client's affairs:
    - i. Where it is permitted by law.
    - ii. To protect his/her interests.
    - iii. Where there is a duty to disclose in the public interest.

5. There must either be permission or a legal duty or, in exceptional circumstances, a public duty.
6. Independence is an important issue a natural consequence of the fundamental principles of integrity and objectivity but not a stated fundamental principle of professional ethics in itself.
  - a. There are a number of different issues to be considered here. Where the previous auditor has fees still owing by the client, the new auditor needs not decline appointment solely for this reason. He/she should decide how far he/she may go in aiding the former auditor to obtain his/her fees but should avoid entanglement in any dispute, otherwise he/she may be asked to give an opinion on whether the fees are reasonable or the work was 'up to standard'.

However, the fact that the previous auditors are in dispute over fees may indicate that there could be future problems over charges, and hence lead the prospective auditors to question whether on commercial grounds they should accept the assignment.

Secondly, it is not the place of A B & Co, nor is it within their power, to give professional clearance to their successors. They are merely required, after obtaining the client's permission and on request from the new auditor, to discuss freely with him/her all matters relevant to the appointment of which he/she should be aware and disclose all information which appears to them to be relevant to the client. They cannot refuse to do this because they are owed fees.

- b. There is no objection in principle to a practice providing a client with services in addition to the audit. However, care must be taken not to perform management functions or to make management decisions. For audit clients that are not public interest entities, services related to the preparation of accounting records and financial statements may be provided as long as the services are of a routine or mechanical nature (i.e. they require little or no professional judgment) and any self-review threat created is reduced to an acceptable level. It is also important that the auditors obtain from the directors an acknowledgement of their responsibilities for presenting a set of accounts that give a true and fair view, and maintaining accounting records that comply with the law.

In the case of a listed company, however, the auditor should not participate in the preparation of the company's accounts and accounting records.

## **6.9. Additional activities (Questions and answers)**

### **6.9.1. Remedial activities (Questions and answers)**

#### **Questions:**

1. Who set international standards on auditing (ISAs)?
2. What is IAASB in full word?

#### **Answers:**

1. International Auditing and Assurance Standards Board
2. International Auditing and Assurance Standards Board

### **6.9.2. Consolidation activities**

#### **Questions:**

1. Identify the role of International Auditing and Assurance Board.
2. Describe the functions of international regulation of auditors.
3. Identify the fundamental principles of ethics as per IESBA.

#### **Answers:**

1. It is to serve the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards.
2. The functions of international regulations of auditors are :
  - Setting minimum standards and requirements for auditors.
  - Providing guidance for those countries without a well-developed national regulatory framework
  - Aiding intra-country recognition of professional accountancy qualifications
3. Integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

### **6.9.3. Extended activities**

#### **Questions:**

1. It is very important that the auditor is impartial, and independent of management, so that he can give an objective view on the financial statements of an entity. This opinion is true? Discuss

#### **Answers:**

1. Yes. Because, the fundamental principles require that auditors behave with integrity in all professional and business relationships and they strive for objectivity in all their professional and business judgments. Objectivity is a state of mind but in certain roles the preservation of objectivity has to be shown by the maintenance of independence from those influences which could impair objectivity.

# UNIT 7

## AUDITING PLANNING

### 7.1. Key unit competence

To be able to execute audit planning and risk assessment

### 7.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in unit 6 the international auditing standards in his lesson one (1), in which they described the following international standards:

- Planning an audit of financial statement (ISA:300),
- Materiality in planning and performing an audit (ISA: 320),
- Identifying and assessing the risk of material misstatement through understanding the entity and its environment (ISA:315),
- The auditor's response to assessed risks (ISA: 330), and
- Evaluation of misstatement identified during the audit (ISA: 450).

So, with this prior knowledge, skills, attitudes and values it should help them to appreciate the role of audit planning in the before starting the audit work.

### 7.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection and the importance of audit planning in reducing material misstatement and audit risks, while promoting other environmentally friendly businesses e.g. use of renewable energies (solar energy).

**Gender education:** emphasis throughout this unit has to be put on how females have the right of perform the same task as male, and tells them that both males and females have the equal opportunities to be auditors in their community when they can understand, explain, and perform audit planning. E.g. identifying and assessing the risk of material misstatement through understanding the entity and its environment during the audit planning. This can be taken as the source of equality and equity between both males and females in the community.

**Inclusive education:** in addition to all having equal opportunities to carry out audit activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan system that do not discriminate. Students need to understand that audit activities should not discriminate but promote inclusiveness of all etc.

**Peace and Values:** you need to emphasize to learners the need to live in peace and harmony with others. Students need to appreciate the role of audit planning in promoting peace in the company by avoiding activities that can lead them to the risk of material misstatement and audit risk.

**Standardization culture:** In every lesson take an opportunity to share with learners that standards should be respected since they are part and parcel of our lives. From school uniform, to class size, to lesson duration, language of instruction, among others. So always, create opportunities to discuss about the standards with learners during their everyday and audit activities.

## 7.4. Guidance on introductory activity

**NOTE:** Follow the guidance about the introductory activity:

Students in small groups, pairs or individual observe and analyse the image then discuss about audit planning then identify the major activities done in audit planning.

During the activity, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair-share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Appreciate the team's presentations and remind them that this activity was not meant come to the very right answers but to help them become aware of what to expect in the unit. Answers to the activity will be got as the unit progresses.



Guide them to take notes in their books referring to learners' book.

You can support student's answers by referring to possible answers to the introductory activity below:

### Possible answers for introductory activity

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

1. Audit planning means developing a general strategy and a detailed approach for the expected nature, timing and extent of the audit.
2. The activities around audit planning are the : planning strategies,risk assessment,understand the entity and materiality assessment.

## 7.5. List of lessons/sub-heading

Heading		Lesson title/sub-heading	Learning objectives	Number of periods
7.1. Audit planning		Introductory activity	Arouse the curiosity of students on the content of unit 7	1
	1	Meaning and objectives of audit planning	Describe the audit planning	2
	2	Audit planning strategy	Explain audit strategies	3
	3	Limitations of audit planning	Explain the limitations of audit planning	2
7.2. Materiality in auditing	1	Meaning and methods of calculating materiality	Describe materiality in auditing	4
	2	Difference between materiality in government auditing and in private sector	Explain the difference between materiality in government auditing and in private sector	2
	3	Role of materiality in auditing	Explain the role of materiality in auditing	1
7.3. The entity and its environment	1	Understanding the entity and its environment	Describe the entity and its environment	2

7.4. Audit risk	1	Meaning and types of audit risks	Describe audit risk	3
	2	Model and calculation of audit risk	Explain model and calculation of audit risk	4
	3	Assessing the risk of material misstatement and responding to risk assessment	Explain how to assess and to respond to risk assessed	3
<b>End Unit Assessment</b>				<b>1</b>
<b>Total number of periods</b>				<b>28</b>

## Lesson 1: Audit planning

### a) Learning objective

Describe the audit planning

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

Read the Key unit competence in the syllabus to determine what students will know and be able to do by the end of the unit. Look at the action verb, concept and context of learning objective. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objective link to the key unit competence.

### d) Learning activities

#### Activity 7.1

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question and answer approach to

make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

### Answers to learning activity 7.1

#### 1. Importance of audit planning are:

- Help the auditor devote appropriate attention to important areas of the audit.
- Help the auditor identify and resolve potential problems on a timely basis.
- Help the auditor properly organise and manage the audit so it is performed in an effective manner.
- Assist in the selection of appropriate team members and assignment of work to them.
- Facilitate the direction, supervision and review of work.
- Assist in coordination of work done by auditors of components and experts.

#### 2. Audit strategy is the document sets out in general terms how the audit is to be conducted and sets the scope, timing and direction of the audit. The audit strategy then guides the development of the audit plan, which contains the detailed response to the auditor's risk assessment.

#### 3. When setting audit strategy the following areas are considered:

- The timetable for reporting, key dates and statutory obligations.
- Reporting framework and scope of the audit.
- Initial materiality levels.
- Preliminary risk assessment.

- Audit team members and skills required.
- Arrangements for directing, supervising and reviewing the work of audit team members. Consider the need for the service of experts.
- Location of client premises and travel/accommodation requirements.

### e) Application activities 7.1

Students analyse questions individually and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

#### Answers to application activity 7.1

1. The audit strategy is a document that outlines the general strategy of the audit. It sets the direction of the audit, describe the expected scope and conduct of the audit and provides guidance for the development of the audit plan.

The audit plan is a more detailed document than the audit strategy and includes instructions to the audit team that set out the audit procedures the auditors intend to adopt. The audit plan may also contain references to other matters such as audit objectives, timing, sample sizes and the basis of selection for each account areas. It also serves as a means to control and record the proper execution of the audit work.

2. Key contents of an audit strategy document are:
  - Timetable for reporting, key dates and statutory obligations.
  - Section on understanding the company's environment.
  - Section on understanding the company's accounting and internal system.
  - Initial materiality levels.
  - Preliminary risk assessment.
  - Audit team members and skills required.
  - Arrangements for directing, supervising and reviewing the work of audit team members.
  - Consider the need for the services of experts.

## Lesson 2: Materiality in auditing

### a) Learning objective

Describe materiality in auditing

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson, lesson 1 Students studied the meaning of audit planning, the importance of audit planning and audit planning strategies. That will help to discuss about materiality in audit planning.

### d) Learning activities

#### Activity 7.2

- Put students in small groups and give clear instruction about the activity
- Ask them to observe the pictures in student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on the difference between the overall materiality and the performance materiality. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

#### Answers to learning activity 7.2

1. Information is material if its omission or misstatement could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have to be useful.

2. a) Overall materiality is based on the auditor's professional judgment as to the maximum amount of misstatements that if not correct in the financial statements will not affect the economic decisions taken by a financial statement users.
- b) Performance materiality is an amount less than materiality for the financial statements as a whole (i.e. planning materiality) 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.

### **e) application activities 7.2**

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### **Answers to application activities 7.2**

1. a) Because the business is stable, auditors are likely to base overall materiality on a percentage of revenue or total assets, or possibly an average of both. Profit before tax is unlikely to be used overall as its fluctuation does not appear to be significant. However, a different materiality level may be set when considering the one-off expense, since it may be particularly significant to readers of the accounts.
  - b) Auditors are likely here to pay some attention to the level of profit when setting materiality, because the outside members regard profit as significant. However, the auditors are also likely to take into account total and net assets. Low profits will be of less significance if the business has a strong asset base, but more significance if the business is in long-term financial difficulty.
2. Bank interest is less than 5% of profit before tax and so it is likely to be immaterial. Although the director's bonus is also immaterial by value, it is material by nature, and so is likely to be tested in detail.



## Lesson 3: The entity and its environment

### a) Learning objective

Describe the entity and its environment

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson (materiality in auditing) Student studied the meaning of material misstatement in auditing, and the methods of calculating materiality, and the importance of materiality in audit planning. That will help to discuss about how to know the entity and its environment.

### d) Learning activities

#### Activity 7.3

- Put students in small groups and give clear instruction about the activity
- Ask them to observe the pictures in student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings

Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on the necessary information the auditor needs to generate about the client's company that can help him to conduct the audit work without any risks of material misstatement. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### Answers to learning activity 7.3

1. The above image show different questions the Auditor asks himself/herself to generate information that can allow him/her to understand the client's company and its environment.
2. **Why:** The reasons the auditor is to obtain the understanding of the entity and its environment are very much bound up with assessing risks and exercising audit judgment. We shall look at these aspects more in the next two topics of this Unit.

#### **Why:**

- To identify and assess the risks of material misstatement in the financial statements.
- To enable the auditor to design and perform further audit procedures.
- To provide a frame of reference for exercising audit judgment, for example, when setting audit materiality.

#### **What:**

- Industry, regulatory and other external factors, including the applicable financial reporting framework.
- Nature of the entity, including operations, ownership and governance, investments, structure and financing.
- Entity's selection and application of accounting policies.
- Objectives and strategies and related business risks that might cause material misstatement in the financial statements.
- Measurement and review of the entity's financial performance.
- Internal control framework.

#### **How:**

- Inquiries of management and others within the entity.
- Analytical procedures.
- Observation and inspection.
- Prior period knowledge.
- Client acceptance or continuance process.
- Discussion by the audit team of the susceptibility of the financial statements to material misstatement.
- Information from other engagements undertaken for the entity.

### e) Application activities 7.3

This activity can be given as a normal individual work, where students use the acquired knowledge to provide answers to the given questions. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the teacher. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### Answers to application activities 7.3

1. The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statement whether due to error or fraud, and to design the nature, timing, and extent of further audit procedure.
2. More specifically, the international standards on auditing requires that an auditor understand the company's objectives and strategies and those related business risks that might reasonably be expected to result in risk of material misstatement.
3. An auditor must understand each component of the client's financial reporting controls. This includes the control environment, risk assessment process, information system, control activities that relate to the audit, and the client's monitoring of the controls.
4. The main duty of an auditor is to determine whether financial statement follow generally accepted accounting principles. The securities and exchange commission requires all public companies to conduct regular reviews by external auditors, in compliance with official auditing procedures.

## Lesson 4: Audit risk

### a) Learning objective

Describe audit risk

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, and resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

Read the learning objective to determine what students will know and be able to do by the end of the lesson. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objectives are linked to the key unit competence.

### **d) Learning activities**

#### **Activity 7.4**

- Put students in small groups and give clear instruction about the activity
- Ask them to observe the image in the student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on audit risk, and say if it is possible for an auditor to draw an inappropriate audit report on financial statement. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

#### **Answers to learning activity 7.4**

1. Yes, it is possible.
2. It is called audit risk

### **e) Application activities 7.4**

This activity can be given as a normal individual or group activity, where students read and discuss about the scenario in the student book, then they may outline the potential materiality of the risk and discuss factors in the likelihood of the risk arising. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

## Answers to application activities 7.4

- The key risk arising from the above information is that trade accounts receivable will not be carried at the appropriate value in the financial statements, as some may be irrecoverable. Where receipts are not matched against invoices in the ledger, the balance on the ledger may include old invoices that the customer has no intention of paying.
- It is difficult to assess at this stage whether this is likely to be material. Trade accounts receivable is likely to be a material balance in the financial statements, but the number of irrecoverable balances may not be material. Analytical procedures, for example, to see if the level of accounts receivable has risen year-on-year, in a manner that is not explained by price rises or levels of production, might help to assess this.
- A key factor that affects the likelihood of the material misstatement arising is the poor controls over the receivables ledger. The fact that invoices are not matched against receipts increases the chance of old invoices not having been paid and not noticed by Kigali Solutions Ltd. It appears reasonably likely that the trade accounts receivable balance is overstated in this instance.

## Skills lab activity 7

Guidance on the skills lab activity.

To do this skills lab activity, students can either visit the school bursar or the cashier. The trainer can request students to take accounting documents of their choice.

### i. Build

- Remind students on the expected objective for the attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research

### ii. Practice

Guide students on accessing the real accounting documents

Ensure that all needed documents are available

Respond to any questions for clarification and support accordingly

### **iii. Present**

Choose randomly any two teams to present their findings

Allow students to ask question to their fellows

### **iv. Conclusion**

The teacher emphasizes on the objective of the activity reminding students that they have to follow the same sampling procedures and know the effect of each sampling factor on the sample size.

The following are key areas for reference:

Sampling procedures

Factor affecting the sample size.

## **7.6. Summary of the unit**

### **1. Audit planning**

#### **1.1. Meaning and importance of audit planning**

##### **a. Meaning of audit planning**

Audit planning means developing a general strategy and a detailed approach for the expected nature, timing and extent of the audit. The auditor plans to perform the audit in an efficient and timely manner. In simple words, developing an overall strategy for the effective conduct and scope of the examination.

##### **b. The importance of audit planning**

An effective and efficient audit relies on proper planning procedures. The planning process is covered in general terms by ISA 300 Planning an audit of financial statements which states that the auditor shall plan the audit so that the engagement is performed in an effective manner.

### **2. planning strategies**

Audit strategy set the scope, timing and the direction of the audit, and guides the development of the more detailed audit plan.

The audit strategy is the key planning document. It considers general areas of planning such as:

- The timetable for reporting, key dates and statutory obligations
- Reporting framework and scope of the audit



- Initial materiality levels
- Preliminary risk assessment
- Audit team members and skills required
- Arrangements for directing, supervising and reviewing the work of audit team members
- Consider the need for the service of experts
- Location of client premises and travel/accommodation requirements

## **2. Materiality in auditing**

### **2.1. Meaning and methods of calculating materiality**

- a. Meaning of materiality
- b. Determining materiality for the financial statements as a whole
- c. determining performance materiality

### **2.2. Difference between materiality in government and in private sector.**

Materiality in governmental audit is different from materiality in private sector auditing for several reasons.

Most importantly, due to the format of state and local government financial statements under GAAP (general accepted accounting principles), the AICPA (American institute of certified public accountant) audit guide for state and local governments requires auditors to consider materiality by “opinion unit” rather than for the financial statements taken as a whole.

### **1. Role of materiality in auditing**

- It influences the auditor’s time budget on specific items
- It indicates the auditor’s plan
- It influences the auditor’s plan
- It determines the amount of audit evidence to be gathered.
- It is required by the professional body ICPAR ( institute of certified public accountants of Rwanda) as an incidental objective.

## **3. The entity and its environment**

### **1. the entity and its environment**

The auditor is required to obtain an understanding of the entity and its environment in order to be able to assess the risks of material misstatement and direct his audit approach accordingly.

ISA 315 (ISA 315: para. 5) states that 'the auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.

## **4. Audit risk**

### **1. Meaning and types of audit risk**

#### **Meaning of audit risk**

Audit risk is the risk that the auditors give an inappropriate audit opinion when the financial statements are materially misstated. It has two elements: the risk that the financial statements contain a material misstatement (inherent risk and control risk) and the risk that the auditors will fail to detect any material misstatements (detection risk).

### **2. Model and calculation of audit risk**

Looking at audit risk as a whole, we can see it can be represented by the audit risk model as:

$$\text{Audit risk (AR)} = \text{Inherent risk (IR)} * \text{Control risk (CR)} * \text{Detection risk (DR)}$$

### **3. Assessing the risk of material misstatement and responding to risk assessment**

#### **a. Assessing the risk of material misstatement**

Steps of assessing the risk of material misstatement:

- Identify risks throughout the process of obtaining an understanding of the entity
- Relate the risks to what can go wrong at the assertion level
- Consider whether the risks are of a magnitude that could result in a material misstatement
- Consider the likelihood of the risks causing a material misstatement

#### **b. responding to risk assessment**

The auditors must formulate an approach to the identified risks of material misstatement. They must formulate overall responses and detailed further audit procedures, which will comprise tests of controls and substantive procedures or substantive procedures only.

## 1. Overall responses

Overall responses to risks of material misstatement will be changes to the general audit strategy or re-affirmations to staff of the general audit strategy.

- Emphasizing to audit staff the need to maintain professional skepticism
- Assigning additional or more experienced staff to the audit team
- Using experts
- Providing more supervision on the audit
- Incorporating more unpredictability into the audit procedures
- Making general changes to the nature, timing and extent of audit procedures

## 2. Responses to the risks of material misstatement at the assertion level

The ISA says that 'the auditor shall design and perform further audit procedures whose nature, timing and extent are based upon and are responsive to the assessed risks of material misstatement at the assertion level. Nature refers to the purpose and the type of test that is carried out. ISA 330 requires that auditors should carry out tests of controls and substantive procedures.

## 7.7. Additional information for the teacher

This section provides guidance on the auditor's consideration of audit risk and materiality when planning and performing an audit of financial statements in accordance with generally accepted auditing standards. Audit risk and materiality affect the application of generally accepted auditing standards, especially the standards of field work and reporting, and are reflected in the auditor's standard report.

Audit risk and materiality, among other matters, need to be considered together in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures.

The auditor should consider audit risk and materiality both in:

- a) Planning the audit and designing audit procedures, and
- b) Evaluating whether the financial statements taken as a whole are presented fairly in all material respects, in conformity with generally accepted accounting principle.

The auditor should consider audit risk and materiality in the first circumstance to obtain sufficient competent evidential matter, on which to properly evaluate the financial statements in the second circumstance.

## 7.8. End unit assessment

### Answers to end unit assessment activities

1. B
2. B, This illustrate detection risk.
3. No. A partner cannot delegate responsibility for the audit opinion. He/ she can however delegate aspects of the detailed audit work.
4. Inquiry, analytical procedures, observation and insection.
5. An audit plan usually contains:
  - Audit tests.
  - Test objectives.
  - Timing of the tests.
  - Sample sizes.
  - Basis of sample selection.

6.  $10\% = 60 * 60 * DR$

$$0.10 = 0.6 * 0.6 * DR$$

$$0.10 = 0.36 * DR$$

$$0.10 / 0.36 = DR$$

$$DR = 0.2777777778 = 28\%$$

If inherent risk and control risk are assumed to be 60% each, detection risk has to be set at 27.8% in order to prevent the overall audit risk from exceeding 10%.

## 7.9. Additional activities (Questions and answers)

### 7.9.1 Remedial activities (Questions and answers)

1. What is audit risk?

**Answer:** Audit risk is the risk that auditors may give an inappropriate opinion when the annual financial statements are materially misstated.

2. What are the components of audit risk?

**Answer:** The three components of audit risk are inherent, control risk and detection risk.

3. Which one is not the level of audit materiality:

- A. Immaterial.
- B. Material.
- C. Material detection.
- D. Very material
- E. No of the above

**Answer: C**

4. The first phase in planning an audit and designing an audit approach is to:

- A. Accept the client and perform initial audit planning
- B. Set the preliminary judgement of materiality
- C. Understand the client's business and industry
- D. Perform preliminary audit procedures
- E. All of the above

**Answer: A**

5. .... is the risk that the financial statements contain a material misstatement due to fraud or error to the audit. (choose one from the choices below):

- A. Inherent risk
- B. Client business risk
- C. Acceptable audit risk
- D. Risk of material misstatement

**Answer: D**

6. Initial audit planning involves four matters. Which of the following is not one of them?

- A. Develop an overall audit strategy
- B. Request that bank balances be confirmed
- C. Schedule engagement staff and audit specialists
- D. Identify the client's reason for the audit.

**Answer: B**

7. Materiality does not depend on the decisions of users who rely on the statements to make the decisions. (answer by true or false)

**Answer: False**

### **7.9.2. Consolidation activities (Questions and answers)**

1. Give examples of figures used as a basis for setting materiality

**Answer:** Commonly materiality is set using one or more of the following figure:

- Profit before tax
  - Total assets
  - Revenue
  - Less frequently the following figures are used:
  - Gross profit
  - Profit after tax
  - Net asset
2. What are the key tasks that should be performed when work is delegated to assistant?

**Answer:**

The audit engagement partner has responsibility for the quality of the audit performed

- He must ensure that the audit staff approach the job in the correct manner and have proper communication both between themselves and with the client.
  - The engagement partner is also responsible for ensuring that the work of other members of the audit team is directed, supervised and reviewed.
3. Explain what you understand by the term audit risk, making reference to:
- a) Inherent risk
  - b) Control risk
  - c) Detection risk

**Answer: Audit risk** is the risk that auditors may give an inappropriate opinion when the financial statements are materially misstated. Audit risk is the product of two components: the risk of material misstatement in the financial statements (inherent and control risks) and the risk that the auditor will fail to discover material misstatements (detection risk).



## Inherent risk

Inherent risk is the likelihood that a specific item in the accounts will be misstated due to characteristics of that item or of the organization as a whole before consideration of related controls. Organizational factors include the nature of its business or whether the directors are under pressure to produce favorable results. Factors affecting individual items include the complexities of the accounting involved, such as whether a significant degree of estimation is involved.

## Control risk

Control risk is the risk that an organization's internal controls fail to prevent, or detect and correct material misstatements. Control risk depends on whether the controls that have been designed are appropriate for the business, and whether the controls in place are operating properly.

## Detection risk

Detection risk is the risk that audit procedures fail to identify material misstatements. Sampling risk, the risk that the auditors' conclusion differs from what would be the conclusion if the whole population was tested, is a component of detection risk. Other elements of detection risk are the risk that auditors might use inappropriate procedures or fail to recognize a misstatement.

4. List three potential overall responses to assessed risks

**Answer:** Any of:

- Emphasizing the need for professional scepticism
- Assigning additional/more experienced staff
- Using experts
- Providing more supervision
- Incorporating more unprectability

5. Which one is not a preliminary judgement about audit audit material?

- A. Determining the nature, timing, and extent of risk assessment procedures
- B. Identify and assessing the risk of material misstatement
- C. Determining the nature, timing and extent of further audit procedures
- D. The nature of business entity

**Answer: D**

6. Materiality does depend on the decisions of users who rely on the statements to make the decision (answer by true or false)

**Answer: True**

7. If an auditor establishes a relatively high level for materiality, then the auditor will:
- A. Accumulate more evidence than if a lower level had been set
  - B. Accumulate less evidence than if a lower level had been set
  - C. Accumulate proximately the same evidence as would be the case were materiality lowe
  - D. Accumulate an undetermined amount of evidence
  - E. All of the above

**Answer: B**

### ***7.9.3. Extended activities (Questions and answers)***

1. The audit partner has set the overall level of audit risk for a client as 5%. Your risk assessment of the client has indicated that inherent risk is 90% and control risk is 50%.What level of detection risk should be prescribed for this client?

**Answer**

$$AR = 0.05$$

$$IR = 90\%$$

$$CR = 50\%$$

$$DR = ?$$

$$AR = IR * CR * DR$$

$$DR = AR / IR * CR$$

$$DR = 0.05 / 0.9 * 0.5$$

$$DR = 0.05 / 0.45$$

$$DR = 0.11111111 * 100 = 11.1\%$$

2. ISA 320 materiality in planning and performing an audit provides guidance on the concept of materiality in planning and perform an audit.

**Required:**

Define materiality and determine how the level of materiality is assessed.

**Answer:**

- Materiality for the financial statements as a whole (referred to from now on as 'overall materiality') and performance materiality must be determined for all audits.
- In the context of the financial statements, a matter is material if its omission or misstatement would reasonably influence the economic decision of users taken on the basis of the financial statements.
- Performance materiality is a materiality level set by the auditor for particular transactions, account balances and disclosures.
- Ultimately, both overall and performance materiality are determined using the auditor's judgment as to how the users will be affected by misstatements for a particular area. However it is useful to use benchmarks as a starting point, such as 5% of profit before tax, or 1% of total assets.

When setting performance materiality, the possibility of a number of misstatements with a low value aggregating to high overall value must be considered. This result is being lower than overall materiality

# UNIT 8 | AUDIT EVIDENCE AND SAMPLING

## 8.1 Key unit competence

To be able to explain the audit procedures in sampling and gathering audit evidence

## 8.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in unit 6 international auditing standards, and different standards regarding audit evidence and audit sampling were introduced.

E.g.

- Audit evidence (ISA: 500)
- Audit evidence-specific considerations for selected items (ISA: 501);
- External confirmation (ISA: 505);
- Analytical procedures (ISA: 520);
- Audit sampling (ISA: 530);

In unit 7 they were also introducing some audit procedures that can be used to search information about the entity and its environment.

So, with this prior knowledge, skills, attitudes and values it should help them to develop audit evidence and sampling.

## 8.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection and the importance of evidence and sampling procedures in reducing risk of material misstatement during execution of the audit work.

**Gender education:** emphasis throughout this unit has to be put on how females have the right of perform the same task as male, and tells them that both males and females have the equal opportunities to be auditors in their community when they can understand, explain, and perform audit planning. e.g. identifying and assessing the risk of material misstatement through applying audit evidence, and sampling procedures during execution of the audit work. This can be taken as the source of equality and equity between both males and females in the community.

**Inclusive education:** in addition to all having equal opportunities to carry out audit activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan system that do not discriminate. Students need to understand that audit activities should not discriminate but promote inclusiveness of all etc.

**Peace and Values:** you need to emphasize to learners the need to live in peace and harmony with others. Students need to appreciate the role of audit execution procedure in promoting peace in the company by avoiding activities that can lead them to the risk of material misstatement and audit risk.

**Standardization culture:** In every lesson take an opportunity to share with learners that standards should be respected since they are part and parcel of our lives. From school uniform, to class size, to lesson duration, language of instruction, among others. So always, create opportunities to discuss about the standards with learners during their everyday and audit activities.

## 8.4. Guidance on introductory activity

**NOTE:** Follow the guidance about the introductory activity:

Students in small groups, pairs or individual observe and analyse the image provided in the student book, then ask them to provide answers.

During the activity, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair-share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Appreciate the team's presentations and remind them that this activity was not meant come to the very right answers but to help them become aware of what to expect in the unit. Answers to the activity will be got as the unit progresses.

Guide them to take notes in their books referring to learners' book.

You can support student's answers by referring to possible answers to the introductory activity below:

### Possible answers for introductory activity

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

1. The auditor is looking for information that can help him/her to generate audit evidence.
2. No, it is not possible. He/she must select the sample documents that his/her opinion will be based on.
3. He/she can use different audit procedures to obtain needed information.
4. Yes, he/she can apply Computer-Assisted Auditing Techniques (CAATs) (audit software and test data).

## 8.5. List of lessons/sub-heading

Heading	Lesson title/sub-heading		Learning objectives	Number of periods
8.1. Audit execution and procedures	Introductory activity		Arouse the curiosity of students on the content of unit 8	1
	1	Meaning and steps of audit execution	Describe audit execution and its steps	2
	2	Audit procedures	Explain the audit procedures	3
8.2. Audit evidence	1	Meaning of audit evidence	Explain the audit evidence	1
	2	Qualities of audit evidence	Explain the qualities of audit evidence	1
	3	Types of audit evidence	Explain the techniques of gathering audit evidence	2
	4	Techniques of audit evidence	Explain the techniques of gathering audit evidence	2



8.3. Audit sampling	1	Meaning of audit sampling	Describe audit sampling	2
	2	Sample size	Explain sampling risk and non-sampling risk	4
	3	Techniques of audit sampling	Explain techniques of audit sampling	2
	4	Factors affecting sample size	Explain factors affecting sample size	2
8.4. Audit in IT environment	1	Computer assisted audit techniques(CAATs)	Explain the computer-assisted audit techniques	2
	2	Advantages and disadvantages of CAATS	Identify the advantages and disadvantages of CAATS	1
	3	Meaning of audit software, its benefits and difficulties	Describe the audit software	1
	4	Test data	Explain test data	1
<b>End Unit Assessment</b>				<b>1</b>
<b>Total number of periods</b>				<b>28</b>

## Lesson 1: Audit execution and procedures

### a) Learning objective

Explain audit execution, its steps and audit procedures

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

Read the Key unit competence in the syllabus to determine what students will know and be able to do by the end of the unit. Look at the action verb, concept and context of learning objective. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objective link to the key unit competence.

## **d) Learning activities**

### **Activity 8.1**

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question and answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

#### **Answers to learning activity 8.1**

1. The terms in small circles are called audit procedures/audit techniques.
2. They surround the big circle named audit execution because the audit work is executed through the use of these audit procedures/techniques.

## **e) Application activity 8.1**

Students individually analyse the questions and come up with possible answers. This activity may be given as a homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

## Answers to application activity 8.1

1. C
2. The difference is given as follows: **substantive procedures:** are audit procedures designed to detect material misstatements at the assertion level while

**Analytical procedures:** are pair financial data with non-financial data and determine the correlation between them. Comparison of previous trends versus current trends, as well as evaluation of the difference between the client's record and the substantive evidence, are also considered analytical procedures.

### Lesson 2: Audit evidence

#### a) Learning objective

Describe the audit evidence

#### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, scenario, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

#### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In unit 6, lesson 1 Students studied standards regarding audit evidence. That will help to discuss the meaning of audit evidence, the quality of audit evidence and the procedure for generating audit evidence.

#### d) Learning activities

##### Activity 8.2

- Put students in small groups and give clear instruction about the activity
- Ask them to read the scenario in student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings

- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on when to discuss audit evidence, qualities of audit evidence, and qualities of audit evidence. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### Answers to learning activity 8.2

1. The technical term used for the information found by Mr GAKIRE is audit evidence.
2. The means used by Mr GAKIRE when searching information are called audit procedures. He has used external confirmation procedure.
3. No, because he was supposed to accept the evidence that fulfils all qualities of a good audit evidence.

### e) Application activity 8.2

This activity can be given as a normal individual activity, where students must write the letter corresponding to the correct answer from question 1 to 3 and give open answers to question 4 and 5. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the teacher. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

### Answers to application activity 8.2

1. B and c are correct.
2. b, c and d are correct.
3. B
4. Sources of audit evidence are:
  - Accounting records.
  - Audit procedures performed to test accounting records.
  - Information obtained during the audit of previous years.
  - Audit firm's quality control procedures for acceptance of audit.
  - Work of management's expert.
  - Confirmation from third parties.

- Comparable data of other companies engaged in the same industry.
- Written representations from management to support other evidences obtained during the audit.

### **Lesson 3: Audit sampling**

#### **a) Learning objective**

Describe audit sampling

#### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

#### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In unit 6, lesson 1 Students studied standards regarding audit sampling. That will help to discuss the meaning of audit sampling, the sample size and the techniques of audit sampling.

#### **Activity 8.3**

- Put students in small groups and give clear instruction about the activity
- Show the pictures in student book and ask student to observe and analyze it then provide answers to asked questions provided in the activity.
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on when to discuss audit sampling, sample size, and techniques of audit sampling. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### Answers to learning activity 8.3

1. In auditing, the people in the big circle is called population.
2. In auditing the people in the small circle are called the sample
3. The people in the small circle may be selected based on the different factors to be considered when selecting the sample.

### e) Application activities 8.3

This activity can be an individual activity, where students provide answers to asked question through acquired knowledge. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

### Answers to Application Activity 8.3

1. Random sampling, systematic sampling, haphazard sampling, block sampling, and monetary unit sampling.
2. The difference between sampling risk and non-sampling risk is given below:
  - **Sampling risk** is the risk that the auditor's conclusion, based on a sample of a certain size, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure.
  - **Non-sampling risk** is the risk that the auditor might reach an erroneous conclusion for any reason not related to sampling risk. For example, most audit evidence is persuasive rather than conclusive, the auditor might use inappropriate procedures, or the auditor might misinterpret evidence and fail to recognize a misstatement or deviation.
3. The importance of audit sampling enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to provide the auditor with reasonable basis on which to draw conclusions about the entire population. Audit sampling can be applied using either statistical or non-statistical approaches.



4. Testing procedures do not involve sampling are:
  - Testing 100% of items in a population, and
  - Testing all items with certain characteristics as selection is not representative.
5. In designing the audit sampling, the auditor applies judgment in considering:
  - Audit objective
  - Population
  - Sampling unit
  - Risk and assurance
  - Tolerable misstatement
  - Expected error in the population, and
  - Stratification

## **Lesson 4: Audit in IT environment**

### **a) Learning objective**

Explain the computer-assisted audit techniques

### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, teacher guide, computer, internet, projector, image, text books, chalk or marker pen, chalk board or white board, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In ICT learners were introduced some accounting software; such as sage, quick book and other information technology skills related to accounting that can help them to understand computer-assisted audit techniques.

### **d) Learning activities**

#### **Activity 8.4**

- Put students in small groups and give clear instruction about the activity
- Ask them to observe and analyze the image in student book and

answer the questions provided in the activity

- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on computer-assisted audit software. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

#### Answers to learning activity 8.4

1. Applications of auditing procedures to be applied using the computer as an audit tool are called Computer-Assisted Auditing Techniques(CAATs).
2. These application are called audit software and test data.

#### e) Application activities 8.4

This activity can be given as a normal individual activity, where students provide answers on asked questions. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the teacher. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### Answers to Application Activity 8.4

1. Two (2) types of CAATs are: audit software and test data.
2. CAATs may be used in performing various auditing procedures, including the following:
  - Tests of details of transactions and balances.
  - Analytical review procedures.
  - Tests of computer information system controls.
3. The examples of use of audit software are:
  - Access the client's data files and obtain information without the need to ask the client for information.

- Perform calculations and comparisons in analytical procedures.
- Sampling programs to extract data for audit testing, e.g. select a sample of receivables for confirmation.
- Scan a file to ensure that all documents in a series have been accounted for or to search for large and unusual items.
- Compare data elements in different files for agreement (e.g. prices on sales invoices to authorized prices in master file).
- Re-perform calculations, e.g. totalling receivables ledger.
- Prepare documents and reports, e.g. Produce receivables' confirmation letters and monthly statements.

4. Two(2) benefits of using test data are:

- Test data provides evidence that the software or computer system used by the client are working effectively by testing the program controls and in some cases there may be no other way to test some program controls.
- Once the basic test data have been designed, the level of ongoing time needed and costs incurred is likely to be relatively low until the client's systems change.

5. Test data has two aspect as shown below:

- Data representing **valid transactions**. Here the auditor is looking to confirm that the system produces the required documentation such as sales invoices and updates the accounting records.
- Data that is **invalid** for any reason. Here the auditors are reviewing controls that prevent processing of data that is clearly wrong, negative amounts or non-existent customers for example, or which breaches limits set down by the company (for example transactions which take credit customers over their credit limit). Auditors are interested in seeing not only that the system rejects the transaction, but also that breaches are reported (by means of exception reports).

6. Procedures for gathering audit evidence are:

- Inspection (of an item).
- Observation (of a procedure).
- Inquiry.
- External confirmation.
- Recalculation.
- Re-performance.
- Analytical procedures.

## Skills lab activity 8

Guidance on the skills lab activity.

To do this skills lab activity, students can either visit the school bursar or the cashier. The trainer can request students to take accounting documents of their choice.

### **i. Build**

- Remind students on the expected objective for the attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research

### **ii. Practice**

Guide students on accessing the real accounting documents

Ensure that all needed documents are available

Respond to any questions for clarification and support accordingly

### **iii. Present**

Choose randomly any two teams to present their findings

Allow students to ask question to their fellows

### **iv. Conclusion**

The teacher emphasizes on the objective of the activity reminding students that they have to follow the same sampling procedures and know the effect of each sampling factor on the sample size.

The following are key areas for reference:

Sampling procedures

Factor affecting the sample size.

## 8.6. Summary of the unit

### 1. Audit execution and procedures

#### 1.1. Meaning and steps of audit execution

##### a. Meaning

Audit execution is where the auditing take place. Before starting, the auditor is presented with all relevant information regarding the audit. The audit forms are connected to the system and updated in real time.

The audit execution consists mainly on the assessment and valuation of the questions on the basis of the replies in the audit, the determination of the audit result and the degree of fulfilment, and the rating of the audit. The lead auditor prepares the execution of an audit.

##### b. steps of audit execution

- Appointment of the auditor
- Communication with the previous auditor
- Letter of engagement sent to the client
- Investigate relevant internal control and accounting systems
- Evaluate operation of internal control and accounting systems by applying relevant tests
- Ensure the correctness of accounting records and final accounts
- Carry out final review
- Prepare and submit the report

#### 1.2. Audit procedures

##### a. Meaning

Audit procedures are the techniques, processes, and methods that auditors use to obtain reliable audit evidence, which enable them to gain a sound judgment about an organization's financial status. Audit procedures are conducted to help determine whether or not a company's financial statement is credible and factual.

1. Tests of controls
2. Substantive procedures
  - Analytical procedures
  - Tests of details

## **b. Types of audit procedure**

- Inquiry
- External confirmation
- Observation
- Inspection of documents
- Inspection of physical assets
- Recalculation
- Re-performance
- Ticking (Pointing)
- Casting (Checking of summation)
- Calling-over (Stepping)
- Vouching
- Tracing (verification)

## **2. Audit evidence**

### **2.1. Meaning of audit evidence**

Audit evidence is all the information, whether obtained from audit procedures or other sources that is used by the auditor in arriving at the conclusion on which the auditor's opinion is based. The auditor obtains evidence from several sources.

Some of significant source of audit evidence are:

- Accounting records
- Audit procedures performed to test accounting records
- Information obtained during the audit of previous years
- Audit firm's quality control procedures for acceptance of audit
- Work of management's expert
- Confirmation from third parties
- Comparable data of other companies engaged in the same industry
- Written representations from management to support other evidences obtained during the audit.

### **2.2. Qualities of audit evidence**

- Sufficiency
- Relevance
- Reliability



## 2.3. Types of Audit evidence

- Primary audit evidence
- Secondary audit evidence
- Circumstantial Audit evidence
- Hearsay evidence

## 2.4. Procedures for generating audit evidence

- A number of audit testing procedures are available to the auditor as a means of generating audit evidence.
- Inspection (of an item)
- Observation (of a procedure)
- Inquiry
- External confirmation
- Recalculation
- Re-performance
- Analytical procedures

## 3. Audit sampling

### 3.1. Meaning of audit sampling

#### 1. Meaning

Audit sampling is the application of audit procedures to less than 100% of items with a population of audit relevance such that all sampling units have a chance of selection.

Auditors do not normally examine all the information available to them as it would be impractical to do so and using audit sampling will produce valid conclusion. ISA 530 Audit sampling provides guidance to auditors.

#### 2. Sample size

##### a. Sampling risk

Sampling risk

Non-sampling risk

##### b. Risk and sample size

If you recall, in the previous unit we illustrated how the prescribed level of detection risk is affected by inherent risk and control risk, given a desired level of audit risk. This relationship is described by the audit risk model:  $AR = IR * CR * DR$ .

### 3. Techniques of audit sampling

**Statistical sampling** is an approach to sampling that involves random selection of the sample items, and the use of probability theory to evaluate sample results, including measurement of sampling risk.

**Non-statistical sampling** is a sampling approach that does not have these characteristics.

- a) Random selection
- b) Systematic selection
- c) Haphazard selection
- d) Sequence or block selection
- e) Monetary unit sampling

### 4. Factors affecting the sample size

- Audit objective
- Population
- Sampling unit
- Risk and assurance
- Tolerable misstatement
- Expected error in the population, and
- Stratification

## 4. Audit in IT environment

### 1. Computer assisted audit techniques

#### a. Meaning of CAATs

Computer-assisted audit techniques (CAATs) are commonly used by auditors. They consist of audit software and test data.

- b. Auditing around the computer
- c. Auditing through the computer
- d. Auditing with the computer

Auditing with the computer refers to the use of CAATs to assist in auditing work. CAATs consist of audit software and test data which we will look at in detail below.

### 2. Advantages and disadvantages of CAATs

- a. The advantages of using CAATs are:

## Advantages of CAATs

- Auditors can test program controls as well as general computer controls
  - A greater number of items can be tested more quickly and accurately
  - Transactions can be tested, rather than paper records that could be incorrect
  - CAATs are cost-effective in the long term if the client does not change its systems
  - Results can be compared to results from traditional testing and if correlation exists, overall confidence is increased.
- b. The challenges associated with using CAATs include:

## Challenges of using CAATs are:

- Setting up the software needed for CAATs can be time consuming and expensive.
- Audit staff will need to be trained so they have a sufficient level of IT knowledge to apply CAATs.
- Not all client systems will be compatible with the software used with CAATs.
- There is a risk that live client data is corrupted and lost during the use of CAATs.
- Information in real-time systems is constantly changing.
- Testing can be limited by the data held on the system.
- There is a risk of over-reliance on 'infallible' computerization of audit procedures.
- Auditor judgment must still be applied throughout the testing process

## 3. Audit software

### a. Meaning

Audit software are computer programs used by the auditor to interrogate a client's computer files. Audit software consists of computer programs used by the auditors, as part of their auditing procedures, to process data of audit significance from the entity's accounting system. It may consist of generalized audit software or custom audit software. Audit software is used for substantive procedures.

### b. Audit software: Example of use

- Access the client's data files and obtain information without the need to ask the client for information.
- Perform calculations and comparisons in analytical procedures.

### **c. Benefits and difficulties of using audit software**

- Benefits of using audit software
- Difficulties of using audit software

## **4. Test data**

### **a. Meaning**

Test data is data submitted by the auditor for processing by the client's computer system, to test that the system processes the data as expected.

**Test data** techniques are used in conducting audit procedures by entering data (e.g. a sample of transactions) into an entity's computer system, and comparing the results obtained with pre-determined results. Test data is used for tests of controls.

Test data has two aspects:

1. Data representing **valid transactions**.
2. Data that is **invalid** for any reason.

### **b. Benefits and problems of using test data**

- Benefits of using test data
- Problems with using test data

## **8.7. Additional information for the teacher**

### **1. Sources of audit evidence**

Some audit evidence is obtained by performing audit procedures to test the accounting records, for example, through analysis and review, performing procedures followed in the financial reporting process, and reconciling related types and applications of the same information. Through the performance of such audit procedure, the auditor may determine that the accounting records are internally consistent and agree to the financial statements.

More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting record, minutes of meetings, or a management representation.

Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors (benchmarking data).

## 2. Audit sampling procedure

The application of sampling techniques in substantive procedures, illustrated below, involves the following steps:

- a. Designing the sample
- b. Selecting a sample
- c. Performing the audit procedures
- d. Evaluating results of the tests
- e. Summarizing the result.

## 8.8. End unit assessment

### Answers to end unit assessment activities

1. Challenges of using CAATs are:
  - Setting up the software needed for CAATs can be time consuming and expensive.
  - Audit staff will need to be trained so they have a sufficient level of IT knowledge to apply CAATs.
  - Not all client systems will be compatible with the software used with CAATs.
  - There is a risk that live client data is corrupted and lost during the use of CAATs.
  - Information in real-time systems is constantly changing.
  - Testing can be limited by the data held on the system.
  - There is a risk of over-reliance on 'infallible' computerization of audit procedures.
  - Auditor judgment must still be applied throughout the testing process
2. **Audit software** are computer programs used by the auditor to interrogate a client's computer files. Audit software consists of computer programs used by the auditors, as part of their auditing procedures, to process data of audit significance from the entity's accounting system. It may consist of generalized audit software or custom audit software. Audit software is used for substantive procedures

**Test data** is data submitted by the auditor for processing by the client's computer system, to test that the system processes the data as expected.

Test data techniques are used in conducting audit procedures by entering data (e.g. a sample of transactions) into an entity's computer system, and comparing the results obtained with pre-determined results. Test data is used for tests of controls.

### **Advantages of CAATs**

- Auditors can test program controls as well as general computer controls
- A greater number of items can be tested more quickly and accurately
- Transactions can be tested, rather than paper records that could be incorrect
- CAATs are cost-effective in the long term if the client does not change its systems

3. The qualities of audit evidence are:

#### **a. Sufficiency**

It means that audit evidence should be complete and adequate to prove any material fact. For example, complete physical counting of items of stock is sufficient to verify the value of stock.

The auditor must assess whether the evidence is sufficient to allow him/her to reach the opinion that the financial statements give a true and fair view. If the auditor decides that the evidence obtained is insufficient to reach this opinion (or any other opinion) he/she may take any other action depending on the circumstances that can allow him/her to obtain more evidence by means of tests of controls and substantive procedures.

#### **b. Relevance**

Audit evidence should be relevant to the purpose for which it is required. For example, checking of physical existence of assets in accordance with the schedule of assets is relevant for audit purposes.

#### **c. Reliability**

Evidence is reliable if it is considered correct and accurate. For example, if the auditor receives a certificate of stock valuation from an outsider expert instead of an official of the company then it is more reliable. Similarly, documentary evidence instead of oral evidence is more reliable. A physical inspection by the auditor himself/herself is more reliable than evidence obtained from others.



4. Audit sampling can be done using either **statistical sampling** or **non-statistical sampling** methods.

**Statistical sampling** is sampling method involving random selection of the sample items, and the use of probability theory to evaluate sample results, including measurement of sampling risk.

**Non-statistical sampling** is another sampling method that does not have these characteristics.

## 8.9. Additional activities (Questions and answers)

### 8.9.1. Remedial activities (Questions and answers)

1. Which of the following would have the least effect on a sample size? :
- A. Increase in the required confidence level
  - B. Increase in number of invoices in population
  - C. Increase in tolerable misstatement
  - D. Increase in assessed risk

**Answer: C**

2. To what does 'sufficiency' of audit evidence relate?
- A. Reliability
  - B. Quality
  - C. Relevance
  - D. Quantity

**Answer: D**

3. What will increase the reliability of evidence
- A. Confirmation
  - B. Amount of information
  - C. Effective control

**Answer: C**

4. The most reliable form of audit evidence is:
- A. Analytical procedures
  - B. Visual observation of a transaction or event by the auditor
  - C. Written document
  - D. Oral representation of the third parties.

**Answer: D**

5. Which of the following statements regarding analytical procedures is not correct?
- A. Analytical tests emphasize a comparison of client internal control to GAAP.
  - B. Analytical procedures are required on all audits
  - C. Analytical procedures can be used as substantive tests.
  - D. For certain accounts with small balances, analytical procedures alone may be sufficient evidence

**Answer: A**

### **8.9.2. Consolidation activities (Questions and answers)**

1. Summarize the factors that affect sample sizes for substantive tests.

**Answer:**

Factors that affect the sample sizes of substantive tests are:

- a. Inherent risk
- b. Control risk
- c. Detection risk
- d. Tolerable misstatement rate
- e. Expected misstatement rate
- f. Population value
- g. Number of items (in small population)

Stratification may also lead to smaller sample sizes

2. What is the difference between random and haphazard selection?

**Answer:**

**Random selection** uses random number tables or computerized generator to select the sample.

For example, the auditors might tell a computer program there are 450 receivables numbered 1–450 and they want a sample of 30. The computer would randomly select 30 numbers between 1 and 450 to be the sampled items.

**Haphazard selection** is where an auditor himself selects items ‘at random’. It may be an alternative to random selection provided auditors are satisfied that the sample is representative of the entire population. This method requires care to guard against making a selection which is biased, for example towards items which are easily located, as they may not be representative. It should not be used if auditors are carrying out statistical sampling

3. Explain the terms ‘audit software’ and ‘test data’ and list the advantages of using CAATs in an audit.

**‘Audit software’** consists of computer programs used by auditors to process data of audit significance from the client’s accounting system. It may comprise generalized audit software or custom audit software. It is used for substantive procedures.

**‘Test data’** involves entering data such as a sample of transactions into the client’s accounting system and comparing the results obtained with pre-determined results. Test data is used for tests of controls.

4. Explain the reason why the auditor should communicate the previous auditor before accepting the appointment.

**Answer:**

If the auditor has been appointed in place of another auditor, he should enquire from the retiring auditor, the reasons for his removal as an auditor. If the retiring auditor discloses some information due to which the new auditor would not be able to work independently or in accordance with the professional ethics then he should not accept the appointment.

5. The one of the following is an example of vouching:
  - A. trace inventory purchases from the acquisitions journal to supporting invoices
  - B. trace selected sales invoice to the sales journal
  - C. trace details of employees pay checks to the payroll journal
  - D. all of the above are example of vouching

**Answer: A**

### **8.9.3. Extended activities (Questions and answers)**

1. The results of tests of detail on a sample of receivable balances recorded as FRW 2,000,000 indicate that the correct balances should be Frw1,950,000. The total of balances for similar items has been recorded as Frw10,000,000

#### **Required:**

#### **Explain:**

- a) What the auditor might conclude about the projected misstatement in the population of trade receivables.
- b) The relevance of the concept of tolerable misstatement in this situation.

#### **Answer:**

- The misstatement in the sample is FRW 50,000 (FRW 2,000,000 – FRW 1,950,000).
- The misstatement rate in the sample is 2.5% ( $50,000/2,000,000$ ). Extrapolating this over the population is a whole, the projected misstatement is that total trade receivables contain errors of FRW 250,000 ( $10,000,000 \times 2.5\%$ ) and trade receivables should therefore be stated at FRW 9,750,000 (FRW 10,000,000 - FRW 250,000).
- The auditor will compare the projected misstatement in the population to his pre-set tolerable misstatement. If the tolerable misstatement in the population was, say, FRW 300,000 then the error is, in effect, not material and could be ignored.

# UNIT 9

## AUDIT DOCUMENTATION

### 9.1. Key unit competence

To be able to evaluate the form, content and extent of audit documentation

### 9.2. Prerequisite (knowledge, skills, attitudes and values)

In senior 4 Unit 2 in management accounting and unit 2 in financial accounting you analyzed source documents used. This prior knowledge, skills or competences should help the students to be able to apply that knowledge related to business activities in their locality and be able to realize their contribution as students towards business activities.

### 9.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address crosscutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the crosscutting issues where possible taking consideration of their environment or community around them.

**Gender education:** Emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the meaning of audit report, its basic elements. Being citizens of Rwanda, males and females are encouraged to start business, they should know the importance of audit report for them as owners of the business.

**Inclusive education:** In addition to all having equal opportunities to carry out business activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan education system that do not discriminate.

**Peace and Values:** You need to emphasize to students the benefit of living in peace and harmony with others. Students need to appreciate the role played by auditors in promoting peace and patriotism in the community avoiding activities that are illegal e.g., frauds, fraudulent manipulations of accounts, falsification of accounting documents and make sure that every business they plan to have is legal and contributes to national development goals.

**Standardization culture:** You need to emphasize to students why adhering to ethics and integrity requirements at workplace and their respective community is very crucial for a self-reliance national development. This will help them to abide by international auditing and Assurance Standards Board.

**Financial education:** Teacher and students should know that resources and materials used in teaching and learning activities must not be mismanaged. This issue will also be addressed when studying auditing. Students will learn what is permitted and what is prohibited to manage learning resources and materials well. They will put in mind that misusing materials is wasting money.

#### **9.4. Guidance on introductory activity**

**NOTE:** The students won't be able to answer all the questions at this stage; they can answer one question. The most important thing is that you want to challenge students to be expectant and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide interest and motivation for students to be able to describe the audit documentation.

The introductory activity will also evoke students' interests about what to expect in this unit as they answer the questions that follow in the activity. Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content.

Use an appropriate method such as small groups or pairs and provide students with Unit 9 introductory activity, give clear instructions to the activity.

They observe photo and discuss what activities may have carried out. They read a scenario about audit documentation and discuss about documents to be gathered.

During grouping or pairing, mix boys and girls and students with different abilities.

During the discussion, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud/congratulate the actors after.



Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Harmonize their findings or answers, and help them draw conclusions/summary to questions. Answer or address any questions or challenges about the activity. Guide them to make notes in their books referring to students' book.

### **Possible answers for introductory activity**

1. The documents gathered by the auditor are called audit documentation and include:
  - Audit working papers
  - Audit file
  - Audit Note Book
2. The purpose or objectives of gathering those documents are the following:
  - It provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective.
  - It provides evidence that the audit was planned and performed in accordance with ISAs and other legal and regulatory requirements.
  - It assists the engagement team to plan and perform the audit.
  - It assists team members responsible for supervision to direct, supervise and review audit work.
  - It enables the team to be accountable for its work
  - It allows a record of matters of continuing significance to be retained.
  - It enables the conduct of quality control reviews and inspections (both internal and external).

## 9.5. List of lessons/sub-heading

Heading	Lesson title/ sub-heading	Learning objectives	Number of periods
9.1. Components of audit documentation	Introductory activity	Arouse the curiosity of students on the content of unit 9	1
	1 Meaning and objectives of audit documentation	Explain the meaning and objectives of audit documentation.	3
	2 Audit working papers	Explain the form and the content of audit working papers	3
	3 Audit file	Explain the permanent and current audit file	3
	4 Audit note book	Explain the auditor note book and its content	3
<b>End Unit Assessment</b>			<b>1</b>
<b>Total number of periods</b>			<b>14</b>

### Lesson 1: Components of audit documentation

#### a) Learning objective

Describe the components of audit documentation

#### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

#### c) Prerequisites/Revision/Introduction

Students are familiar with term documents referring to documentation studied in financial accounting (unit 2 and 3) and management accounting (unit 2) senior four. Again, they live in society where financial documents are applied.

#### d) Learning activities 9.1

- Invite students to read individually the questions in the student book and work in pairs to share with the classmates.
- Have some pairs makes the presentations.
- Provide constructive feedback in terms of supplements.

#### Answers to learning activity 9.1

1. Documents identified on the picture are:
  - Permanent audit file.
  - Current audit file.
  - Audit working papers.
  - Audit note book.
2. The documents observed from the pictures are called audit documentation.

#### e) Application activities 9.1

Invite students to read the application activities in student book and answer them.

#### Answers to Application Activity 9.1

1.
  - Audit documentation is the principal record of auditing procedures applied, evidence obtained, and conclusions reached by the auditor in the engagement.
  - Audit documentation is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise.
  - Audit Note Book is a register maintained by the audit staff to record important points, observed, errors, doubtful queries, explanations, and clarifications to be received from the clients. An Audit Note Book is used during the course of an audit to note down necessary points so that s/he does not forget them.

Audit Note Book. It is an essential book used to note important points that shall be included in the Auditor's report. It is a complete record of doubts and their clarification. It helps the auditor in his subsequent audits. It is also used as a guide to the other audit clerks.

2. The types of audit file are:

- Permanent audit file.
- Current audit file.

### Skills lab activity 9

Guidance on the skills lab activity

In conducting this skills lab activity, you can facilitate students in their learning groups to design appropriate working papers showing all necessary information required by international audit standards.

#### **i. Build**

Given that students are facilitated by the teacher,

- Remind students on the expected objective of designing working papers.
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understanding of the assignment
- Remind them that everybody full participation is mandatory.

#### **ii. Practice**

- Guide students on accessing the real materials
- Ensure that the source of materials is accessible for all
- Respond to any questions for clarification and support accordingly

#### **iii. Present**

- Choose randomly any two teams to present their findings
- Allow students to ask question to their fellows

#### **iv. Conclusion**

The teacher emphasizes on the objective of the research reminding students that they have to follow the design of audit documentation.

The following are key areas for reference:

Audit documentation

How to design working papers

## **9.6. Summary of the unit**

### **Lesson 1: Components of audit documentation**

#### **1. Meaning and objectives of audit documentation**

##### a. Meaning of audit documentation

Audit documentation refers to the records or documentation of procedures that auditors perform, the audit evidence that they obtained and the conclusion that they make based on the evidence obtained.

##### b. Objectives of audit documentation

Here is the summary of objectives of audit documentation:

- c. It provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective.
- d. It provides evidence that the audit was planned and performed in accordance with ISAs and other legal and regulatory requirements
- e. It assists the engagement team to plan and perform the audit.
- f. It assists team members responsible for supervision to direct, supervise and review audit work.
- g. It enables the team to be accountable for its work
- h. It allows a record of matters of continuing significance to be retained.
- i. It enables the conduct of quality control reviews and inspections (both internal and external)

#### **1.2. Audit working paper**

##### a. Definition

Audit working papers are documents which contain all information gathered from the company audited and show all evidences to help the auditor to prepare the final report and to form his opinion.

- b. The form and content of working papers
- c. Features of good working papers
- d. Advantages (Reasons) of collecting working papers
- e. How Audit working Papers are gathered
- f. Ownership of working papers

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client. They should not, however, be a substitute for the client's accounting records.

### **1.3. Audit file**

The auditor maintains two audit files for each client. These two files are known as:

- Permanent audit file
- Current audit file

#### **Permanent audit file**

##### **a. Definition**

Permanent audit file is a file which contains all documents that are required by the auditor as long as he remains the auditor of this particular company.

Permanent audit file is a file which contains information of continuing importance / nature to the auditor i.e. that information which the auditor will use beyond one financial period.

N.B. In preparing this file, the auditor should bear in mind the following points:

1. That the objective of the file is to maintain a permanent record of information of permanent importance to the auditor.
2. This file must be updated at each annual audit.

b. The contents of permanent audit file.

#### **Current audit file**

##### **a. Definition**

It contains information which will be used by the auditor for the current year under audit only. A current audit file contains information regarding audit conducted for the current period

This file contains documents in respect of one specific year.

b. Contents of current audit file.

### **1.4. Audit Note Book**

#### **a. Definition**

Audit Note Book is a register maintained by the audit staff to record important points, observed, errors, doubtful queries, explanations, and clarifications to be received from the clients. An Audit Note Book is used during the course of an audit to note down necessary points so that s/he does not forget them.



## **b. Purpose of audit Note Book**

The purpose is to note down various points which need to be either clarified with the client or the chief auditor. Audit Note Book is also used for recording important points to be included in the Auditor's Report. It is a complete record of doubts and their clarification.

## **c. Importance of Audit Note Book**

1. Audit note book shall be taken as reliable evidence even by the Court of law in case of dispute or if the auditor is charged with negligence.
2. It is useful for drawing the audit program.

## **d. Advantages of Audit Note Book**

Some the advantages of audit note book are given below:

1. Audit note book enables the auditor to record important points, which arise during the course of his audit; otherwise he might forget these points.
2. An auditor can produce this book as documentary evidence in a suit filed against him for negligence or misfeasance
3. It facilitates the preparation of the audit report.
4. If the assistant in charge is changed before the completion of a particular work, it acts as a guide and makes the completion of balance work easier.
5. It can help in making an assessment of the work of audit clerks.
6. It provides a key to evaluate the efficiency of the audit staff.

## **e. Disadvantages of Audit Note Book**

There are, however, certain disadvantages of audit note book. They are as follows:

1. Very often, it creates misunderstanding between the client staff and the audit staff.
2. If it is not properly and carefully prepared it cannot be used as evidence against the auditor for negligence.
3. Audit staff has to depend too much upon the client's staff for its preparation.

### **a. Contents of an Audit Note Book**

- a. A list of books of accounts maintained by the client.
- b. The technical term used in the business.
- c. The names of the principal officers their powers, duties and responsibilities.
- d. The points which requires further explanations and clarification.
- e. The mistakes and errors discovered .
- f. The total or balance of certain books of accounts, bank reconciliation statement.
- g. Accounting methods followed in the business.
- h. The points which have to be incorporated in the audit report.
- i. Any matters which require discussion with the senior or with the auditor.
- j. Date of commencement and completion of the audit.

## **9.7. Additional information for teachers**

### **The form and content of working papers**

The form and content of working papers are affected by matters such as:

- a. The size and complexity of the entity
- b. The nature of the audit procedures to be performed
- c. The identified risks of material misstatement
- d. The significance of the audit evidence obtained
- e. The nature and extent of exceptions identified
- f. The audit methodology and tools used

### **How Audit working Papers are gathered**

1. By taking photocopies of the client's statements.
2. By taking notes relating to areas of weak internal control system, material errors and frauds.
3. By filing up evidence from third parties.
4. Auditor's own judgment which is put on record and filed.
5. Important documents from the company.

## 9.8. End unit assessment

### Answers to end unit assessment activities

1. The objectives of audit documentation are:
  - a. It provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective.
  - b. It provides evidence that the audit was planned and performed in accordance with ISAs and other legal and regulatory requirements.
  - c. It assists the engagement team to plan and perform the audit.
  - d. It assists team members responsible for supervision to direct, supervise and review audit work.
  - e. It enables the team to be accountable for its work
  - f. It allows a record of matters of continuing significance to be retained.
  - g. It enables the conduct of quality control reviews and inspections (both internal and external).
2. An audit note book is defined as a register kept by an audit team to record crucial/important points observed during the audit.

The purpose is to note down various points which need to be either clarified with the client or the chief auditor. Audit Note Book is also used for recording important points to be included in the Auditor's Report. It is a complete record of doubts and their clarification.

3. Difference between permanent audit file and current audit file

Permanent audit file	Current audit file
<ul style="list-style-type: none"><li>▪ Permanent audit file is a file which contains all documents that are required by the auditor as long as he/she remains the auditor of this particular company.</li><li>▪ Permanent audit file is a file which contains informations of continuing importance / nature to the auditor i.e.that informations which the auditor will use beyond one financial period.</li></ul>	<ul style="list-style-type: none"><li>▪ Current audit file is that file which contains information which related primarily to the set of accounts being audited i.e. It contains informations which will be used by the auditor for the current year under audit only.</li></ul>

4. The features of good working papers are:
  - a. They should be properly headed.
  - b. They should indicate the period covered by them or when they were collected or recorded.
  - c. They should be as complete as possible so that they do not call for further explanation.
  - d. They should be sufficiently detailed.
  - e. They should be kept safely as a safeguard from misuse or destruction.
  - f. Symbols used should be explained.
7.
  - a. Audit working papers
  - b. Audit documentation

## 9.9. Additional activities (Questions and answers)

### 9.9.1. Remedial activities (Questions and answers)

**Question 1.** What are the types of audit file?

**Answer 1.** The types of audit file are:

- Permanent audit file
- Current audit file

**Question 2:** Give three advantages of collecting Audit working papers

**Answer 2**

- a. They are used as a basis for planning the current year's audit.
- b. They are used as a means of controlling the current year's audit through their review.
- c. They enable the auditor to form an opinion.

**Question 3:** What is the importance of Audit Note Book?

**Answer 3**

1. Audit note book shall be taken as reliable evidence even by the Court of law in case of dispute or if the auditor is charged with negligence.
2. It is useful for drawing the audit program.

### **9.9.2. Consolidation activities (Questions and answers)**

**Question1:** Define Audit Note Book and give its content.

**Answer 1** Audit Note Book is a register maintained by the audit staff to record important points, observed, errors, doubtful queries, explanations, and clarifications to be received from the clients. An Audit Note Book is used during the course of an audit to note down necessary points so that s/he does not forget them.

#### **Contents of an Audit Note Book**

- a. A list of books of accounts maintained by the client.
- b. The technical term used in the business.
- c. The names of the principal officers their powers, duties and responsibilities.
- d. The points which requires further explanations and clarification.
- e. The mistakes and errors discovered .
- f. The total or balance of certain books of accounts, bank reconciliation statement.
- g. Accounting methods followed in the business.
- h. The points which have to be incorporated in the audit report.
- i. Any matters which require discussion with the senior or with the auditor.
- j. Date of commencement and completion of the audit.

**Question2.** Outline the form and content of audit working papers

#### **Answer 2:**

The form and content of working papers are affected by matters such as:

- a. The size and complexity of the entity
- b. The nature of the audit procedures to be performed
- c. The identified risks of material misstatement
- d. The significance of the audit evidence obtained
- e. The nature and extent of exceptions identified
- f. The audit methodology and tools used

### **9.9.3. Extended activities (Questions and answers)**

**Question1:** State whether the working papers are the property of the client or auditor. Whether the client can demand custody of such working papers?

**Answer1:** – Working papers are the record of various audit procedures performed, audit evidence obtained, allocation of work between audit team

members etc. Audit working papers are the documents and evidence that an auditor collects and retains with himself during the audit. Thus, the audit working papers are the property of auditor and not of the client. No, client cannot demand custody of such working papers. The auditor may on his discretion make portions of or extracts of working papers available to his client. But the client cannot ask the auditor for the custody of working papers.

**Question2:** Differentiate permanent audit file from current Audit file based on their contents.

### Answer 2

Permanent file	Current file
<ul style="list-style-type: none"> <li>▪ Statutory or legal documents like Memorandum of association and Articles of association.</li> <li>▪ Details relating to the nature of the business, its operations</li> <li>▪ Organization plan and chart showing the duties and authorities of various officials of the company.</li> <li>▪ Details of accountig systems and internal control in operation.</li> <li>▪ Copies of important agreements and minutes of important meetings of board of Directors.</li> <li>▪ List of accounting books or record maintained by the company.</li> <li>▪ Copies of previous years financial statement.</li> </ul>	<ul style="list-style-type: none"> <li>▪ A copy of the final accounts of the respective year.</li> <li>▪ Completed internal control questionnaires.</li> <li>▪ Audit programme</li> <li>▪ Audit time table</li> <li>▪ All relevant list e.g. list of fixed asset, a list of debtors, a list of creditors etc.</li> <li>▪ Correspondence with the client in respect of the current audit.</li> </ul>



# UNIT 10

## INTERNAL CONTROL SYSTEM

### 10.1. Key unit competence

To be able to evaluate internal control system (ICS)

### 10.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in Unit five entitled auditor responsibility where students learnt that the auditor has the responsibility of strengthen the internal control system of the organisation. So, with this prior knowledge, skills, attitudes and values it should help them to appreciate the usefulness of internal control system and understand how it contributes to the protection of resources of an organization.

### 10.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or community around them.

**Environment and sustainability:** environment is one of the greatest factors that can affect both positively or negatively any business activity and one cannot start up a business without the environment. Therefore, great care for environment is crucial. Students are to be advised on the importance of environmental protection.

**Gender education:** emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the process of internal control system in the company. So that this will encourage people to take the first step to comply with internal control practices in the organisation.

**Inclusive education:** in addition to all having equal opportunities to carry out business activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan system that do not discriminate. Students need to understand internal control procedures and the management of the organisation should not discriminate but promote inclusiveness of all.

**Peace and Values:** you need to emphasize to learners the need to live in peace and harmony with others. Students need to appreciate the role of audit in promoting peace and patriotism in the community avoiding activities that are illegal e.g. fraud, nepotism, embezzlement and make sure that every economic activity they plan to have is legal and contributes to national development goals.

**Standardization culture:** you need to emphasize to students the need for standard in a business legal aspect. This will help them to abide by auditing standards and understand how these standards contributed to business development as well as the economic development.

#### **10.4. Guidance on introductory activity**

**NOTE:** The students won't be able to answer all the questions at this stage; they can answer one question. The most important thing is that you want to challenge students to be expectant and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide interest and motivation for students to be able to identify auditing practices related to business activities as opportunity of fighting against malpractices and mismanagement of business resources.

The introductory activity will also evoke students' interests about what to expect in this unit as they answer the questions in the activity. Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content.

Use an appropriate method such as small groups or pairs and provide students with Unit 10 introductory activity, give clear instructions to the activity.

They read the case study and discuss what activities may have carried out. They read a scenario on how the management can be advised on matters relating to employee management, how the management should do to make the organisation more productive and strategies to be used by the management to protect organisational assets. During grouping or pairing, mix boys and girls and students with different abilities.

During the discussion, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud/congratulate the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Harmonize their findings or answers, and help them draw conclusions/summary to questions. Answer or address any questions or challenges about the activity. Guide them to make notes in their books referring to students' book.

Students present their findings, results, answers through presentations on the introductory activity.

Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the unit.

You can support student's answers by referring to possible answers to the introductory activity below:

### Answers for introductory activity (case study)

**Note:** These responses may be shared or not with the students. They are specifically to guide you while harmonizing students' responses during presentation.

- Lack of segregation of duties
- Failure to comply with the human resource policies
- Lack of documentation of petty cash management

## 10.5. List of lessons/sub-heading

Heading	Lesson title/ sub-heading	Learning objectives	Number of periods
10.1. Features of internal control system	Introductory activity	Arouse the curiosity of students on the content of unit 10	1
	1	Meaning and features of internal control system	3
	2	Elements of internal control system	3
10.2. Assessment and recording of information systems	1	Assessment of information system and internal control	3
	2	Recording the information system and internal control	3
10.3. Communication and control activities	1	Communication with the management	2
	2	Control activities of internal control	3
	3	Benefits and limitation of internal control system	1
<b>End Unit Assessment</b>			<b>2</b>
Total number of periods			<b>21</b>

## **Lesson 1: Features of internal control system**

### **a) Learning objective**

Explain the meaning, features and elements of internal control system

### **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, marker pen, flipchart, computer, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

Learners were introduced in Unit five entitled auditor responsibility where students learnt that the auditor has the duty of checking on policies and procedures used by the organisation. So, with this prior knowledge, skills, attitudes and values it should help them to appreciate the usefulness of internal control system and understand how it contributes to the protection of resources of an organization.

### **d) Learning activities**

#### **Activity 10.1**

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and learners' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question and answer approach to make sure they are active and their curiosity in learning and discovery is aroused.

Encourage students to work together, value each other's contributions, share ideas, etc.

### Answers to learning activity 10.1

1. To observe the internal control elements and ensure that they are well implemented
2. Elements of internal control system are:
  - The control environment.
  - The entity's risk assessment process.
  - The information system relevant to financial reporting.
  - Control activities.
  - Monitoring of controls.

### Application activities 10.1

Students analyse and discuss about the questions either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

### Answers to application activity 10.1

1. The following are the requirements to achieve the overall objectives of application controls:
  - Completeness, accuracy and authorisation of input
  - Completeness and accuracy of processing
  - Maintenance of master files and standing data files contained therein (Standing data is data that will be used over and over again, for example, staff grades or rates of pay. Master files use data and store an accumulation of transactions.)
2. Ways through which segregation of duties should be carried out
  - Segregation of function. The key functions that should be segregated are the carrying out of a transaction, recording that transaction in the accounting records and maintaining custody of assets that arise from the transaction.



- The various steps in carrying out the transaction should also be segregated.
- The carrying out of various accounting operations should be segregated. For example, the same staff should not record transactions and carry out the reconciliations at the period-end. To emphasise the distinction between control objectives and control activities, the table below illustrates some examples of control objectives and their related control activities.

## Lesson 2: Assessment and recording of information systems

### a) Learning objective

Explain how to assess information system, methods used to record or evaluate accounting and control system

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, marker pen, flipchart, computer, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In Unit 3 where students studied the appointment of an auditor as a part of people who monitor the internal control system of the organization. In unit five students have also studied auditor's responsibilities which explains duties which contribute to strengthen the internal control system. So, with this prior knowledge, skills, attitudes and values it should help them to appreciate the usefulness of internal control system and understand how it contributes to the protection of resources of an organization.

### d) Learning activities

#### Activity 10.2

- Put students in small groups and give clear instruction about the activity
- Ask them to read and analyze the scenario in the student book and answer the questions provided in the activity

- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on how to assess information system, methods used to record or evaluate accounting and control system. Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

### **Answers to learning activity 10.2**

1. In order to assess the accounting system, the auditor should do the following:
  - Assess the adequacy of the accounting system as a basis for preparing the financial statements.
  - Identify the types of potential misstatements that could occur in the financial statements.
  - Consider factors that affect the risk of misstatements.
  - Design appropriate audit procedures.
2. The auditor will test controls of the internal control system of the company as under:
  - Inspection of documents supporting controls or events to gain audit evidence that internal controls have operated properly: e.g. verifying that a transaction has been authorised.
  - Inquiries about internal controls which leave no audit trail: e.g. determining who actually performs each function not merely who is supposed to perform it.
  - Re-performance of control procedures: e.g. reconciliation of bank accounts, to ensure they were correctly performed by the entity.
  - Examination of evidence of management views: e.g. minutes of management meetings.
  - Testing of internal controls operating on computerised systems or over the overall information technology function: e.g. access controls.
  - Observation of controls. Auditors will consider the manner in which the control is being operated.

3. Several techniques for recording the assessment of control risk are the following:
  - Narrative notes.
  - Questionnaires.
  - Flowcharts.
  - Checklists.

### e) Application activities 10.2

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### Answers to application activity 10.2

1. **The major question is the following:** 'How good is the system of controls?'
2. In order to obtain the audit evidence about the effectiveness of the internal control system, the auditor should consider the following:
  - How controls were applied
  - The consistency with which they were applied during the period
  - By whom they were applied

## Lesson 3: Communication and control activities

### a) Learning objective

Explain communication with the management during the audit, control activities, limitations and benefits of internal control.

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chinks, marker pen, flipchart, computer, resourceful person and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

In unit five students have studied auditor's responsibilities relating to duties of communicating to the management about the strength and weakness of the internal control system. So, with this prior knowledge, skills, attitudes and values should help them to appreciate the usefulness of internal control system and understand how it contributes to the protection of resources of an organization.

### **d) Learning activities**

#### **Activity 10.3**

- Put students in small groups and give clear instruction about the activity
- Ask them to read the scenario in student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary on when to use communication with the management during the audit, control activities, limitations and benefits of internal control. . Answers or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

#### **Answers to learning activity 10.3**

1. Ways in which auditors communicate findings on the internal control system to the organisation:
  - a) The Communication of Significant deficiencies in internal controls shall be communicated in writing to those charged with governance in a report to management.
  - b) Communicating of deficiencies in internal control is reported to those charged with governance and management. This implies that the objective of the auditor is to communicate appropriately to those charged with governance and management.
  - c) Sufficient information to enable those charged with governance and management to understand the context of the communication, in particular that:
    - The purpose of the audit was for the auditor to express an opinion on the financial statements.

- The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures appropriate in the circumstances, but not to express an opinion on the effectiveness of internal control.
  - The matters being reported are limited to those deficiencies identified during the audit and which the auditor has concluded are sufficiently important to merit being reported to those charged with governance.
2. Five statements reflecting the deficiencies in the internal control system of an organisation are:
- The susceptibility to loss or fraud of the related asset or liability
  - The subjectivity and complexity of determining estimated amounts
  - The amounts exposed to the deficiencies
  - The volume of activity that has occurred or could occur
  - The importance of the controls to the financial reporting process

### **e) Application activities 10.3**

This activity can be given as a normal individual or group activity, where students assess information system, methods used to record or evaluate accounting and control system. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

#### **Answers to Application Activity 10.3**

1. Auditors shall:
- Assess the adequacy of the accounting system as a basis for preparing the accounts
  - Identify the types of potential misstatements that could occur in the accounts
  - Consider factors that affect the risk of misstatements
  - Design appropriate audit procedures

2. When setting up the internal controls in the accounting system, the management of an entity assesses the following:
  - Transactions are executed in accordance with proper authorisation.
  - All transactions and other events are promptly recorded at the correct amount, in the appropriate accounts and in the proper accounting period.
  - Access to assets is permitted only in accordance with proper authorisation.
  - Recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

### Skills lab activity 10

#### Guidance on the skills lab activity:

In conducting this skills lab activity, under the supervision of teacher, students in their learning teams, role playing the communications with management, where one group play as management another as auditor.

#### i. Build

Given that students play the role of the management and others play the one of the auditor;

- Remind students on the expected objective relating to internal control system
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understanding of the assignment
- Remind them that everybody full participation is mandatory.

#### ii. Practice

During research on internet, care about the following concerns:

- Guide students on accessing the real website
- Ensure that internet is connected for all
- Respond to any questions for clarification and support accordingly



### **iii. Present**

During the group presentation, the teacher must assess whether the student participation in the skills lab activity was effective by:

- Selecting randomly anyone in all groups to present the report on behalf of team members.
- Allow students to ask question to their fellows.

All team members being presenting are expected to contribute to the plenary by answering some questions that the presenter is not covering as well as expected.

### **iv. Conclusion**

The teacher emphasizes on the objective of the research reminding students that they were expected to discover and understand Explain the meaning, features and elements of internal control system.

## **10.6. Summary of the unit**

- a. features of internal control system
- b. Meaning and features of internal control system
- c. Meaning of internal control system
- d. Features of internal control system
  - Organization plan
  - Segregation of functions
  - Control of access to assets
  - Authorization system and procedure

## **1.2. Elements of internal control system**

Internal control has five elements:

- The control environment
- The entity's risk assessment process
- The information system relevant to financial reporting
- Control activities
- Monitoring of controls

### **a. The control environment**

- Components of the control environment
- Communication and enforcement of integrity and ethical values
- Commitment to competence
- Participation by those charged with governance

- Management's philosophy and operating style
- Organizational structure
- Assignment of authority and responsibility
- Human resource policies and practices
- Entity risk assessment process

## **b. Information system relevant to financial reporting**

### **c. Control activities**

#### **Examples of control activities**

- Activities relating to authorization,
- Performance reviews,
- Information processing,
- Physical controls and segregation of duties.

#### **Components of control activities**

- Approval and control of documents
- Controls over computerized applications
- Checking the arithmetical accuracy of records
- Maintaining and reviewing control accounts and trial balances
- Reconciliations of accounts balances such as bank account.
- Comparing the results of cash, security and inventory counts with accounting records
- Comparing internal data with external sources of information
- Limiting physical access to assets and records
- Segregation of duties

### **d. Monitoring of controls**

Small companies – the problem of control

#### **Controls in a computer environment**

## **2. Assessment and recording of information systems**

### **2.1. Assessment of information systems and internal control**

Auditors should assume control risk is high, unless it is assessed as low, and the assessment confirmed by tests of controls.

- a) Accounting systems and the control environment
- b) Tests of controls

### c) Questionnaires

- Internal Control Questionnaires (ICQs)
- Internal Control Evaluation Questionnaires (ICEQs)
- Internal Control Questionnaires (ICQs)

#### **Areas to apply questionnaires:**

- Goods inward
- The sales (revenue) cycle
- The purchases (expenditure) cycle
- Wages and salaries
- Inventories
- Non-current assets
- Management information and general controls

## **2.2. Recording the information system and internal control**

The auditor must keep a record of client's systems which must be updated each year. This can be confirming understanding:

### **3. Communication and control activities**

#### **3.1 Communication with the management**

- a. meaning of communication with the management
- b. The meaning of deficiency in the internal control of the organization
- c. information that the auditor should communicate to the management

#### **3.2 Control activities of internal control**

- a. Meaning of control activities
- b. Examples of control activities

## **4. Benefits and limitations of internal control system**

### 4.1. Benefits of internal control system

### 4.2. Limitations of internal control system

## 10.7. Additional information for teachers

### Components of COSO framework:

**Control environment.** The control environment seeks to make sure that all business processes are based on the use of industry-standard practices. This can help ensure that the business is run in a responsible way. It may also reduce an organization's legal exposure if the organization is able to prove that its business processes are all based around industry standard practices. Additionally, the control environment can help with making sure that an organization is adhering to regulatory compliance requirements.

**Risk assessment and management.** Risk assessment and management which is sometimes referred to as enterprise risk management is based on the idea that risk is an inherent part of doing business. However, those same risks can sometimes cause a business to suffer adverse consequences. As such, organizations commonly adopt risk management plans that help them to identify risks and either reduce or eliminate risks deemed to pose a threat to the organization's well-being.

**Control activities.** Control activities are also tied to the risk management. They are essentially internal controls that are put into place to make sure that business processes are performed in a way that helps an organization to meet its business objectives without introducing unnecessary risks into the process.

**Information and communications.** Communications rules are put in place to make sure that both internal and external communications adhere to legal requirements, ethical values and standard industry practices. For example, private sector organizations commonly adopt privacy policies establishing how customer data can be used.

**Monitoring.** At a minimum, monitoring is performed by an internal auditor who makes sure that employees are adhering to established internal controls. However, in the case of public companies, it is relatively common for an outside auditor to evaluate the organization's regulatory compliance. In either case, the audit results are usually reported to the board of directors

## 10.8. End unit assessment

### Answers to end unit assessment activities

1. Internal control is the process designed and affected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of the entities objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.
2. Features of internal control are explained as under:

Effective internal control depends on good organization. Reducing the level of errors and irregularities helps to ensure that the objectives of the control system are achieved effectively. Learn the characteristics of a good internal control system here.

#### **Organization plan**

The first feature of an internal control system is the organization plan. In order for it to be effective, it must be simple and flexible. This plan should clearly outline the functions of each unit and its staff members.

#### **Segregation of functions**

Structural independence of an organization means separating the functions of each area of the company. This is essential for an effective internal control system, as it ensures that one person is not responsible for all stages of an operation.

#### **Control of access to assets**

Effective internal control depends to a large extent on the security of the processes. An organization achieves an adequate degree of security when access to assets or accounting records is limited. This involves restricting physical or remote access to assets or the preparation of documents for authorizing access thereto.

#### **Authorization system and procedure**

Effective internal control includes methods to monitor the records of operations and transactions. The procedures involved in an activity must include periodic audits and reviews, as well as obtaining control information.

Records that report the outcome of a particular activity should be produced by independent sources so that they can be compared to those in the area performing the task. In the event of a discrepancy, this will show a failure in the transaction log.

### **3. Elements of internal control system are the following:**

**A. The control environment:** The control environment is the framework within which controls operate. The control environment is very much determined by the management of the business.

**B. Entity risk assessment process:** An auditor must obtain an understanding of whether the entity has a process for: identifying business risks relevant to financial reporting objectives, estimating the significance of the risks, assessing the likelihood of their occurrence, deciding upon actions to address those risks.

### **C. Information system relevant to financial reporting**

The information system relevant to financial reporting is a component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions and to maintain accountability for the related assets, liabilities and equity.

**D. Control activities:** Control activities are those policies and procedures that help ensure that management directives are carried out.

**E. Monitoring of controls:** Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions.

4. a) Segregation of function. The key functions that should be segregated are the carrying out of a transaction, recording that transaction in the accounting records and maintaining custody of assets that arise from the transaction.

b) The various steps in carrying out the transaction should also be segregated.

c) The carrying out of various accounting operations should be segregated. For example the same staff should not record transactions and carry out the reconciliations at the period-end. To emphasise the distinction between control objectives and control activities, the table below illustrates some examples of control objectives and their related control activities.



**5. a. Definition: Control activities:** Control activities are those policies and procedures that help ensure that management directives are carried out.

**b. Examples of control activities**

Approval and control of documents

Controls over computerised applications

Checking the arithmetical accuracy of records

Maintaining and reviewing control accounts and trial balances

Reconciliations

**6. Table illustrating control objectives and control activities**

<b>Examples of control objectives</b>	<b>Examples of control activities</b>
(Sales and receivables) To ensure that goods and services supplied on credit are only supplied to customers with good credit ratings.	Referring any new credit customer to the credit control department which performs credit checks on the customer before their order is accepted. Only accepting orders from customers who have no credit problems.
(Purchases and payables) To ensure that goods and services purchased are ordered under proper authority and using proper procedures.	Authorizing purchase orders at the correct level of authority before the orders are placed.
(Wages and salaries) To ensure that employees are only paid for work they have done.	Using clock cards to record the hours worked by staff who are paid on an hourly rate. Ensure overtime worked is authorized by a manager or supervisor.
(Inventories) To ensure that inventory records are up to date and accurately maintained, and are supported by regular physical inventory counts.	Recording and confirming all movements of inventory inwards and outwards.
(Non-current assets) To ensure that all non-current assets are correctly recorded, adequately secured and properly maintained.	Maintaining a register of non-current assets for all non-current assets, and containing details of the cost of the asset.

7. Problems relating to internal control system and application of controls in small companies

- Auditors can have difficulties not because there is a general lack of controls but because the evidence available as to their operation and the completeness of the records is insufficient.
- Segregation of duties will often appear inadequate in enterprises having a small number of staff.
- Similarly, because of the scale of the operation, organisation and management controls are likely to be rudimentary at best.
- The onus is on the proprietor, by virtue of his day-to-day involvement, to compensate for this lack.
- Where the manager of a small business is not himself the owner, he may not possess the same degree of commitment to the running of it as an owner-manager would.

8. a. Definition: tests of controls are audit procedures 'designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

b. Table illustrating how tests controls are applied in internal control system:

<b>Tests of controls</b>
Inspection of documents supporting controls or events to gain audit evidence that internal controls have operated properly: e.g. verifying that a transaction has been authorized
Inquiries about internal controls which leave no audit trail: e.g. determining who actually performs each function not merely who is supposed to perform it
Re-performance of control procedures: e.g. reconciliation of bank accounts, to ensure they were correctly performed by the entity
Examination of evidence of management views: e.g. minutes of management meetings
Testing of internal controls operating on computerized systems or over the overall information technology function: e.g. access controls
Observation of controls. Auditors will consider the manner in which the control is being operated

9. Matters to consider when determining whether a deficiency in internal control is significant:

- The likelihood of the deficiencies resulting in material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts.
- The amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur.
- The importance of the controls to the financial reporting process.
- The cause and frequency of the exceptions identified as a result of the deficiencies.
- The interaction of the deficiency with other deficiencies in internal control.

10. Limitations of internal control system are under:

- **The potential for human error:** These include the fact that human judgement in decision-making can be faulty or produce simple errors and mistakes.
- **The possibility of controls being by-passed or over-ridden:** Controls can be circumvented by the collusion of two or more people or management may inappropriately override controls.
- **Collusion among employees:** In any organisation collusion exist among employees due to different conflicting circumstances.
- **The costs of controls outweighing their benefits:** smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. It would not make commercial sense to employ additional staff purely for the purposes of achieving greater segregation of duties.
- **Controls tending to be designed to cope with routine and not non-routine transactions** Non-routine transactions are by their very nature unusual. As a result, it will be difficult to predict what these might be and therefore is less likely that a system will have been devised to deal with these effectively.

11. Benefits of internal control are the following:

- Assess the adequacy of the accounting system as a basis for preparing the accounts.
- Identify the types of potential misstatements that could occur in the accounts.
- Consider factors that affect the risk of misstatements.
- Design appropriate audit procedures.
- The assessment of the controls of an entity will have an impact on that risk assessment.

## 10.9. Additional activities (Questions and answers)

### 10.9.1. Remedial activities (Questions and answers)

**Question1.** What do you understand by Internal Control System?

**Answer1.** Internal control is the process designed and affected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of the entities objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

**Question2.** What does control environment mean?

**Answer2.**The control environment: The control environment is the framework within which controls operate. The control environment is very much determined by the management of the business. The control environment includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity.

**Question3.** Among the features of internal control system explain the concept "organisation plan"

**Answer3.** The first feature of an internal control system is the organization plan. In order for it to be effective, it must be simple and flexible. This plan should clearly outline the functions of each unit and its staff members.

### 10.9.2. Consolidation activities (Questions and answers)

**Question1.** Describe limitations of internal control system.

**Answer1.**

- **The potential for human error:** These include the fact that human judgement in decision-making can be faulty or produce simple errors and mistakes.
- **The possibility of controls being by-passed or over-ridden:** Controls can be circumvented by the collusion of two or more people or management may inappropriately override controls.
- **Collusion among employees:** In any organisation collusion exist among employees due to different conflicting circumstances.

- **The costs of controls outweighing their benefits:** Smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. It would not make commercial sense to employ additional staff purely for the purposes of achieving greater segregation of duties.
- **Controls tending to be designed to cope with routine and not non-routine transactions:** Non-routine transactions are by their very nature unusual. As a result, it will be difficult to predict what these might be and therefore is less likely that a system will have been devised to deal with these effectively.

**Question2.** Describe benefits of internal control system

Answer2.

- Assess the adequacy of the accounting system as a basis for preparing the accounts
- Identify the types of potential misstatements that could occur in the accounts
- Consider factors that affect the risk of misstatements
- Design appropriate audit procedures

### 10.9.3. Extended activities (Questions and answers)

**Question1.** Design a table which reflects differences between control objectives and control activities using examples.

Answer1.

**Table illustrating control objectives and control activities**

Examples of control objectives	Examples of control activities
(Sales and receivables) To ensure that goods and services supplied on credit are only supplied to customers with good credit ratings.	Referring any new credit customer to the credit control department which performs credit checks on the customer before their order is accepted. Only accepting orders from customers who have no credit problems.
(Purchases and payables) To ensure that goods and services purchased are ordered under proper authority and using proper procedures.	Authorizing purchase orders at the correct level of authority before the orders are placed.

(Wages and salaries) To ensure that employees are only paid for work they have done.	Using clock cards to record the hours worked by staff who are paid on an hourly rate. Ensure overtime worked is authorized by a manager or supervisor.
(Inventories) To ensure that inventory records are up to date and accurately maintained, and are supported by regular physical inventory counts.	Recording and confirming all movements of inventory inwards and outwards.
(Non-current assets) To ensure that all non-current assets are correctly recorded, adequately secured and properly maintained.	Maintaining a register of non-current assets for all non-current assets, and containing details of the cost of the asset.



# UNIT 11

## TEST OF CONTROL

### 11.1. Key unit competence

To be able to describe the characteristics of effective accounting systems

### 11.2. Prerequisite (knowledge, skills, attitudes and values)

In senior 4 Unit 1 in financial accounting you analysed asset, liability, while in senior 4 unit 6 you analysed different types and methods used in inventory management. This prior knowledge, skills or competences should help the students to be able to describe the characteristics of effective accounting systems and be able to realize their contribution as students towards business activities.

### 11.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address crosscutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the crosscutting issues where possible taking consideration of their environment or community around them.

**Gender education:** emphasis throughout this unit has to be put on how both males and females have same rights and obligations to do auditing activities which can generate a true and fair view of financial statement. So as to promote better standard of auditing activities as well as the community.

**Environment and sustainability:** the greatest source of accounting system is the environment and the society. The effective accounting system cannot be applied without the environment. Therefore, great care has to be taken for environment and society. Therefore, test of control the only way through which the environment can be safe from harm but only done appropriately.

**Peace and Values:** you need to emphasize on students need to live in peace and harmony with others. Students need to identify potential contributions of effective accounting system towards society and promoting peace.

**Standardization culture:** you need to emphasize to students, the need for standards even in business activities to ensure that these activities bring in enough income to the economy and to maintain order in business environment.

**Financial education:** teacher and students should know that resources and materials used in teaching and learning activities must not be mismanaged. This issue will also be addressed when studying test of control. Students will learn what is permitted and what is prohibited to manage learning resources and materials well. They will put in mind that misusing materials is wasting money.

## 11.4. Guidance on introductory activity

**NOTE:** The students won't be able to answer all the questions at this stage; they can answer one question. The most important thing is that you want to challenge students to be expect and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide interest and motivation for students to be able to describe the characteristics of effective accounting systems as opportunity of fighting against illegal accounting records.

The introductory activity will also evoke students' interests about what to expect in this unit as they answer the questions that follow in the activity. Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content.

Use an appropriate method such as small groups or pairs and provide students with Unit 11 introductory activity, give clear instructions to the activity. They observe image and discuss the relationship between small circles and big circle. During grouping or pairing, mix boys and girls and students with different abilities.

During the discussion, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud/congratulate the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair share or large group discussion. Ensure all students are given an opportunity to give their views and should be respected.

Harmonize their findings or answers, and help them draw conclusions/summary to questions. Answer or address any questions or challenges about the activity. Guide them to make notes in their books referring to students' book.

### Possible Answers for introductory activity

Auditors must ascertain the accounting system and internal control system. If auditors decide to rely on controls, they must test them.

Means that the small circles show accounting systems and big circle shows its test.

## 11.5. List of lessons/sub-heading

Headings	Lesson title/ sub-heading	Learning objectives	Number of periods
11.1. Sales system	Introductory activity	Arouse the curiosity of students on the content of unit 11	1
	1 Control objectives	Identify the control objectives of sales system	1
	2 Control activities	Explain the control activities of sales system	3
	3 Tests of controls	Explain test controls of sales system	1
11.2. Purchases system	1 Control objectives	Identify the control objectives of purchase system	1
	2 Control activities	Explain the control activities of purchase system	3
	3 Tests of controls	Explain tests of controls of purchase system	1
11.3. Payroll system	1 Control objectives	Identify the control objectives of payroll system	1
	2 Control activities	Explain the control activities of payroll system	2
	3 Tests of controls	Explain tests controls of payroll system	1

11.4. Inventory system	1	Control objectives	Identify the control objectives of inventory system	1
	2	Control activities	Explain the control activities of inventory system	2
	3	Tests controls	Explain tests controls of inventory system	1
11.5. Non- current assets	1	Control objectives	Identify the control objectives of non-current asset system	1
	2	Control activities	Explain the control activities of non-current asset system	2
	3	Tests controls	Explain tests controls of non- current asset system	1
11.6. Non– current liabilities	1	Control objectives, Control activities, Tests controls	Explain the control objectives, control activities and test of control of non-current liabilities system	2
11.7. Management information	1	Control objectives, Control activities, Tests controls	Explain the control objectives, control activities, tests of controls of management information system	1
<b>End Unit Assessment</b>				<b>2</b>
<b>Total number of periods</b>				<b>28</b>

## Lesson 1: Sales system

### a) Learning objective

Explain the control objectives, control activities and test controls of sales system

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction

Students are familiar with term sales from entrepreneurship S1, S2, S3 and from S4, S5 Accounting. Again, they live in society where sales system applied. So they refer to their community to explain sales system.

### d) Learning activities

- Invite student teachers to read individually the question in the student book and work in pairs to share with the classmates.
- Have some pairs make the presentations?
- Provide constructive feedback in terms of supplements

### Answers to learning activity 11.1

- Different circles containing the following: customer, dispatch, invoice, credit control, order.
- All elements are used in the sales system: customer, dispatch, invoice, credit control, order.

### e) Application activities 11.1:

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answers below as you assess their work.

## Answers to Application Activity 11.1

1. Procedures for the preparation of invoices and credit notes including the following:
  - Authorisation of selling prices/use of price lists
  - Authorisation of credit notes
  - Verification of prices, quantities, extensions and totals on invoices and credit notes
2. References are obtained for new customers

### Lesson 2: Purchases system

#### a) Learning objective

Explain the control objectives, control activities and test controls of purchase system

#### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

#### c) Prerequisites/Revision/Introduction

Students are familiar with term purchase from entrepreneurship S1, S2, S3 and from S4, S5 Accounting. Again, they live in society where purchase system applied. So they refer to their community to explain purchase system.

- Learning activities
- Invite students to observe individually the image in the student book and work in pairs to share with the classmates the activities do.
- Some pairs make the presentations
- Provide constructive feedback from the findings

## Answers to learning activity 11.2

Supplies, purchase order, contract, negotiation, quotes, acquisition

#### d) Application activity 11.2:

- Invite students to read, discuss in pairs the application activities in student book
- Have some pairs to present their findings



- Ask other pairs to supplement
- Give constructive feedback

### Answers to Application Activity 11.2

1. Orders should only be raised in response to an authorized purchase requisition
2. The most important objectives of internal control relating to suppliers and purchases are:

#### Ordering

To ensure that:

- All orders for, and expenditure on, goods and services are properly authorised, and are for goods and services that are actually received and are for the company.
- Orders are only made to authorized suppliers.
- Orders are made at competitive prices.

#### Receipt and invoices

To ensure that:

- Goods and services received are used for the organization's purposes and not private purposes.
- Goods and services are only accepted if they have been ordered, and the order has been authorized.
- All goods and services received are accurately recorded.
- Liabilities are recognized for all goods and services that have been received.
- All credits to which the organization is due are claimed.
- Receipt of goods and services is necessary to establish a liability.

#### Accounting

To ensure that:

- All expenditure is authorized and is for goods that are actually received.
- All expenditure that is made is recorded correctly in the general (nominal) and payables (purchase) ledgers.
- All credit notes that are received are recorded in the general and payables ledgers.
- All entries in the payables ledger are made to the correct payables ledger accounts.
- Cut-off is applied correctly to the payables ledger.

## Lesson 3: The payroll system

### a) Learning objective

Explain the control objectives, control activities and test controls of payroll system

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction

Students are familiar with term payroll from management accounting S4, unit 1 and S4 financial accounting unit 2.

### d) Learning activities

- Put students in groups ask them to analyse the image in student book.
- Guide student's discussions towards the question
- Invite students to share their findings

### Answers to learning activity 11.3

The following such as: basic salary, allowances, gross salary, deductions and net salary are the components of payroll and the remaining contents in the small circles illustrate the record of all employees and the related report about the payroll for the whole organization.

### e) Application activities 11.3:

Invite students to read the application activities in student book and answer individually accordingly.

### Answers to Application Activity 11.3

1. The true answer is 'd' and gives evidence that the correct payments have been made to the tax authorities.
2. Auditors should confirm that wages have been paid at the correct rate by agreeing the calculation of gross pay to:
  - a) Authorized rates of pay.
  - b) Production records.
  - c) Clock cards, time sheets or other evidence of hours worked

## Lesson 4: The inventory system

### a) Learning objective

Explain the control objectives, control activities and test controls of inventory system

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction

Students are familiar with inventory from S4 management accounting Unit 6. Again, they can refer to their community and analyse different types and methods used in inventory management.

### d) Learning activities

- Put students in groups ask them to analyse picture in student book.
- Guide student's discussions towards the questions.
- Invite students to share their findings

#### Answers to learning activity 11.4

1. The activities carried out from the above pictures are the following: storing items, dispatch, data recording, and transport.
2. The elements used in the inventory system are the following: stock/store/warehouse, delivery, data recording etc.

### e) Application activities 11.4:

Invite students to read the application activities in student book and answer individually accordingly.

#### Answers to Application Activity 11.4

1. Controls over inventory levels may be done by:
  - Maximum inventory limits.
  - Minimum inventory limits.
  - Re-order quantities and levels.
  - Arrangements for dealing with returnable containers
2. (b) and (c) are the appropriate tests of controls in the audit of inventory.

## Lesson 5: Non-current assets

### a) Learning objective

Explain the control objectives, control activities and test controls of non-current asset

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction

Students are familiar with term non-current asset from entrepreneurship S3 and from S4, S5 Accounting. Again, they live in society where non-current assets are located. So they refer to their community to identify non-current assets.

### d) Learning activities

- Put students in groups ask them to analyse the picture in student book.
- Guide student's discussions towards the question.
- Invite students to share their findings

### Answers to learning activity 11.5

All items/things are non-current assets or fixed assets.

### e) Application activities 11.5

- Invite students to read, discuss in pairs the application activities in student book
- Have some pairs to present their findings
- Ask other pairs to supplement
- Give constructive feedback

## Answers to Application Activity 11.5

1. Auditors should normally test that:
  - a) Non-current assets purchases have been authorised.
  - b) The purchase price can be confirmed to supporting documentation.
  - c) The asset has been recorded in the cash book and non-current asset register.
  - d) An appropriate depreciation rate has been chosen and has been applied correctly to the asset.
2. 'd' is not a test of controls over non-current assets but it is a test of valuation

### Lesson 6: Non-current liabilities

#### a) Learning objective

Explain the control objectives, control activities and test controls of Non-current liabilities

#### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

#### c) Prerequisites/Revision/Introduction

Students are familiar with term non-current liabilities from entrepreneurship S3 and from S4, S5 Accounting. Again, they live in society where there are non-current liabilities. So they refer to their community to identify non-current liabilities.

#### d) Learning activities

- Put students in groups ask them to analyse image in student book.
- Guide student's discussions towards the questions.
- Invite students to share their findings

## Answers to learning activity 11.6

1. The non-current liabilities are: payable after one year, arises from long-term funding, long-term loans (debentures).
2. The most important objectives of internal control relating to non-current liabilities are to ensure:

**Authorization:** that loans and any other long-term borrowings are properly authorized.

**Completeness:** that all non-current liabilities have been recognized and disclosed.

**Accuracy:** that the value of the liability has been correctly recorded, and that interest payable has been calculated correctly and included in the correct accounting period.

**Classification and understandability:** that long-term loans and interest on loans have been correctly disclosed in the financial statements.

### e) Application activities 11.6:

- Invite students to read, discuss in pairs the application activities in student book
- Have some pairs to present their findings
- Ask other pairs to supplement
- Give constructive feedback

## Answers to Application Activity 11.6

The control activities will be:

- **Maintenance of appropriate accounting records** (including distinction between current and non-current liabilities).
- **Statements** from loan or lease providers should be reconciled with the relevant ledger accounts on a regular basis.

## Lesson 7: Management information

### a) Learning objective

Explain the control objectives, control activities and test controls of management information



## **b) Teaching resources**

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, internet, case studies and any other trustworthy and reliable resources to enhance learning.

## **c) Prerequisites/Revision/Introduction**

Students are familiar with term management information from entrepreneurship S3 and from S4, S5 Accounting.

## **d) Learning activities**

- Put students in groups ask them to read the image in student book.
- Guide student's discussions towards the question.
- Invite students to share their findings

### **Answers to learning activity 11.7**

All of the following: people, computer software, computer hardware, procedure and network are the components of information system.

## **e) Application activities 11.7:**

- Invite students to read, discuss in pairs the application activities in student book
- Have some pairs to present their findings
- Ask other pairs to supplement
- Give constructive feedback

### **Answers to Application Activity 11.7**

There should be controls in place to ensure budgets are regularly set, and reports and information are provided on time to the specified degree of accuracy and detail.

As well as the control aspects, auditors will be concerned with the management information system's ability to provide useful data for analytical procedures.

And finally, auditors will review the contents of internal management accounting reports, and confirm in particular that budgets are being set and that actual results are being compared with budgeted figures.

## Skills lab activity 11

Guidance on the skills lab activity.

In doing this skills lab activity, you can visit school bursar or request students to make a research on the internet where need be.

### **i. Build**

Given that students visit the required place,

- Remind students on the expected objective for the visit attendance
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research

### **ii. Practice**

Guide students on accessing the real information

Ensure that all students are understood

Respond to any questions for clarification and support accordingly

### **iii. Present**

Choose randomly any two teams to present their findings

Allow students to ask question to their fellows

### **iv. Conclusion**

The teacher emphasizes on the objective of the visit reminding students that they have to follow those accounting system.

The following are key areas for reference:

- Purchase system
- Payroll system
- Inventory system

## 11.6. Summary of the unit

It is best to examine controls in terms of the various components of the accounting system. Most commonly these will be: **sales, purchases, wages and other systems such as inventory, non-current assets and management information.**

### 1. Sales system

#### Control objectives and Control activities

Control objectives	Control activities
Goods and services are only supplied to customers with good credit ratings and who are within approved credit limits.	<ul style="list-style-type: none"><li>▪ Segregation of duties; credit control, invoicing and inventory dispatch</li><li>▪ Authorization of credit terms to customers</li><li>▪ Credit limits confirmed before new orders are accepted</li></ul>
Customers pay promptly.	<ul style="list-style-type: none"><li>▪ Authorization of credit terms to customers</li><li>▪ Credit limits confirmed before new orders are accepted</li><li>▪ Balance statements sent regularly to customers</li></ul>
Orders are recorded correctly.	Sequential numbering of blank order documents. The sequence of orders processed is accounted for.
Orders are fulfilled.	<ul style="list-style-type: none"><li>▪ Matching of customer orders with production orders and dispatch notes</li><li>▪ Regular review for orders which have not yet been delivered</li></ul>
All dispatches of goods are recorded.	<ul style="list-style-type: none"><li>▪ Authorization of dispatch of goods</li><li>▪ Examination of goods outwards as to quantity, quality and condition</li><li>▪ Recording of goods outwards on a timely basis</li><li>▪ Pre-numbering of dispatch notes and delivery notes and regular checks on sequence</li></ul>

All goods and services sold are correctly invoiced.	<ul style="list-style-type: none"> <li>▪ Agreement of goods outwards records to customer orders, dispatch notes and invoices</li> <li>▪ Preparation of invoices</li> </ul>
All invoices raised relate to goods and services that have been supplied by the business.	<ul style="list-style-type: none"> <li>▪ Agreement of goods outwards records to customer orders, dispatch notes and invoices</li> <li>▪ Signature of delivery notes by customers</li> <li>▪ Matching of sales invoices with dispatch and delivery notes and sales orders</li> </ul>
Credit notes are only given for valid reasons.	<ul style="list-style-type: none"> <li>▪ Condition of returns reviewed</li> <li>▪ Recording of goods returned on goods returned notes</li> <li>▪ Management approves credit notes issued</li> </ul>
All sales that have been invoiced are recorded in the general and receivables ledgers.	<ul style="list-style-type: none"> <li>▪ Segregation of duties: recording sales, maintaining customer accounts and preparing statements</li> <li>▪ Regular reconciliation of receivables ledger control account</li> </ul>
All credit notes that have been issued are recorded in the general and receivables ledgers.	<ul style="list-style-type: none"> <li>▪ Segregation of duties: recording sales, maintaining customer accounts and preparing statements</li> <li>▪ Separate recording of sales returns, price adjustments etc.</li> </ul>
All entries in the receivables ledger are made to the correct receivables ledger accounts.	<ul style="list-style-type: none"> <li>▪ Retention of customer remittance advices</li> <li>▪ Regular preparation of receivables' statements</li> <li>▪ Review of receivables' statements</li> </ul>
Cut-off is applied correctly to the receivables ledger.	<ul style="list-style-type: none"> <li>▪ Cut-off procedures to ensure goods dispatched and not invoiced (or vice versa) are properly dealt with in the correct period</li> </ul>
Potentially irrecoverable debts are identified.	<ul style="list-style-type: none"> <li>▪ Timely review and follow-up of overdue accounts</li> <li>▪ Authorization of writing off of irrecoverable debts</li> </ul>

## Tests of controls

The precise nature of the tests of controls performed by the auditor would depend on the way in which the control is being operated by the audit client. Procedures however would typically include the following.

Review the organisation chart and verify that references are being obtained. Verify that a sample of new accounts on the sales ledger have been authorised by senior staff. Examine computer application controls for credit limits. For a sample of customer orders obtain evidence that they have been matched with production orders and despatch notes. Verify that price lists and terms of trade are properly documented, authorised and communicated. Obtain evidence of authorisation of goods despatched e.g. signature of despatch note. Review and test the entity's procedures for accounting for numerical sequences of despatch notes and inspect despatch notes to confirm that they are sequentially numbered. Examine delivery notes for evidence of confirmation of receipt of goods by customers e.g. customer signature. Obtain evidence that procedures relating to the accuracy of invoices have been performed. Review and test the entity's procedures for accounting for numerical sequences of invoices and inspect invoices to confirm that they are sequentially numbered. Review and observe procedures for matching of invoices to despatch notes and re-perform a sample. Obtain evidence of authorisation of credit notes. Evaluate procedures for the preparation of customer statements. Review supplier statement reconciliations produced by the audit client. Re-perform a sample of supplier statement reconciliations produced by the audit client to determine whether they have been performed accurately. Review control account reconciliations to the receivables ledger produced by the client. Re-perform a sample of control account reconciliations to the receivables ledger to determine whether they have been performed accurately. Confirm authorisation of irrecoverable receivables allowances/write offs.

## 2. The purchases system

Control objectives and Control activities

Control objectives	Control activities
All orders for, and expenditure on, goods and services are properly authorized, and are for goods and services that are actually received and are for the company.	<ul style="list-style-type: none"> <li>▪ Order forms prepared only when a purchase requisition has been received</li> <li>▪ Authorization of order forms (in accordance with pre-defined authority levels)</li> <li>▪ All orders made on official company documents, and showing suppliers' name, quantity order and price</li> <li>▪ Review of orders not received</li> </ul>
Orders are only made to authorized suppliers.	<ul style="list-style-type: none"> <li>▪ Central policy for choice of suppliers, and list of approved suppliers maintained</li> <li>▪ Supplier master file data periodically reviewed by management to ensure approved suppliers remain suitable/appropriate</li> </ul>
Orders are made at competitive prices.	<ul style="list-style-type: none"> <li>▪ Monitoring of supplier prices in relation to other potential alternative suppliers</li> <li>▪ Monitoring of supplier terms and taking advantage of favorable conditions (bulk order, discount)</li> </ul>
Goods and services received are used for the organization's purposes and not private purposes.	<ul style="list-style-type: none"> <li>▪ Evidence required of requirements for purchase before purchase authorized (re-order quantities and re-order levels)</li> </ul>
Goods and services are only accepted if they have been ordered, and the order has been authorized.	<ul style="list-style-type: none"> <li>▪ Authorization of order forms (in accordance with pre-defined authority levels)</li> <li>▪ Safeguarding of blank order forms</li> </ul>
All goods and services received are accurately recorded.	<ul style="list-style-type: none"> <li>▪ Examination of goods inwards</li> <li>▪ Recording arrival and acceptance of goods</li> <li>▪ Comparison of goods received notes with purchase orders</li> </ul>



<p>Liabilities are recognized for all goods and services that have been received.</p>	<ul style="list-style-type: none"> <li>▪ Recording arrival and acceptance of goods</li> <li>▪ Comparison of goods received notes with purchase orders</li> <li>▪ Prompt recording of purchases and purchase returns in day books and ledgers</li> <li>▪ Referencing of supplier invoices; numerical sequence and supplier reference</li> </ul>
<p>All credits to which the organization is due are claimed.</p>	<ul style="list-style-type: none"> <li>▪ Recording return of goods (pre-numbered goods returned notes)</li> <li>▪ Procedures for obtaining credit notes from suppliers</li> </ul>
<p>Receipt of goods and services is necessary to establish a liability.</p>	<ul style="list-style-type: none"> <li>▪ Recording arrival and acceptance of goods (pre-numbered goods received notes)</li> <li>▪ Comparison of goods received notes with purchase orders</li> <li>▪ Referencing of supplier invoices; numerical sequence and supplier reference</li> <li>▪ Confirmation of suppliers' invoices – Prices, quantities, accuracy of calculation</li> </ul>
<p>All expenditure is authorized and is for goods that are actually received.</p>	<ul style="list-style-type: none"> <li>▪ Authorization of payments, in accordance with: <ul style="list-style-type: none"> <li>– Authority limits</li> <li>– Confirmation that goods have been received, accord with purchase order, and are properly priced and invoiced</li> </ul> </li> </ul>
<p>All expenditure that is made is recorded correctly in the general and payables ledgers.</p>	<ul style="list-style-type: none"> <li>▪ Segregation of duties: accounting and verification functions</li> <li>▪ Prompt recording of purchases and purchase returns in day books and ledgers</li> <li>▪ Regular maintenance of payables ledger</li> <li>▪ Comparison of supplier statements with payables ledger balances on a regular basis</li> <li>▪ Reconciliation of payables ledger control account to total of payables ledger balances</li> <li>▪ Invoices properly allocated to general ledger accounts; invoices coded with expenditure codes, signed off by responsible company official</li> </ul>

All credit notes that are received are recorded in the general and payables ledgers.	<ul style="list-style-type: none"> <li>▪ Comparison of supplier statements with payables ledger balances</li> </ul>
All entries in the payables ledger are made to the correct payables ledger accounts.	<ul style="list-style-type: none"> <li>▪ Comparison of supplier statements with payables ledger balances</li> <li>▪ Regular maintenance of payables ledger</li> </ul>
Cut-off is applied correctly to the payables ledger.	<ul style="list-style-type: none"> <li>▪ Cut-off accrual of unmatched goods received notes at year end</li> </ul>

### Tests of controls

A most important test of controls is for auditors to confirm that all purchases have been authorised. The officials who approve the invoices should be operating within laid-down authority limits. Procedures however would typically include the following.

Observe the processing of purchase orders throughout the purchasing cycle and evaluate whether proper segregation of duties is operating. Examine application controls for re-order levels. Verify that authorised supplier lists exist and have been communicated. Obtain evidence of regular management reviews of supplier terms. Examine a sample of purchase orders for evidence that they have been authorised. Observe procedures for receipt of goods to verify that the goods actually received are matched to the purchase order. Review entity's procedures for accounting for pre-numbered documents and inspect a sample of goods received notes for evidence of sequential numbering. Review a sample of goods received notes for evidence of matching to purchase orders. Examine supporting documentation for evidence that purchase invoices are matched to goods received notes and orders. Review a sample of purchase invoices for evidence that their accuracy has been verified (e.g. signature or initials) and re-perform the procedures. Review evidence of approval of invoice coding to relevant expenditure account by responsible staff member. Test application controls relating to the input of purchase invoices and credit notes. For example, perform a batch reconciliation to determine whether purchase invoices have been entered accurately and a sequence check to determine whether all credit notes have been recorded. Review procedures for reconciling supplier statements to payables ledger accounts and re-perform a sample of reconciliations. Review reconciliations of the payables ledger accounts and payables ledger control account. Re-perform a sample of reconciliations of the

payables ledger accounts and the payables ledger to ensure that they have been performed accurately.

### 3. The payroll system

#### Control objectives and Control activities

Control objectives	Control activities
Employees are only paid for work that they have done.	<ul style="list-style-type: none"> <li>▪ Staffing and segregation of duties</li> <li>▪ Authorization for engagement and discharge of employees (new staff are correctly added to the payroll system, and leavers are removed)</li> <li>▪ Recording of hours worked by timesheets, clocking in and out arrangements</li> <li>▪ Review of hours worked</li> <li>▪ Salary and hourly payroll reports are reviewed and approved for payment by management</li> </ul>
Gross pay has been calculated correctly and authorized.	<ul style="list-style-type: none"> <li>▪ Maintenance of personnel records and regular comparison of wages and salaries to details in personnel records</li> <li>▪ Authorization for:               <ul style="list-style-type: none"> <li>– Changes in pay rates</li> <li>– Overtime</li> <li>– Non-statutory deductions (for example pension contributions)</li> <li>– Advances of pay</li> </ul> </li> <li>▪ Recording of changes in personnel and pay rates</li> <li>▪ Recording of hours worked by timesheets, clocking in and out arrangements</li> <li>▪ Review of hours worked</li> <li>▪ Recording of advances of pay</li> <li>▪ Holiday pay arrangements</li> <li>▪ Review of wages against budget</li> </ul>
Gross and net pay and deductions are accurately recorded on the payroll.	<ul style="list-style-type: none"> <li>▪ Bases for compilation of payroll</li> <li>▪ Preparation, review and approval of payroll</li> </ul>

Wages and salaries paid are recorded correctly in the bank and cash records.	<ul style="list-style-type: none"> <li>▪ Bases for compilation of payroll</li> <li>▪ Preparation, review and approval of payroll</li> </ul>
Wages and salaries are correctly recorded in the general ledger.	<ul style="list-style-type: none"> <li>▪ Preparation, review and approval of payroll</li> <li>▪ Review of wages against budget</li> </ul>
The correct employees are paid.	<ul style="list-style-type: none"> <li>▪ Segregation of duties</li> <li>▪ Authorization of wage cheque</li> <li>▪ Verification of identity</li> <li>▪ Recording of distribution; employees sign for cash wages received</li> <li>▪ Preparation and signing of cheques and bank transfer lists</li> <li>▪ Comparison of cheques and bank transfer list with payroll</li> <li>▪ Maintenance and reconciliation of wages and salaries bank account</li> </ul>
Wages and salaries are only paid to valid employees.	<ul style="list-style-type: none"> <li>▪ Payroll master file is periodically reviewed for accuracy (e.g. to confirm leavers have been removed)</li> <li>▪ Preparation and signing of cheques and bank transfer lists</li> <li>▪ Maintenance and reconciliation of wages and salaries bank account</li> </ul>
Statutory and non-statutory deductions have been calculated correctly and are authorized.	<ul style="list-style-type: none"> <li>▪ Maintenance of separate employees' records, with which pay lists may be compared as necessary</li> <li>▪ Reconciliation of total pay and deductions between one pay day and the next</li> <li>▪ Payroll deductions table data is periodically reviewed by management for accuracy and compliance with current taxation rates</li> <li>▪ Comparison of actual pay totals with budget estimates or standard costs and the investigation of variances</li> </ul>

The correct amounts are paid to the taxation authorities.

- Comparison of actual pay totals with budget estimates or standard costs and the investigation of variances
- Agreement of gross earnings and total tax deducted with the returns submitted to the taxation authorities

## Tests of controls

The precise nature of the tests of controls performed by the auditor would depend on the specific control activities operated by the entity. However, they would typically include the following:

Review payroll and HR job descriptions and company policies on the payroll process, to evaluate whether proper segregation of duties is in place. Review a sample of starters and leavers in the year and verify that the correct documentation is in place e.g. personnel files. Review the entity's procedures for reporting changes (e.g. wage increases) to the payroll department. Obtain evidence of authorisation of standing data in payroll system. Review and test authorisation procedures for hiring staff, wage rates, overtime etc. Observe employees' use of clocking-in procedures. Inspect a sample of clock-cards/timesheets for evidence of approval by the appropriate level of management. Review documentary evidence that a sample of payroll calculations have been independently re-performed by entity staff e.g. review of spreadsheet printout. Test operation of computerised controls e.g. range checks. Inspect documentary evidence of management's review of agreement of gross earnings and total tax deducted to taxation returns. Examine paid cheques or a certified copy of the bank list for evidence of proper authorisation. Where wages are paid in cash attend the pay-out and observe procedures. Review payroll budgeting procedures adopted by the client. Review reconciliation of the payroll master file to the wages and salaries account in the general ledger. Review procedures for classifying payroll costs to ensure that costs are not incorrectly capitalised.

## 4. The inventory system

### Control objectives and Control activities

Control objectives	Control activities
All inventory movements are authorized and recorded.	<ul style="list-style-type: none"><li>▪ Segregation of duties; custody and recording of inventories</li><li>▪ Receipt, review and recording of goods inwards (all deliveries of goods from suppliers should pass through a goods inwards section to the stores, and be recorded and confirmed as received)</li><li>▪ Issues of inventory supported by appropriate documentation</li><li>▪ Issues of inventory should only be made on basis of properly authorized requisitions</li><li>▪ Maintenance of inventory records</li></ul>
Inventory records only include items that belong to the entity.	<ul style="list-style-type: none"><li>▪ Receipt, review and recording of goods inwards (all deliveries of goods from suppliers should pass through a goods inwards section to the stores, and be recorded and confirmed as received)</li><li>▪ Procedures in place to include inventory held at third parties and to exclude inventory held on consignment for third parties</li><li>▪ Inventories received should be compared to purchase orders to confirm ownership</li></ul>
Inventory records include inventory that exists and is held by the entity.	<ul style="list-style-type: none"><li>▪ Segregation of duties; custody and recording of inventories</li><li>▪ Receipt, review and recording of goods inwards (all deliveries of goods from suppliers should pass through a goods inwards section to the stores, and be recorded and confirmed as received)</li><li>▪ Maintenance of inventory record</li><li>▪ Physical safeguards in place to ensure inventory is not stolen</li><li>▪ Inventory counted regularly</li></ul>



Inventory quantities have been recorded correctly.	<ul style="list-style-type: none"> <li>▪ Segregation of duties; custody and recording of inventories</li> <li>▪ Receipt, review and recording of goods inwards</li> <li>▪ Inventory issues supported by appropriate documentation</li> <li>▪ Maintenance of inventory record</li> <li>▪ Reconciliations of accounting record with physical inventory levels (inventory counts)</li> </ul>
Cut-off procedures are properly applied to inventory.	<ul style="list-style-type: none"> <li>▪ All dispatch documents processed daily to record the dispatch of finished goods</li> <li>▪ All goods inwards reports processed daily to record the receipt of inventory</li> <li>▪ Reconciliation of inventory counts to book record and control accounts</li> </ul>
Inventory is safeguarded against loss, pilferage or damage.	<ul style="list-style-type: none"> <li>▪ Precautions against theft, misuse and deterioration</li> <li>▪ Security over inventory held by third parties, and third party inventory held by entity</li> <li>▪ Inventory counts</li> </ul>
The costing system values inventory correctly.	<ul style="list-style-type: none"> <li>▪ Computation of inventory valuation</li> <li>▪ Review of condition of inventory</li> </ul>
Allowance is made for slow-moving, obsolete or damaged inventory.	<ul style="list-style-type: none"> <li>▪ Computation of inventory valuation</li> <li>▪ Inventory managers regularly review condition of inventory</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Control of inventory levels</li> <li>▪ Arrangements for dealing with returnable containers</li> </ul>

### Tests of controls

To confirm this, tests must be carried out on how inventory movements are recorded and how inventory is secured.

Select a sample of inventory movement's records and re-perform matching to goods received and goods despatched notes. Confirm that movements have been authorised as appropriate. Select a sample of goods received and goods despatched notes and agree to inventory movement records. Re-perform a sample of reconciliations of inventory records with the general ledger to confirm

that they are performed and reviewed. Examine evidence of sequence of inventory records. If the company uses perpetual inventory counting (i.e. it counts inventory on a regular basis throughout the year, rather than at the year-end alone). Observe security arrangements for inventories. Consider environment in which inventories are held. Review procedures for counting inventory and attend the count.

## 5. Non-current assets

### Control objectives and Control activities

Control objectives	Control activities
Non-current assets are properly accounted for and recorded.	<ul style="list-style-type: none"> <li>▪ Segregation of duties; authorization, custody and recording of assets</li> <li>▪ Maintenance of appropriate accounting record (including distinction between capital and revenue expenditure)</li> <li>▪ Maintenance of non-current asset register</li> </ul>
Security arrangements over non-current assets are sufficient.	<ul style="list-style-type: none"> <li>▪ Maintenance of non-current asset register</li> <li>▪ Physical inspection of non-current assets</li> <li>▪ Precautions against theft or misuse Physical safeguards in place to ensure assets are not stolen or damaged Where necessary, access is restricted to authorized personnel only</li> <li>▪ Portable assets (e.g. laptops) should be tagged and movements in and out of the entity's premises recorded</li> </ul>
Non-current assets are maintained properly.	<ul style="list-style-type: none"> <li>▪ Physical inspection of non-current assets</li> <li>▪ Precautions against theft or misuse</li> <li>▪ Assets should be regularly inspected and maintained</li> </ul>
Non-current asset acquisitions are authorized.	<ul style="list-style-type: none"> <li>▪ Authorization of capital expenditure</li> <li>▪ Annual capital expenditure budgets should be approved by the board</li> </ul>
Non-current asset disposals are authorized and proceeds of disposals are accounted for.	<ul style="list-style-type: none"> <li>▪ Authorization of sales, scrapping or transfer of non-current assets</li> <li>▪ Proceeds from disposal recorded, and related to disposal</li> </ul>

Depreciation rates are reasonable.	<ul style="list-style-type: none"> <li>▪ Authorization of depreciation rates</li> <li>▪ Calculation and confirmation of depreciation rates</li> </ul>
All income from income yielding non-current assets is collected.	<ul style="list-style-type: none"> <li>▪ Identification of income-producing assets</li> </ul>

### Tests of controls

A key concern of auditors will be proper controls over movements (acquisitions and disposals) during the year.

Confirm maintenance of a non-current asset register. Review annual capital budgets produced by the board and confirm that they are authorised. For a sample of acquisitions and disposals recorded in the non-current asset register confirm authorisation (and board approval if necessary). Inspect invoices to confirm that they have been appropriately approved. Review reconciliations of the non-current assets register to the general ledger accounts and confirm that discrepancies are followed up. Re-perform a sample of reconciliations. Verify that depreciation rates are authorised and are in line with company policy. Review evidence of arithmetical accuracy of depreciation and re-perform a sample of calculations. Review evidence of calculations of profits or losses on disposal and re-perform a sample of calculations. Review adequacy of physical security measures.

## 11.6. Non-current liabilities

Control objectives	Control activities
Non-current liabilities have been properly accounted for and recorded.	<ul style="list-style-type: none"> <li>▪ <b>Maintenance of appropriate accounting record</b> (including distinction between current and non-current liabilities)</li> <li>▪ <b>Statements</b> from loan or lease providers should be reconciled with the relevant ledger accounts on a regular basis</li> </ul>
Non-current liabilities are authorized.	<ul style="list-style-type: none"> <li>▪ Authorization of new loans, mortgages etc. should be submitted to the <b>board for approval</b></li> </ul>
Interest charges are reasonable.	<ul style="list-style-type: none"> <li>▪ The calculation of interest charges should be checked for accuracy</li> </ul>

## Management information

The management information system is an important aspect of the control environment, since timely and accurate information helps management supervise operations. There should be controls in place to ensure budgets are regularly set, and reports and information are provided on time to the specified degree of accuracy and detail.

As well as the control aspects, auditors will be concerned with the management information system's ability to provide useful data for analytical procedures.

As well as testing based on individual components of the accounting system, the auditor will also perform some general tests, including the following.

- **Test postings** from books of prime entry to the general ledger.
- **Confirm** that the general ledger is regularly balanced.
- **Test vouch** a sample of journal entries to original documentation.

## 11.7. Additional information for teachers

A significant number of auditor suggested substantive procedures such as 'recalculating gross and net pay calculations', rather than a test of control which might be to 'review evidence of the recalculation of payroll'. Auditor need to review their understanding of these different types of audit procedures and ensure that they appreciate that substantive tests focus on the number within the financial statements whereas test of controls are verifying if client procedures are operating. A substantive procedure provides evidence regarding an assertion, whilst a test of control provides evidence regarding the effectiveness of controls operated by the entity.

## 11.8. End unit assessment

### Answers to end unit assessment activities

1. A company can ensure goods ordered do not exceed requirements by setting re-order quantities and re-order limits.
2. Invoices from suppliers should be reviewed for correctness of prices and quantities and accuracy of calculation. They should be compared with purchase orders and goods received notes.
3. C Assets being sold at a profit suggests an error may have been made in depreciation (as value of asset is supposed to be written down over its useful life to the company).

4.

#### a) Inherent risk

##### **Reasons for high inherent risk associated with Mpundu Ltd.'s inventory**

###### **Finished goods warehouse**

The warehouse is located five miles away from the factory.

This increases the risk of there being goods not included in the count because they are in transit or loaded onto a lorry and forgotten about.

###### **Work-in-progress**

The company has work-in-progress.

This can be difficult to value correctly, as the value often depends on judgmental issues, such as degree of completion or apportionment of overheads.

###### **Inventory held at retail stores**

There is a significant amount of inventory maintained at various third party premises, which may be spread around the country.

The inventory at the retailers may come from various sources and they may not give an accurate return of the inventory that belongs to Mpundu Ltd.

This also increases the risk that inventory will not be included in the count.

### Three-month returns

There is a policy that unsold inventory is returned to Mpundu Ltd after three months when the price is then heavily discounted.

This has two risks attached to it. The first is that goods will be in transit on the date of the count and will therefore not be included. The second is that the valuation may become complex if the discounted price drops below cost, as inventory must be valued at the lower of cost and NRV.

#### b) Tasks to undertake at the inventory count

- Assess whether the staff are following inventory count instructions by attending count and observing how it is carried out in order to assess the inventory count's reliability as a source of evidence.
- Perform test counts, matching from the records to the physical inventory and vice versa to determine the accuracy of the counts being performed.
- Observe whether procedures for identifying damaged or obsolete inventory are working properly.
- Ask management how inventory held at third parties is accounted for and confirm that there are returns from all retail outlets to ensure that all inventory owned is included.
- Observe whether there are appropriate controls in place over the movement of inventory during the inventory count, and make note of details of last goods in and out. This is to ensure that cut-off is appropriate.
- Conclude whether the inventory count has been carried out properly and is reliable.

## 11.9. Additional activities(Questions and answers)

### 11.9.1. Remedial activities (Questions and answers)

#### Questions:

1. What are the key elements in authorization of credit terms to customers?
2. What procedures should auditors carry out on credit notes received?
3. If the client has a system of perpetual or continuous inventory counts, what are the most important features this system should have?



## Answers:

1. References and credit checks should be obtained before customers are given credit. Credit limits should be authorized by senior staff and should be regularly reviewed.
2. Auditors should:
  - Verify the correctness of credit notes with previous correspondence.
  - Confirm by reviewing inventory records and records of returns that goods have been returned.
  - Assess whether credit notes have been correctly accounted for by reconciling entries in the purchase day book and purchase ledger.
3.
  - a) The inventory counts should be carried out regularly.
  - b) All inventory should be counted at least once a year.
  - c) Counts should be carried out by staff independent of the inventory/ stores function.
  - d) The results of the inventory counts should be properly recorded, and take account of goods in transit.
  - e) The results of the inventory counts should be reconciled to book inventory records.
  - f) Records should be updated immediately for discrepancies noted.

### **11.9.2. Consolidation activities**

## Questions:

1. What are the most important authorization controls over amounts to be paid to employees?
2. To ensure that goods and services are only supplied to customers with good credit ratings'. This statement describes a:
  - A. Risk
  - B. Control objective
  - C. Control activity
  - D. Test of controls

## Answers:

1. The most important authorization controls over wages and salaries are controls over:
  - A. Engagement and discharge of employees
  - B. Changes in pay rates
  - C. Overtime
  - D. Non-statutory deductions
  - E. Advances of pay
2. B Confirming the credit ratings of potential customers is a control. The objective of this control is to ensure that goods and services are only provided to customers with good credit ratings.

### **11.9.3. Extended activities**

#### **Questions:**

1. Nzubaka Ltd is a construction company (building houses, offices and hotels) employing a large number of workers on various construction sites. The internal audit department of Nzubaka Ltd is currently reviewing cash wages systems within the company.

The following information is available concerning the wages systems:

- Hours worked are recorded using a clocking in/out system. On arriving for work and at the end of each day's work, each worker enters their unique employee number on a keypad.
- Workers on each site are controlled by a foreman. The foreman has a record of all employee numbers and can issue temporary numbers for new employees.
- Any overtime is calculated by the computerised wages system and added to the standard pay.
- The two staff in the wages department make amendments to the computerised wages system in respect of employee holidays, illness, as well as setting up and maintaining all employee records.
- The computerised wages system calculates deductions from gross pay, such as employee taxes, and net pay. Finally, a list of net cash payments for each employee is produced.
- Cash is delivered to the wages office by secure courier.
- The two staff place cash into wages packets for each employee along with a handwritten note of gross pay, deductions and net pay. The packets are given to the foreman for distribution to the individual employees.

## Required

- I. Identify and explain four deficiencies in Nzubaka Ltd's system of internal control over the wages system that could lead to misstatements in the financial statements.
- II. For each deficiency, suggest an internal control to overcome that deficiency.

## Answers:

1. You need to identify the control deficiencies and suggest controls to overcome them. The best way to present your answer is in a columnar format because this allows you to link each deficiency with a recommendation. Make sure you explain the deficiencies you have identified fully, as required by the question. Go through the scenario carefully, noting down potential deficiencies as you do so. Six deficiencies are listed below for your reference, but only four are required.

### Wages system – deficiencies and recommended controls

Deficiency	Internal control recommendation
The foreman is in a position to set up fictitious employees onto the wages system as he has authority to issue temporary employee numbers. This would allow him to collect cash wages for such bogus employees.	The issue of new employee numbers should be authorized by a manager and supported by employee contract letters etc.
The two wages clerks are responsible for the set up and maintenance of all employee records. They could therefore, in collusion, set up bogus employees and collect cash wages from them.	The list of personnel should be matched with the payroll by a manager and all new employee records should be authorized before being set up on the system.
The wages clerks are responsible for making amendments to holidays and illness etc. They could make unauthorized amendments which affect individual staff members' pay.	Any amendments to standing data on the wages system should be done by an authorized manager so that unauthorized amendments are not made. A log of amendments should be regularly reviewed.

<p>The computer system calculates gross pay and any deductions but these are hand-written by the wages clerks for the staff pay packets, so errors could be made and incorrect wages issued.</p>	<p>A pay-in slip should be generated by the computer system and included in the wage packet to reduce the chance of errors in deductions and gross pay being made.</p>
<p>The computer automatically calculates gross pay and deductions, however there is no procedure to ensure the calculations are accurate.</p>	<p>One of the wages clerks should verify the gross pay and deductions for a sample of employees to gain assurance that the computer is calculating amounts correctly.</p>
<p>The foreman distributes cash wages to the employees. He could therefore misappropriate any wages not claimed.</p>	<p>The distribution of wages should be overseen by another manager. Any unclaimed wages should be noted on a form and returned to the wages department.</p>

# UNIT 12

## PROCEDURES IN AUDIT OF FINANCIAL STATEMENTS

### 12.1. Key unit competence

To be able to demonstrate working knowledge in respect of performance of audit procedures

### 12.2. Prerequisite (knowledge, skills, attitudes and values)

Learners were introduced in senior 4 in the course of financial accounting unit 10 about the preparation of the financial statements of a sole trader, also in senior 6 in the course of auditing in unit 1 and 8, learners covered key concepts in auditing and evidence gathering respectively. Therefore, the learners are with prior knowledge, skills, attitudes and values that will help them to easily understand and perform the audit procedures in auditing of the financial statements.

### 12.3. Cross-cutting issues to be addressed:

**Environment and sustainability:** Environment is one of the factors in every human activity. Students should also be taught about environment concerns in relation to their work related activities. Should be unlighted on environmental concerns especially in use of papers and how best can reduce the use of papers in printing working papers and audit report during when they are in their professional practice/work. This is in the framework of maintaining the world green by reducing the number of trees used in making papers and related materials for human use.

**Gender education:** teachers should always consider to have gender balance in their teaching practices. Both male and female students should accord those equal opportunities while responding to questions raised and other tasks organized in class environment and outside class environment. This will enable both female and male students to acquire the expected skills and knowledge thus contributing to the development of the country.

**Inclusive education:** in addition to all having equal opportunities to students. The learners with disabilities should be facilitated to equally learn like their colleagues. The teacher should monitor his or her students well, for students with disabilities and similar tendencies should be also given support and ensure that they are able to learn well. Therefore, teachers should plan the reasons accordingly and ensure that students with such disabilities are catered for.

**Peace and Values:** the teacher should emphasis the relevant of peace and values in an individual's life. Students should be unlighted on the purpose of creating peaceful environment, its advantages and disadvantages. Students should also be shared of purpose of respecting cultural values. The teachers should endeavour to point out the relevance of peace and cultural values in relation to the profession of auditing and accounting.

**Standardization culture:** the students should be shared on importance of performing substantive audit procedures. Students should also be shared on the purpose of collecting audit evidences. The teacher should focus more on the relevance and reliability of audit evidences.

## 12.4. Guidance on introductory

Students should be helped to pass through the case and ensure that they are able interpret it. The teacher should ask questions to inspire and attract the attention of the students. The teacher should listen carefully the students' responses and thereafter link the students' responses to lesson going to be taught.

The teacher creates a conducive environment in the class where every students is free to respond and accord attention to subject matter.

You can support students' answers by referring to possible answers to the introductory activity below:

### Possible answers for introductory activity (case study)

**Note:** These responses may be shared or not with the students. They are specifically meant to guide him while listening to students' responses.

1. Purposes of audit are the following:

- To ascertain whether the financial statements are prepared in all material respect and free from material misstatement due to errors and frauds
- To review/ carry out an assessment on the internal control.
- To issue the audit report on financial statements and on internal controls (Management letter).



2. The elements to audit are the following:

- Financial statements of the company.
- Preparation of financial statements in all material respect and free from material misstatement due to errors and frauds
- Assessment on internal control

## 12.5. List of lessons/sub-heading

Headings	Lesson title/sub-heading		Learning objectives	Number of periods
12.1. Substantive procedures	Introductory activity		Arouse the curiosity of students on the content of unit 12	1
	1	The nature of substantive procedures	Explain the nature of substantive procedures	1
	2	Financial statement assertions	Explain the financial statement assertions	1
	3	Methods of obtaining audit evidence	Explain the methods of obtaining audit evidence	1
12.2. Analytical procedures	1	Using analytical procedures	Explain the using analytical procedures	1
	2	The nature of analytical procedures	Explain the nature of analytical procedures	1
	3	Analytical procedures in substantive testing	Develop the analytical procedures in substantive testing	1
	4	Investigation of fluctuations and relationships	Explain investigation about unexpected variation	1

12.3. Audit procedures for some elements of financial statements	1	Inventory	Explain audit procedures for inventory	1
	2	Non- current assets	Explain audit procedures for non-current assets	1
	3	Account receivable, Cash and bank balances	Explain audit procedures for account receivable, cash and bank balances	1
	4	Liabilities	Explain audit procedures for Liabilities	1
	5	Expenses and Revenues	Explain audit procedures for expenses and revenues	1
<b>End Unit Assessment</b>				<b>1</b>
<b>Total number of periods</b>				<b>14</b>

## Lesson 1: Substantive procedures

### a) Learning objective

To the learners will be able to explain the the nature of substantive audit procedures, audit assertions and the different methods of collecting audit evidences.

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Reference text books, Students text book, internet, case studies, Marker, Black Board, Chalk and any other trustworthy and reliable resources to enhance learning.

### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

Students should be briefed on previous unit where the students covered test of controls. The teacher should emphasis more on tests of controls and how they are performed. Therefore, after, students should be introduced to other tests that can be performed by auditor other than test controls. Here, the teacher should proceed with the lessons in this unit.

### **d) Learning activities**

- Put students in small groups and give clear instruction about the activity
- Ask them to interpret the picture in students' book and answer the questions provided in the activity
- Guide students' make sure that everyone is participating
- Invites students to present to their answers
- Give them the appropriate answers to the question asked.

### **Answers to learning activity 12.1**

1. He is performing /doing substantive audit/audit procedures/tests in details.
2. His main role/task is to collect/gather audit evidences
3. He is using the following materials: papers, files, and the pen..

### **e) Application activity 12.1.**

Students will be put in small groups

- Each group will be given an exercise to perform
- Students will be monitored and supervised by the teacher to ensure their active participative in performing the exercises
- Each group will be requested to present the work done
- Each student will give opportunity to present the piece of work done
- The teacher will give feedback to each individual group on work done
- Including response to concerns raised by the students.

## Answers to application activity 12.1

### Question 1

- To give reasonable assurances on a company's financial statements.
- To provide an independent opinion of the financial statements.
- To provide the assurance to users of the financial statements.
- An audit is the examination of the financial report of an entity.

### Question 2

**The following are the auditable elements of financial statements:**

- Expenses
- Revenues
- Gain
- Losses
- Assets
- Investments
- Liabilities
- Equity
- Distribution to owners(dividends)

## Lesson 2: Analytical procedures

### a) Learning objective

To explain the nature of analytical substantive audit procedures, and perform an investigation about unexpected variation. Develop the analytical procedures in substantive testing

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Reference text books, Students text book, internet, case studies, Marker, Black Board, Chalk and calculator and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson one, students learnt about the nature of substantive procedures and how audit evidences are collected. The teachers will introduce the lesson to students by referring them to previous substantive procedures covered. This will help students to easily understand substantive analytical procedures.

## d) Learning activities 12.2

### Activity 12.2

- Put students in small groups and give clear instruction about the activity
- Ask them to interpret the picture in students' book and answer the questions provided in the activity
- Guide students' make sure that everyone is participating
- Invites students to present to their answers
- Give them the appropriate answers to the question asked.

### Answers to learning activity 12.2

1. The material shown on the picture above are: a computer, calculators, piece of papers, pen and note books
2. Their purposes are to be used in collecting more reliable audit evidences.

## e) Application activity 12.2

- Students will be put in small groups
- Each group will be given an exercise to perform
- Students will be monitored and supervised by the teacher to ensure their active participative in performing the exercises
- Each group will be requested to present the work done
- Each student will give opportunity to present the piece of work done
- The teacher will give feedback to each individual group on work done
- Including response to concerns raised by the students.

### Answers to application activity 12.2

The following are some of the tasks/audit procedures that should performed;

- Obtain the payrolls for twelve months for the period under audit, and check whether similar number of staff has been consistently at BC Ltd Company the year accounting period.
- Perform the analytical review by establishing the expected amount and agree with reported amount included in the financial statements

Staff category	Number of staff per category(A)	Monthly pay in FRW ( B)	Total monthly pay in FRW per category C=( A*B)
Ordinary staff( officers)	275	650,000	178,750,000
Middle managers	30	1,450,000	43,500,000
Senior manager	15	3,000,000	5,000,000
Total pay for all staff per month(A)			<b>267,250,000</b>
Salary for all 12 months ( B)= (A*12)			<b>3,207,000,000</b>
Amount disclosed in the financial statements( C)			<b>3,100,000,000</b>
Difference observed D = (B-C)			<b>107,000,000</b>

- Seek explanations from the management of BC Ltd regarding the difference of **FRW 107,000,000 ( shown in the table below)**
- In case of disagreement, asses its materiality
- In case qualifies to be material, the issue will be reported.

### Lesson 3: Audit procedures for some elements of financial statements

#### a) Learning objective

To explain audit procedures( substantive procedures) for different elements of financial staments

#### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Reference text books, Students text book, internet, case studies, Marker, Black Board, Chalk and calculator and any other trustworthy and reliable resources to enhance learning.



### **c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)**

Students will be referenced to previous lessons learnt under unit 12. Students should be introduced to key elements covered in previous lessons learnt that related to the new to lesson. Some of the key elements that will be covered include the nature of substantive procedure, methods of collecting evidences and different assertions applied on certain financial statements.

### **d) Learning activities**

#### **Activity 12.3**

- Put students in small groups and give clear instruction about the activity
- Ask them to show the pictures in student book and answer the questions provided in the activity
- Guide students' discussion and make sure that everyone is participating
- Invites students to share their findings or answers.
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions.

#### **Answers to learning activity 12.3**

1. The person in picture is looking careful at the financial statements elements / information at the time of audit.
2. The tool represents any item that can be used during the analysis of the financial information.

### **e) Application activity 12.3**

- Students will be put in small groups
- Each group will be given an exercise to perform
- Students will be monitored and supervised by the teacher to ensure their active participative in performing the exercises
- Each group will be requested to present the work done
- Each student will give opportunity to present the piece of work done
- The teacher will give feedback to each individual group on work done
- Including response to concerns raised by the students.

### Answers to Application Activity 12.3

For each of the balances/class of transactions, the audit should perform some of the substantive audit procedures shown below:

- **Inventory of FRW 10,000,000**
  - i. Obtain a copy of the inventory listing and agree the totals to the general ledger.
  - ii. Cast the inventory listing to ensure it is mathematically correct.
  - iii. Vouch a sample of inventory items to suppliers' invoices to ensure it is correctly valued.
  - iv. Confirm that any inventory held at third-party locations is included in the year-end inventory figure by reviewing the inventory listing.
- **Property plant and Equipment(PPE) of FRW 50,000,000**
  - Compare non-current assets in the general ledger with the non-current assets register and obtain explanations for differences.
  - For a sample of assets which physically exist, check if they are recorded in the non-current asset register.
  - If a non-current asset register is not kept, obtain a schedule showing the original costs and present depreciated value of major non-current assets, ensure that the assets' value and their depreciation amounts were accurately determined.
  - Reconcile the schedule of non-current assets with the general ledger.
- **Receivables FRW 50,000 ,000**
  - i. Agree the balance from individual receivables ledger accounts to receivables' listing and vice versa.
  - ii. Match the total of the receivables' listing to the sales ledger control account
  - iii. Cast and cross cast the trial balance before selecting any samples to test.
  - iv. For sampled receivables balances, issue debtors circularization (request for confirmation)
- **Revenue FRW 100,000,000**
  - Compare the total revenue with that reported in previous years and the revenue budgeted, and investigate any significant fluctuations.

- For a sample of customer orders, trace the details to the related despatch notes and sales invoices and ensure there is a sale recorded in respect of each (to test the completeness of revenue).
- Select a sample of despatch notes in the month immediately before and month immediately after the year end. Trace these through to the related sales invoices and resultant accounting entries to ensure each sale was recorded in the appropriate period.
- Select a sample of credit notes issued after the year end and trace these through to the related sales invoices to ensure sales returns were recorded in the proper period.

## 12.6. Summary of the unit

The unit embarks on the following:

The unit covers mainly substantive audit procedures. Substantive audit procedure is the execution stage of the audit. At this stage of the audit the auditor has to design the appropriate tests/ audit procedures that would enable the auditor to detect any material misstate arising from errors or fraud. In this regard, the auditor performs both substantive audit procedures and analytical audit procedures.

Note that the analytical procedures used where the auditor can easily develop his expectation and conclude the audit of the amount or balances shown in the financial statements. In this case the audit, the auditor can opt to use analytical procedures to develop his expectation and reconcile with the amount shown in the financial statements under audit. The analytical can be applied mainly on audit of salaries and revenue.

During the audit, the auditor has to carry out the audit of different classes of transactions and balances disclosed in the financial statements. The financial statement elements required to be audited include assets, liabilities, expenses and revenue and their disclosures. Thus forming audit opinion on audited financial statements

During the course of the audit financial statements elements, the auditor has to ensure that the audit objectives are addressed by designing the appropriate audit procedures. It should be noted that the audit procedures are always a lined to the audit objectives and audit assertions.

The auditor has to design the audit procedures and ensure that the following audit assertions are verified/ checked.

### a) Income statement assertions

- **Occurrence:** The auditor to check whether the transactions recognized in the financial statements occurred.
- **Completeness:** the audit has to check whether all transactions should have recognized in financial statements have been recognized.
- **Accuracy:** The auditor should ensure that transactions have been accurately reflected in financial statements at the appropriate amounts.
- **Cut-off:** The auditor has to check whether the transactions have been recognized in the correct and relevant accounting time periods.
- **Classification:** The auditor has to check whether the transactions have classified properly and fairly presented in the financial statements.
- **Presentation:** The auditor has to ensure that the transactions are appropriately aggregated or disaggregated and are clearly described.

### b) Financial position statement assertions

- **Existence:** the auditor has to confirm the whether Assets, liabilities and equity interests exist disclosed in the financial statements exist.
- **Rights and obligations:** the auditor hat to confirm whether the entity controls the rights to assets, and liabilities are the obligations of the entity.
- **Completeness:** the auditor need to ensure whether all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- **Accuracy, valuation and allocation:** The auditor has to ensure that the assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded.
- **Classification:** the auditor has to ensure that the assets, liabilities and equity interests have been recorded in the proper accounts.
- **Presentation:** The auditor has also to ensure that the assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described.

The audit also covers different tests performed on some of financial statements elements indicated above.

It should however be noted that during performance of the substantive audit procedures (tests of detail) the auditor has to collect the audit evidences. Below are different methods of collecting audit evidences:

- **Inspection:** the auditor has to inspect documents/records and physical assets **Observation:** Here, the auditor has look at a process or procedure being performed by others.
- **External confirmation:** An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party.
- **Recalculation:** The auditor has to check the mathematical accuracy of documents or records.
- **Re-performance:** This involves the auditor's execution of procedures or controls.
- **Analytical procedures:** The auditor has to make evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

## 12.7. Addition information

The teacher should also able to explain more about on sufficiency and appropriateness of audit evidences and this should be done with ranking of the audit evidences.

The teacher may help students to design the appropriate substantive audit procedures for other financial statements' components not covered in students' text book.

## 12.8. End unit assessment

### Answers to end unit assessment activities

1. Substantive procedures (or substantive tests) are those activities/ tests performed by the auditor to detect any material misstatement due error or fraud.
2. Analytical procedures are used on information where the audit can establish his/her expectations and relate to recorded /disclosed information. Substantive procedures are used where the auditor cannot easily establish expectations on account balances or class of transactions.

Analytical procedures are more applicable to large volumes of transactions that tend to be more predictable over time and can be used at different stages of audit of audit process. Substantive audit procedures can be used only substantive stage of audit/ execution level.

3. In accordance with ISA 500, the auditor should collect audit the evidences through use of the methods shown below:

- Inspection.
- Observation.
- Inquiry.
- Re-performance.
- Recalculation.
- Analytical procedures.
- External confirmation.

4. The main purpose of audit evidence is to be used by the auditor in issuing his/her audit opinion in the audit report.

5. The key audit procedures on the following financial statements:

### **Cash and Bank balances**

The auditor should to perform the following substantive procedures on cash balances:

- Count all cash balances and agree to petty cash book or other record kept.
- Count all cash at same time and ensure all work is done in presence of staff.
- Obtain a certificate of cash in hand from staff member.
- Enquire about IOUs or cheques cashed.
- Confirm balances are in agreement with the accounts.
- In addition, check whether the IOUs and un-cashed cheques have subsequently been cleared timely.

The auditor should to perform the following substantive procedures on bank balances:

- Obtain standard bank confirmations from each bank with which the client conducted business during the audit period.
- Re-perform arithmetic of bank reconciliation.
- Trace cheques shown as outstanding from the bank reconciliation to the cash book prior to the year end and to the after-date bank statements and obtain explanations for any large or unusual items not cleared at the time of the audit.
- Compare cash book(s) and bank statements in detail for the last month of the year, and match items outstanding at the reconciliation date to bank statements.



- Review bank reconciliation previous to the year-end bank reconciliation and test whether all items are cleared in the last period or taken forward to the year-end bank reconciliation.
- Obtain satisfactory explanations for all items in the cash book for which there are no corresponding entries in the bank statement and vice versa by discussion with finance staff.
- Verify contra items appearing in the cash books or bank statements with original entry.
- Verify by inspecting paying-in slips that uncleared bankings are paid in prior to the year end.
- Examine all lodgements in respect of which payment has been refused by the bank; ensure that they are cleared on representation or that other appropriate steps have been taken to effect recovery of the amount due.
- Verify balances per the cash book according to the bank reconciliation by inspecting cash book, bank statements and general ledger.
- Verify the bank balances with reply to standard bank letter and with the bank statements.
- Inspect the cash book and bank statements before and after the year end for exceptional entries or transfers which have a material effect on the balance shown to be in-hand.
- Identify whether any accounts are secured on the assets of the company by discussion with management.
- Consider whether there is a legal right of set-off of overdrafts against positive bank balances.
- Determine whether the bank accounts are subject to any restrictions by enquiries with management.
- Review draft accounts to ensure that disclosures for bank are complete and accurate and in accordance with accounting standards.

### **Property Plant and Equipment (PPE)**

**Obtain or prepare a summary** of tangible non-current assets showing how the following reconcile with the **opening position**.

- Gross book value
- Accumulated depreciation
- Net book value
  - **Compare non-current assets** in the general ledger with **the non-current assets register** and **obtain explanations for differences**.

- For a sample of assets which physically exist, agree that they are **recorded** in the **non-current asset register**.
- If a non-current asset register is not kept, **obtain** a **schedule** showing the original costs and present depreciated value of major non-current assets. **Reconcile** the **schedule** of non-current assets with the **general ledger**.
- 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-year. Confirm that items inspected:
  - Exist
  - Are in use
  - Are in good condition
  - Have correct serial numbers/codes
- **Review records of income-yielding assets**.
- **Reconcile** opening and closing **vehicles** by numbers as well as amounts.
- **Reperform** calculation of revaluation surplus.
- Confirm whether valuations of all assets that have been revalued have been **updated regularly** (full valuation every five years and an interim valuation in year three generally) by asking the Finance Director and inspecting the previous financial statements.
- **Inspect** draft accounts to check that client has recognised revaluation losses in the statement of profit or loss unless there is a credit balance in respect of that asset in equity, in which case it should be debited to equity to cancel the credit. All revaluation gains should be credited to equity.
- **Review insurance policies** in force for all categories of tangible non-current assets and consider the adequacy of their insured values and check expiry dates.
  - **Review depreciation** rates applied in relation to:
    - Asset lives
    - Residual values
    - Replacement policy
    - Past experience of gains and losses on disposal
    - Consistency with prior years and accounting policy

- Possible obsolescence
  - **Review** non-current assets register to ensure that **depreciation** has been **charged on all assets** with a limited useful life.
  - **For revalued assets**, ensure that the charge for **depreciation** is based on the revalued amount by recalculating it for a sample of revalued assets.
  - **Reperform calculation** of depreciation rates to ensure it is correct.
  - **Compare ratios** of depreciation to non-current assets (by category) with:
    - Previous years
    - Depreciation policy rates
      - **Scrutinise** draft accounts to ensure that **depreciation policies** and rates are **disclosed** in the accounts.
      - **Verify title** to land and buildings by inspection of:
        - Title deeds
        - Land registry certificates
        - Leases
          - Obtain a certificate from solicitors/bankers:
- **Stating purpose** for which the deeds are being held (custody only)
- **Stating deeds** are **free** from **mortgage** or **lien**
  - **Inspect registration documents** for vehicles held, confirming that they are in client's name.
  - **Confirm** all vehicles are used for the **client's business**.
  - **Examine documents of title** for other assets (including purchase invoices, architects' certificates, contracts, hire purchase or lease agreements).
  - **Review for evidence** of charges in statutory books and by company search.
  - **Review leases** of leasehold properties to ensure that company has fulfilled covenants therein.
  - **Examine invoices received after year end, orders** and **minutes** for evidence of capital commitments.

These tests are to confirm **rights and obligations, valuation and completeness.**

- Verify additions by inspection of architects' certificates, solicitors' completion statements, suppliers' invoices etc.
- **Review** capitalisation of expenditure by examining for non-current assets additions and items in relevant expense categories (repairs, motor expenses, sundry expenses) to ensure that:
  - Capital/revenue distinction is correctly drawn
  - Capitalisation is in line with consistently applied company policy
    - **Inspect** non-current asset accounts for a sample of purchases to ensure they have been **properly allocated.**
    - Ensure that appropriate **claims** have been made for **grants**, and grants received and receivable have been received, by **inspecting** claims documentations and bank statements.
    - Verify that additions have been **recorded** by **scrutinising** the non-current asset register and general ledger.

These tests are to confirm the assertions of **valuation and completeness.**

- Verify **material** and **labour** costs and **overheads** to invoices, wage records etc.
- Ensure expenditure has been **analysed correctly** and **properly charged** to capital.
- Expenditure should be capitalised if it:
  - **Enhances** the **economic benefits** of the asset in excess of its previously assessed standard of performance
  - **Replaces or restores a component** of the asset that has been treated separately for depreciation purposes, and depreciated over its useful economic life
  - Relates to a **major inspection or overhaul** that restores the economic benefits of the asset that have been consumed by the entity, and have already been reflected in depreciation
    - **Review** costs to ensure that no profit element has been included.
    - **Review** accounts to ensure that **finance costs** have been capitalised or not **capitalised** on a consistent basis, and costs capitalised in period do not exceed total finance costs for period.

These tests are to confirm **rights** and **obligations, completeness, occurrence** and **accuracy**.

- **Verify disposals** with supporting documentation, checking transfer of title, sales price and dates of completion and payment.
- **Recalculate** profit or loss on disposal.
- **Consider** whether **proceeds** are **reasonable**.

If the asset was **used as security**, ensure **release from security** has been correctly made.

**Review** non-current asset disclosures in the financial statements to ensure they meet **IAS 16** criteria.

- For a sample of **fully depreciated assets**, inspect the register to ensure no further depreciation is charged.

## Revenue

The following are some of substantive audit procedures that should be executed the auditor during the audit of revenue;

- Compare the total revenue with that reported in previous years and the revenue budgeted, and investigate any significant fluctuations.
- For a sample of customer orders, trace the details to the related despatch notes and sales invoices and ensure there is a sale recorded in respect of each (to test the completeness of revenue).
- For a sample of sales invoices for larger customers, recalculate the discounts allowed to ensure that these are accurate.
- Select a sample of despatch notes in the month immediately before and month immediately after the year end. Trace these through to the related sales invoices and resultant accounting entries to ensure each sale was recorded in the appropriate period.
- Obtain an analysis of sales by major categories of toys manufactured and compare this to the prior year breakdown and discuss any unusual movements with management.
- Calculate the gross profit margin for the year and compare this to the previous year and expectations. Investigate any significant fluctuations.
- Recalculate the sales tax for a sample of invoices and ensure that the sales tax has been correctly applied to the sales invoice.

- Select a sample of credit notes issued after the year end and trace these through to the related sales invoices to ensure sales returns were recorded in the proper period.

## **Expense**

The following are some of the substantive procedures for expenses;

- For transactions sample, obtain their relevant supporting documents such as invoice, goods received note and payment advice note and perform the following procedures:
- Review the supporting documents and check whether the transactions occurred and relate to the entity
- Check whether all expenses were recorded in the books of accounts at the correct amounts by agreeing the recorded amounts with their relevant supporting documents such as invoices, goods delivered note and goods received note and invoice register, verify the accuracy of the amounts shown on the invoices by reconciling the invoices with goods received note and payment advice.
- Ensure that the transactions were recorded in the correct accounts following the entity's chart of accounts by agreeing the entries passed with the entity's chart of account
- Confirm whether the expenses relate to the correct period (accounting period) by comparing when services have been consumed/benefited (in accrual basis of accounting) and the period of accounting for the expenses.

## **12.9. Additional activities (Questions and answers)**

### ***12.9.1. Remedial Activities (Questions and answers)***

Highlight the three assertions you know.

- Accuracy
- Completeness
- Existence
- Cut off

What is the purpose of the audit assertions?

Assertions play a key role in determining what is true and fair when auditing financial records. They are also helpful in evidence gathering through verifying different financial/audit assertions.



Explain the different three methods of evidence gathering

International standards on auditing (ISA 500) provides different methods of evidences gathering. The following are three methods of evidences gathering:

**External confirmation:** Confirmation is a written request addressed to third parties. An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming Party).

**Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

**Analytical Procedures:** Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

Explain the different types of substantive audit procedures

**Analytical audit procedures:** Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

### **12.9.2. Consolidation activities**

1. Explain where analytical audit procedures are used in audit.

Analytical procedures are used throughout the audit process. They are used mainly in the following:

**Risk assessment:** to direct attention to higher risk areas in determining the nature, timing, and extent of audit procedures

**Substantive testing:** to obtain audit evidence of accuracy or to identify potential misstatements/errors as a substitute for tests of details

**Overall conclusion:** to assist in assessing the propriety of audit conclusions reached and in evaluating the overall opinion.

1. An auditor wishes to:
  - a. Test that the plant and equipment recorded in the financial statements of the client does actually exist
  - b. Confirm the accuracy of the figure for the directors' bonuses
  - c. Understand the nature of an unusual payment recorded in the cash book

**Required:**

State which one of the audit testing procedure would be most useful to the auditor in each of the above contexts?

**Answer:**

- a) (Physical) inspection. The best way of getting the evidence of non-current assets is to go and look at them.
- b) Recalculation. The figure for bonuses computed by the client can be checked by recalculating what they should be.
- c) Inquiry (of management) the auditor should ask management to explain the nature of the unusual item, and should expect a satisfactory answer which can be corroborated by other evidence.

**12.9.3. Extended activities****Question 1****Introduction**

YX Ltd assembles specialist motor vehicles such as Lorries, buses and trucks. The company owns four assembly plants to which parts are delivered and assembled into the motor vehicles.

The motor vehicles are assembled using a mix of robot and manual production lines. The 'human' workers normally work a standard eight-hour day, although this is supplemented by overtime on a regular basis as YX Ltd has a full order book. There is one shift per day; mass production and around the clock working are not possible due to the specialist nature of the motor vehicles being assembled.

**Wages system shift workers**

Shift-workers arrive for work at about 7.00 am and 'clock in' using an electronic identification card. The card is scanned by the time recording system and each production shift-worker's identification number is read from their card by the scanner. The worker is then logged in as being at work. Shift-workers are paid from the time of logging in. The logging in process is not monitored as it is assumed that shift-workers would not work without first logging in on the time recording system. Shift-workers are split into groups of about 25 employees, with each group under the supervision of a shift foreman. Each day, each group of shift-workers is allocated a specific vehicle to manufacture. At least 400 vehicles have to be manufactured each day by each work group.

If necessary, overtime is worked to complete the day's quota of vehicles. The shift

foreman is not required to monitor the extent of any overtime working although the foreman does ensure workers are not taking unnecessary or prolonged breaks which would automatically increase the amount of overtime worked. Shift-workers log off at the end of each shift by re-scanning their identification card.

### **Payment of wages**

Details of hours worked each week are sent electronically to the payroll department, where hours worked are allocated by the computerised wages system to each employee's wages records. Staff in the payroll department compare hours worked from the time recording system to the computerised wages system, and enter a code word to confirm the accuracy of transfer. The code word also acts as authorisation to calculate net wages. The code word is the name of a domestic cat belonging to the department head and is therefore generally known around the department.

Each week the computerised wages system calculates:

- i) Gross wages, using the standard rate and overtime rates per hour for each employee,
- ii) Statutory deductions from wages, and
- iii) Net pay.

The list of net pay for each employee is sent over XY's internal network to the accounts department. In the accounts department, an accounts clerk ensures that employee bank details are on file. The clerk then authorises and makes payment to those employees using XY's online banking systems. Every few weeks the financial accountant reviews the total amount of wages made to ensure that the management accounts are accurate.

### **Termination of employees**

Occasionally, employees leave Blake. When this happens, the personnel department sends an email to the payroll department detailing the employee's termination date and any unclaimed holiday pay. The receipt of the email by the payroll department is not monitored by the personnel department.

### **Salaries system shift managers**

All shift managers are paid an annual salary; there are no overtime payments.

Salaries were increased in July by 3% and an annual bonus of 5% of salary was paid in November.

## Required

- a) List FOUR control objectives of a wages system.
- b) As the external auditors of YX Ltd, write a management letter to the directors in respect of the shift workers wages recording and payment systems which:
  - i) Identifies and explains FOUR deficiencies in that system;
  - ii) Explains the possible effect of each deficiency;
  - iii) Provides a recommendation to alleviate each deficiency.
- d) List THREE substantive analytical procedures you should perform on the shift managers' salary system. For each procedure, state your expectation of the result of that procedure.
- e) Audit evidence can be obtained using various audit procedures, such as inspection. APART FROM THIS PROCEDURE, in respect of testing the accuracy of the time recording system at YX Ltd, explain FOUR procedures used in collecting audit evidence and discuss whether the auditor will benefit from using each procedure.

## Question 2:

Auditors must obtain sufficient appropriate audit evidence to issue an audit opinion on the financial statements. In order to gain that evidence, auditors may use a combination of tests of controls and substantive procedures.

### Required

- a) Explain what is meant by:
  - i. A test of control
  - ii. A substantive procedure and give one example of each that may be used when auditing the completeness of revenue

Your firm is the auditor of BKL Nurseries, a company operating three large garden centres which sell plants, shrubs and trees, garden furniture and gardening equipment (sprinklers) to the public.

### Non-current assets

You are involved in the audit of the company's non-current assets for the year ended 31 December 20X8. The main categories of non-current assets are as follows:

- i. Land and buildings (all of which are owned outright by the company, none of which are leased)
- ii. Computers (on which an integrated inventory control and sales system is operated)

- iii. A number of large and small motor vehicles, mostly used for the delivery of inventory to customers
- iv. Equipment for packaging and pricing products.

The depreciation rates used are as follows:

- v. Buildings 5% each year on cost
- vi. Computers and motor vehicles 20% each year on the reducing balance basis
- vii. Equipment 15% each year on cost

### **Year-end inventory**

Although an inventory control system is operated and up-to-date inventory records are maintained, the year-end inventory quantities that are used in determining the year-end inventory value are arrived at by carrying out full inventory counts at each of the garden centres. The same set of inventory count instructions are provided at each centre and an extract from these is shown below:

- 1) The inventory count will be supervised by the inventory controller for the site and will take place on 1 January 20X9. The count will commence at 6:00am. The centre will be closed on the day of the count. No sales of inventory will take place on 1 January 20X9, but transfer of inventory between garden centres is permitted in order to distribute it to where it will be needed most when the centres are re-opened.
- 2) Staff allocated to the count (one member of staff per count area) will be provided with inventory counting sheets that are produced by the computerised system showing the quantity per the system. These will be distributed and re-collected by the site inventory controller. Where the amount observed is different to the amount on the sheet, it should be crossed out and the new quantity written down.
- 3) The inventory controller will then carry out one test count in each area that has been counted. Where an error is found, the area will be re-counted.
- 4) The quantity for any inventory that looks damaged or unsaleable should be crossed out and allocated a quantity of zero.
- 5) Once all the sheets have been collected up and test counts completed, the inventory controller will manually update the computerised system to reflect the counted quantities. Once the system is updated the count sheets can be discarded.

## Required

- b) List and explain the main financial statements assertions tested for in the audit of non-current assets.
- c) List the sources of evidence available to you to verify the ownership and cost of the land and buildings.
- d) Describe the audit procedures you would perform to check the appropriateness of the depreciation rates on each of the three categories of non-current asset.
- e) Identify and explain seven (7) deficiencies in the inventory counting system highlighted by the extract from BKL's instructions for inventory counting. For each deficiency suggest how it could be overcome.

## Answers:

### Question 1.

- a)
  - To ensure that employees are only paid for work they have done
  - To ensure that pay and deductions have been calculated correctly and authorised
  - To ensure that recorded payroll expenses include all expenses incurred
  - To ensure that the correct employees are paid
  - To ensure that transactions are recorded in the correct period
  - To ensure that wages are correctly recorded in the ledger
  - To ensure that the correct amounts have been paid over to the taxation authorities
- b) Wages system management letter

DPK Certified Auditors

Kigali, Rwanda,

18 February 2020

To The Board of Directors

XY Ltd

Street 6 Kigali, Rwanda

Members of the board,

### Deficiencies in internal control

We set out in this letter deficiencies in the wages system which arose as a



result of our review of the accounting systems and procedures operated by your company during our recent audit. The matters dealt with in this letter came to our notice during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements.

<b>Deficiency</b>	<b>Consequence of deficiency</b>	<b>Recommendation</b>
Shift workers can log in and out just by using their electronic identification cards.	Workers can be paid even if they are not working because the time recording system logs them in and out when their cards are scanned and they are paid from and to this time.	The shift manager should agree the number of workers with the computer records at the start and end of the shift.
The shift manager should agree the number of workers with the computer records at the start and end of the shift.	Workers could be paid at overtime rates when they are not actually working and could collude with the shift foreman for extra overtime without actually working it.	All requests for overtime must be authorized by the shift manager. Overtime costs should also be monitored regularly.
The code word for the time recording system is generally known within the department.	Unauthorized individuals could log onto the system and enter extra hours so that they are paid more than they should be. Fictitious employees could also be set up on the system.	The code word should be changed immediately to one containing random letters and numbers. The system should be set up so that the code word has to be changed on a regular basis, such as every six weeks.

Payments into workers' bank accounts are made by one member of accounts staff, without any authorization.	unauthorized payments into workers' and fictitious bank accounts could be made.	The payroll should be authorized by the Finance Director or another senior manager prior to payments being made.
Review of wages payments is done every few weeks by the financial accountant, seemingly on an ad hoc basis.	There is no regular monitoring of wages by senior management.	The Finance Director should review payroll costs on a weekly basis so that he can assess whether they are reasonable and any unusual amounts can be investigated.

This letter has been produced for the sole use of your company. It must not be disclosed to a third party, or quoted or referred to, without our written consent. No responsibility is assumed by us to any other person. We should like to take this opportunity of thanking your staff for their co-operation and assistance during the course of our audit.

Yours faithfully

DPK Certified auditors

c) Substantive analytical procedures

- i. Perform a proof in total of the salaries charge for the year using the prior year charge and increasing it for the pay increase and taking account of any starters or leavers in the period. The figures should be comparable with the exception of the salary increase and any starters or leavers in the year.
- ii. Perform a comparison of the annual charge to the prior year and to the budgeted figure. Where the variance is significant, investigate further to ascertain why. The figures should be comparable with the exception of the salary increase of 3%.
- iii. Review monthly salaries month by month. The figures should be about the same each month, except for July and November when the pay rise and annual bonus were paid respectively. Any starters or leavers would also be reflected in the relevant month.

**d) Observation:** Observation consists of looking at a process or procedure being performed by others. It could be used here to observe employees scanning their cards when they start and finish a particular shift. However, its use is limited because it only provides evidence that the process happened at the time of observation. It should be used in conjunction with other audit procedures.

**Inquiry:** Inquiry consists of seeking information of knowledgeable individuals, both financial and non-financial, throughout the entity or outside the entity. This can be used to find out how the time recording system works by interviewing relevant staff so would be a good procedure to use.

**Recalculation:** Recalculation consists of checking the mathematical accuracy of documents or records. It could be used to calculate the hours worked according to the information on the time recording system.

**Reperformance:** Reperformance is the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, either manually or using computer-assisted audit techniques. The auditor could test the controls in place within the time recording system using CAATs.

**Analytical procedures:** Analytical procedures consist of evaluations of financial information by studying plausible relationships among both financial and non-financial data. They can be used in this case to compare the time recorded per the system to the standard hours per employee plus any overtime worked.

## Answers:

### Question 2

#### a) Procedures

##### i. Tests of controls

Tests of controls are performed to obtain audit evidence about the operating effectiveness of controls preventing, or detecting and correcting, material misstatements at the assertion level.

A test of control that may be carried out when auditing completeness of revenue is observing or verifying the process of matching of goods despatch notes (GDNs) to invoices. The auditor should also enquire how unmatched GDNs are investigated to ensure related sales are recorded where necessary.

## **ii. Substantive procedures**

Substantive procedures are audit procedures performed to detect material misstatements at the assertion level. They are generally of two types:

- Substantive analytical procedures
- Tests of detail of classes of transactions, account balances and disclosures

An example of a substantive procedure is comparing monthly revenue with prior years, budgets and expectations (e.g. for expected seasonal peaks) and investigating any significant deviations.

### **b) Financial statement assertions for non-current assets**

#### **Completeness**

The amounts stated in the statement of financial position for non-current assets must represent all non-current assets used in the operations of the entity. Significant omissions could have a material effect on the financial statements. Where an entity has lots of small capital items, recording and tracking these can be an issue so good controls are important.

#### **Existence**

Recorded assets must represent productive assets that are in use at the reporting date. Where assets have been disposed, they must not be included in the statement of financial position. Items that are susceptible to misappropriation can also present issues.

#### **Accuracy, valuation and allocation**

Non-current assets must be stated at cost or valuation less accumulated depreciation. Whether an entity has a policy or not of revaluing certain categories of its non-current assets can have a material effect on its financial statements. The depreciation policy in place must be suitable as this can also have a significant bearing on asset values on buildings and large items of plant and equipment.

#### **Rights and obligations**

This is a key assertion for non-current assets because the entity must own or have rights to all the recorded non-current assets at the reporting date. For example, where an asset is leased by the entity, it may not have substantially all the risks and rewards associated with ownership and therefore should not recognise the asset on its statement of financial position.

## Classification

Tangible assets should be recorded in the correct accounts, and expenses which are not of a capital nature are taken to profit or loss.

## Presentation

Non-current assets must be disclosed correctly in the financial statements. This applies to cost or valuation, depreciation policies and assets held under finance leases.

### c) Evidence available

Asset	Ownership	cost
Land and Buildings	<p>Title deeds. These may be held at the bank or the client's solicitors.</p> <p>It may be possible to obtain confirmation of ownership from the central land registry office.</p> <p>The insurance policy should be reviewed to see whom the cover is in favor of.</p>	<p>The cost of the land and building can be traced to original invoices.</p> <p>The company may also have retained the original completion documents from the solicitor on the purchase of the land.</p>

### d) Procedures for depreciation

The purpose of depreciation is to write off the cost of the asset over the period of its useful economic life

#### i. Buildings

To assess the appropriateness of the depreciation rate of 5%, the auditor should:

- Consider the physical condition of the building and whether the remaining useful life assumption is
- Review the minutes of board meetings to ensure there are no relocation plans
- Consider the budgets and ensure that they account for the appropriate amount of depreciation. If they do not, they may give an indication of management's future plans.

## ii. Computers and motor vehicles

The reducing balance basis seems reasonable, given that computers and their software are updated frequently and therefore do wear faster early on in life, however the auditor should consider whether 20% is an appropriate rate given the speed at which technology develops.

The auditor should enquire and observe whether the assets are still in use. The auditor should review the board minutes to ascertain whether there are any plans to upgrade the system.

The auditor should estimate the average age of the motor vehicles according to their registration plates and consider whether the life is reasonable in light of average age and recent purchases. Given that a number of vehicles are delivery vehicles and likely to heavily used, the auditor should look at recent profits and losses on disposals to see if large losses on disposal give an indication the 20% rate might be too low.

The auditor should ask management what the replacement policy of the assets is.

## iii. Equipment

The equipment is depreciated at 15% per year, or over 6–7 years. The auditor should consider whether this is reasonable for all the categories of equipment, or whether there are some assets for which the technology advances more quickly than others. Such assets may require a higher rate of depreciation.

e)

Deficiency and explanation	Possible solution
There is a lack of segregation of duties. The site inventory controller is also the supervisor and count checker. The controller is therefore responsible for the physical assets as well as maintaining the book records. The site inventory controller is a position to cover up his or her own errors or theft of inventory.	An alternative senior member of staff should be made the inventory supervisor. Alternatively, inventory controllers could be rotated so they supervise the count of the garden Centre they are not responsible for.
Transfer of inventory is permitted between centers, increasing the risk of double counting inventory. Also inventory may not be counted at it all if it is in transit during the count.	Movement of inventory between garden centers should not be permitted until all inventory has been counted.



Counters will be working on their own as there is only one allocated per area. This means the risk of error is increased compared to the normal situation where two counters are assigned.

Counts should be performed by pairs of counters, one counting and one checking.

Counters are provided with printed sheets with quantities already showing a quantity from the computer system and are only changed if found to be different from actual quantities. This may lead counters into the temptation of choosing to rely on the system and as a result failing to count all inventory lines.

Staff should be given sheets with items listed but no quantities. The staff should need to fill in the quantities as the count progresses.

Only one test count is carried out in each area by the inventory controller. This is unlikely to deter counters from being careless and the probability of errors being detected by the test count is low.

A larger sample should be test counted by the inventory controller. This could be determined statistically based on the estimated levels of inventory for each area per the system.

Damaged or old inventory quantities are crossed out and those items are given a nil quantity. This means all record of these items is lost and they may still have a value – they need to be assessed by more senior staff members.

Damaged or old inventory quantities should be maintained. They may be highlighted on the list. However, an appropriate independent senior staff member should carry out a separate review for damaged or old items and identify those which may need to be included as part of an inventory provision.

Count sheets are to be discarded once the inventory system is updated. This means there will be no audit trail for inventory quantities and no way to verify how accurately the data has been entered.

Count sheets should be retained and, for a sample of inventory items, an independent person should verify that the quantities on the count sheets have been entered correctly.

# UNIT 13 | AUDIT JUDGEMENT

## 13.1. Key unit competence

To be able to form an audit judgement

## 13.2. Prerequisite (knowledge, skills, attitudes and values)

In senior 6 the previous units you analysed the fundamental concepts in audit, legal and professional requirements, auditor's appointment, auditors requirements, auditor responsibilities, auditor regulations and ethics, audit planning, audit evidence and sampling, audit documentation, internal control, accounting system and audit procedures of financial statements. This prior knowledge, skills or competences should help the students to be able to use and form an audit judgement in their locality and be able to realize their contribution as students towards business.

## 13.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address crosscutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the crosscutting issues where possible taking consideration of their environment or community around them.

**Gender education:** emphasis throughout this unit has to be put on how both males and females have same rights and obligations to do business activities which can generate an income in their local community. So as to promote better standard of living of business activities and their community in the creation of business based employment opportunities and the country by making an audit opinion/judgement leading to socio-economic development.

**Environment and sustainability:** the greatest source of audit is the environment and the society. Audit judgement cannot be applied without the environment. Therefore, great care has to be taken for environment and society. Making an audit opinion is a way of managing public income used by government in protecting environment from harm.

**Inclusive education:** in addition to all having equal opportunities to become businesses, attention will be made on how we all regardless of our background have right to generate ideas that do not discriminate as our needs are the same. Students need to understand that audit should not discriminate but promote inclusiveness of all. Throughout the study of audit judgement, students should be able to evaluate the contribution of auditing in socio-economic development of the community.

**Financial education:** teacher and students should know that resources and materials used in teaching and learning activities must not be mismanaged. This issue will also be addressed when studying auditing. Students will learn what is permitted and what is prohibited to manage learning resources and materials well. They will put in mind that misusing materials is wasting money.

### 13.4. Guidance on introductory activity

**NOTE:** The students won't be able to answer all the questions at this stage; they can answer one question. The most important thing is that you want to challenge students to be expectant and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide interest and motivation for students to be able to use and interpret the audit judgement as opportunity of fighting against uncorrected misstatements of financial statements in the community.

The introductory activity will also evoke students' interests about what to expect in this unit as they answer the questions that follow in the activity. Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content.

Use an appropriate method such as small groups or pairs and provide students with Unit 13 introductory activity, give clear instructions to the activity.

They read the case study and discuss what activities may have carried out. They discuss also about what could be done by auditing financial statements in order to resolve some problems happen in business activities.

During grouping or pairing, mix boys and girls and students with different abilities.

During the discussion, make sure everyone is following and actively participating. Those who are not acting may have to listen attentively without disturbing and should applaud/congratulate the actors after.

Students share their findings, responses or answers to the activity using an appropriate method such as group presentation, pair share or large group

discussion. Ensure all students are given an opportunity to give their views and should be respected.

Harmonize their findings or answers, and help them draw conclusions/summary to questions. Answer or address any questions or challenges about the activity. Guide them to make notes in their books referring to students' book.

### Possible Answers for introductory activity

Audit judgement can be defined as any decision or evaluation made by an auditor, which influences or governs the process and outcome of an audit of financial statements.

Circumstances in which the auditor can make judgement are the following:

1. to review financial statements before reaching an opinion.
2. to review all findings before drawing the opinion.
3. Review of accounting policies.
4. Review for consistency and reasonableness.

## 13.5. List of lessons/sub-heading

Headings	Lesson title/sub-heading	Learning objectives	Number of periods
13.1. Form an audit judgement	Introductory activity	Arouse the curiosity of students on the content of unit 13	1
	1 Overall review of financial statement	Describe overall review of financial statement	2
	2 Events after reporting period	Explain the events occurring after the end of reporting period	2
	3 Going concern	Explain going concern concept	1
	4 Written representations	Explain written representations	2
	5 Completion	Explain completion	1
<b>End Unit Assessment</b>			<b>1</b>
<b>Total number of periods</b>			<b>10</b>

## Lesson 1: Form an audit judgement

### a) Learning objectives

- Describe overall review of financial statements
- Explain the events occurring after the end of reporting period, going concern concept, written representations and the cumulative effect of uncorrected misstatement

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Desks, chalkboard, chalk, papers, internet, computer, students' books, pictures, case studies and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction

Read the key unit competence in the syllabus to determine what students will know and be able to do by the end of the unit. Look at the action verb, concept and context of learning objective. This will help you see the skills, knowledge attitudes embedded in the learning objective. Remember the learning objective link to the key unit competence. Students are familiar with terms audit, auditing, auditor, audit appointment, audit responsibilities and audit opinion from the previous units. Again, they live in society where audit and audit judgement applied.

### d) Learning activities

- Invite students to read and analyse the scenario after that each student reads individually the question in the student book and work in pairs to share with the classmates.
- Have some pairs and make the presentations
- Provide constructive feedback in terms of supplements

### Answers to learning activity 13.1

1. On the above image there is a person (an auditor) who is thinking about the audit opinion.
2. An auditor needs audit judgement when he/she completes his/her work within a limited time period and it is needed because an auditor has to make decision about how an audit is resourced and allocation of tasks.

### e) Application activities 13.1:

Invite students to read, the application activities in student book and answer them.

#### Answers to Application Activity 13.1

1. When reviewing financial statements for consistency and reasonableness auditors should consider:
  - Whether the financial statements reflect the information and explanations and the conclusions reached during the audit.
  - Whether the review reveals any new factors which may affect the presentation and disclosure of the financial statements.
  - The results of analytical procedures at the end of the audit.
  - Whether the presentation of the financial statements may have been unduly influenced by the directors.
  - The effect of the aggregate of uncorrected misstatements.
2. If the management refuses to provide the representation, the auditor should:
  - Discuss the matters with management.
  - Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general, and
  - Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

#### Skills lab activity 13

##### Guidance on the skills lab activity:

In conducting this skills lab activity, you can arrange for students accompanied to attend a presentation on the different cases that can lead the auditor to an audit judgement, then visit the computer laboratory and search the audit books in order to find useful cases. Besides, encourage student to visit Rwandan company website for further research.

##### i. Build

Given that students visit the Rwandan company website,

- Remind students on the expected objective for the computer lab attendance



- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have notebooks where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understanding of the assignment
- Remind them that everybody full participation is mandatory.

## ii. Practice

During research on internet, care about the following concerns:

- Guide students on accessing the real website
- Ensure that internet is connected for all
- Respond to any questions for clarification and support accordingly

For the internet research, a concept note is needed to describe what has been covered during the class lesson and state what are students and teacher's expectations.

## iii. Present

During the group presentation, the teacher must assess whether the student participation in the skills lab activity was effective by:

- Selecting randomly anyone in all groups to present the report on behalf of team members.
- Allow students to ask question to their fellows.

All team members being presenting are expected to contribute to the plenary by answering some questions that the presenter is not covering as well as expected.

## iv. Conclusion

The teacher emphasizes on the objective of the research reminding students that they were expected to discover and understand all the components/contents an audit judgement. After this discovery, students should be able to form an audit judgement of any company/institution.

## 13.6. Summary of the unit

### Overall review of financial statements

Overall review of financial statements is conducted into two aspects:

#### General review

At a general level, the review will check that a clear conclusion has been reached and documented on each of the financial statement areas. Analytical procedures may be used as a final check that the information contained in the draft financial statements 'makes sense'.

#### Specific review

More specifically, the overall review will cover the following matters:

- Compliance by the client with the relevant accounting framework (national legislation and relevant accounting standards).
- A review of the accounting policies adopted by the entity, to assess whether they are acceptable (and comply with accounting standards and industry practice).
- A review of the financial statements for adequate disclosure of relevant information.
- An assessment of whether the information contained in the financial statements is consistent with known business facts.

#### The objectives of the auditor when requesting the written representation from management are to:

- Obtain written representations from management that it has fulfilled its responsibilities in respect of the financial statements and the audit
- Obtain written representations as appropriate to support other audit evidence
- Respond appropriately to written representations provided by management or if management refuse to provide the written representations requested.

## 13.7. Additional information for teachers

### The contents of representation letter

The written representation letter may include the following statements:

- The written representation letter relates to the audit of the client company.

- The management of the entity have fulfilled their responsibilities for the preparation of the financial statements, and the financial statements give a true and fair view and are free from material misstatement.
- The assumptions made by management to make accounting estimates and reach fair values are reasonable.
- Related party relationships and transactions have been disclosed.
- All events after the reporting period have been either adjusted or disclosed.
- The effect of any uncorrected misstatements (a list of which should be attached to the letter) is immaterial.
- The auditors have been provided with all relevant material, including the books of account, and unrestricted access to individuals within the entity.
- All transactions have been recorded and are included in the financial statements.
- Management have disclosed to the auditors all information that is relevant to fraud or suspected fraud.
- Management have disclosed all known instances of non-compliance with laws or regulations that are relevant to the preparation of the financial statements.
- Representations may also be included that refer to specific assertions in the financial statements, if the auditors require that such assertions should be made.

## Examples

The following example of a letter of representation shows the minimum contents of such a letter. However, remember that the auditor may also need to request management to provide written representations about specific assertions in the financial statements.

## Example of a letter of representation

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Ltd for the year ended 31 December 31 20X1 for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or give a true and fair view) in accordance with International Financial Reporting Standards.

We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

### Financial statements

We have fulfilled our responsibilities for the preparation and presentation of the financial statements as set out in the terms of the audit engagement dated..... and, in particular, the financial statements are fairly presented (or give a true and fair view) in accordance with International Financial Reporting Standards.

Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (ISA 540)

Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards. (ISA 550)

All events subsequent to the date of the financial statements and for which International Financial Reporting Standards require adjustment or disclosure have been adjusted or disclosed. (ISA 560)

The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (ISA 450)

## Information provided

We have provided you with:

- all information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements
- additional information that you have requested from us; and
- Unrestricted access to those within the entity.

All transactions have been recorded in the accounting records and are reflected in the financial statements.

We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (ISA 240)

We have disclosed to you all information in relation to fraud or suspected fraud

that we are aware of and that affects the entity and involves:

- management
- employees who have significant roles in internal control; or
- Others where the fraud could have a material effect on the financial statements. (ISA 240)

We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (ISA 240)

We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (ISA 250)

We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (ISA 550)

## 13.8. End unit assessment

### Answers to end unit assessment activities

1. The purpose of a representation letter is to obtain evidence about matters which are critical to the audit where that evidence is not available by other means.

The fundamental weakness of representations is that they are not a substitute for stronger, independent evidence. Therefore, representations will be insufficient if other stronger evidence is expected to be available.

If other evidence would not be expected to be available, auditors will consider the following:

- The fact that making misleading representations to auditors is often illegal.
  - Whether other evidence that auditors have sought to corroborate the representations, does do so.
  - Whether the representations are consistent with other evidence obtained during the course of audit.
  - Whether those making the representations are able to do so knowledgeably.
2. When examining accounting policies, auditors should consider:
    - Policies commonly adopted in particular industries
    - Policies for which there is substantial authoritative support
    - Whether any departures from applicable accounting standards are necessary for the financial statements to give a true and fair view
    - Whether the financial statements reflect the substance of the underlying transactions and not merely their form
  3. Subsequent events include:
    - Event of ending of the reporting period
    - Event of the date of the auditor's report
  4. If the going concern basis of accounting is not appropriate, the entity may not be able to recover the amounts recorded in respect of assets, and there may be changes in the amounts and dates of maturity of liabilities.
  5. (d) The representation letter must contain a list of all material adjustments to the final financial statements.



## 13.9. Additional activities (Questions and answers)

### 13.9.1. Remedial activities

#### Questions

1. Differentiate adjusting events from non-adjusting events.
2. Identify the elements of representation letter.

#### Answers

1. **Adjusting events:** are those that provide further evidence of conditions that existed at the end of reporting period while

**Non-adjusting events:** are those that are indicative of conditions that arose after the end of the report period.

2. Representation letter should:
  - Be addressed to the auditors
  - Contain specified information
  - Be appropriately dated and signed by that specific relevant knowledge. It would ordinarily be dated the same date as the auditor's report.

### 13.9.2. Consolidation activities

#### Questions

1. Explain how the auditors can reduce the risk caused by the aggregate uncorrected misstate
2. Why a written representation is ordinarily more reliable audit evidence than an oral representation?

#### Answers

1. The auditors should reduce the risk caused by uncorrected misstatements by:
  - Performing additional audit procedures;
  - Requesting management to adjust the financial statements for identified misstatements
2. A written representation is ordinarily more reliable audit evidence than an oral representation because it can take the form of:
  - A representation letter from management,

- A letter from the auditor outlining the auditor's understanding of management's representations, duly acknowledged and confirmed by management,
- Relevant minutes of meetings of the board of directors or similar body or a signed copy of the financial statements.

### **13.9.3. Extended activities**

#### **Question**

List five (5) factors which may cast doubt about a company's ability to trade as a going concern and describe reasons why these factors may indicate that a company may not be a going concern.

#### **Answer**

There are many factors which could indicate that a particular company was not a going concern, of which some of the most important are as follows:

- **Failure to generate sufficient profits.** Obviously any company which proves unable to operate at a profit will not be a going concern since the losses which it makes serve to drain existing capital from the business. However, where a previously successful company begins to trade at a loss this may be a symptom of other problems.
- **Reductions in liquidity,** as shown by increasing overdraft levels, worsening gearing and current asset ratios and a growing level of payables. If payables exceed inventories, this could suggest that a company must sell its goods before it can pay for them. As with trading losses, liquidity problems are likely to be a symptom of going concern difficulties as much as they are their cause.
- **Loss of important customers.** If these had previously accounted for a major part of turnover, there could be serious implications unless alternative outlets are found. The company will have insufficient revenue while fixed costs will remain the same. A manufacturing company may continue to produce goods which cannot be sold.
- **Shortage of materials essential to a company's manufacturing process.** This could happen through the failure of a major supplier or simply because of a general shortage of raw materials in the industry. Clearly if a company cannot produce the goods it needs to sell its future must be in doubt.

- **Taking of extended credit by customers.** The most likely cause of this would be poor credit control on the part of the company. Excess credit would reduce working capital and might have a 'knock on' effect if the company found itself unable to meet its own bills as they fell due. In these circumstances, the company could be at risk of being put into receivership or going into liquidation.
- **Overtrading by the company.** If sales are increasing too rapidly, the company may encounter an equally rapid increase in the amount invested in inventory and receivables. A manufacturing company may also find itself buying more plant and equipment in an effort to meet demand. All these factors will have the effect of draining liquid funds from the company, with the result that it may be unable to pay for the goods and services it requires to carry on.
- **Redemption of loan capital.** This may originally have been part of long-term borrowings and redemption is at a time when a company is unable to finance this from its own resources. If alternative sources of finance are not readily available, the company may come under quite severe financial pressure.
- **Replacement of non-current assets** which are nearing the end of their useful lives might be necessary at a time when finance is tight. This may have a serious impact upon the company's ability to maintain capacity levels or even to continue in business at all.
- **Adverse movements in exchange rates.** These would affect companies with substantial imports where the national currency was weak against other currencies and would affect exporting companies where the national currency was strong against other currencies.
- **Reductions in research and development expenditure.** Liquidity problems may encourage a company to cut back on its research and development expenditure. However, the savings are likely to be very short term. In the longer term, the company may become less and less competitive as it fails to produce new products to meet changes in demand.
- **Changes in policy,** such as a decision to lease rather than buy new non-current assets. These may indicate going concern difficulties, particularly where, as is frequently the case, the finance charges for such lease arrangements are higher than they would have been using a conventional bank loan.

# UNIT 14 | AUDIT REPORT

## 14.1. Key Unit competence

Prepare an appropriate audit report

## 14.2. Prerequisite (knowledge, skills, attitudes and values)

In auditing unit 9 on audit documentation, the prior knowledge, skills, attitudes and values from this unit should help students to understand how to prepare an appropriate audit report.

## 14.3. Cross-cutting issues to be addressed:

**Note:** The examples below are just to guide you on how to address cross-cutting issues throughout the unit but this does not mean that these are the only ones. You can address and give students opportunities to discuss all the cross-cutting issues where possible taking consideration of their environment or business activity industry.

**Gender education:** Emphasis throughout this unit has to be put on how both males and females have the equal opportunities to understand and explain the meaning of audit report, its basic elements. Being citizens of Rwanda, males and females are encouraged to start business and be accountable to audit practice; they should know the importance of audit report for them as owners of the business.

**Inclusive education:** In addition to all having equal opportunities to carry out business activities, emphasis has to be put on how we all regardless of our background, economic or social setup have right to develop an ethical understanding of Rwandan system that do not discriminate.

**Peace and Values:** You need to emphasize to students the benefit of living in peace and harmony with others. Students need to appreciate the role played by auditors in promoting peace and patriotism in the community avoiding activities that are illegal e.g., frauds, fraudulent manipulations of accounts and make sure that every business they plan to have is legal and contributes to national development goals.

**Standardization culture:** You need to emphasize to students why adhering to ethics and integrity requirements at workplace and their respective community is very crucial for a self-reliance national development. This will help them to abide by international auditing and Assurance Standards Board.

#### **14.4. Guidance on introductory activity**

**NOTE:** The students won't be able to answer all the questions at this stage. The most important thing is that you want to challenge students to be expectant and to use their previous knowledge and background to self-discover during teaching and learning of this unit.

Explain the purpose of the introductory activity of the lesson. This activity is intended to provide capability for students to prepare an appropriate audit report.

The introductory activity will also arouse students' interests about what to expect in this unit as they answer the questions that follow in the activity.

Students can build on previous knowledge, skills, values and attitudes to help you assess the student's prior knowledge and help link with the new content. Exploit and use engaging methods that can foster team work like small groups, pairs or gallery walk. Provide students with the introductory activity in the student's book, and explain in details what is expected from the activity to be done. During grouping or pairing, ensure an acceptable balance between boys and girls and students' different abilities.

Through question-and-answer approach, check the students' understanding of the instructions to make sure they are going to deliver a good report. Encourage students to work together, value each other's contributions, share ideas, etc. Ensure all students are given an opportunity to give their views and should be respected. Request them to take notes in their books referring to student's book.

Students present their findings, results, answers through presentations on the introductory activity.

Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the unit 14.

You can support student's answers by referring to possible answers to the introductory activity below:

## Answers to the introductory activity

The document prepared by the auditor at the end of audit process which contains his conclusion, opinion and recommendation is called audit report.

### 14.5. List of lessons/sub-heading

Headings	Lesson title/sub-heading		Learning objectives	Number of periods
14.1. Auditor's report	Introductory activity		Arouse the curiosity of students on the content of unit 14	1
	1	Meaning of audit opinion (audit report)	Explain the meaning of audit opinion (audit report)	1
	2	Basic elements of the auditor's report	Explain the basic elements of the auditor's report	2
	3	The auditor's report on financial statements	Explain the auditor's report on financial statements	1
14.2. Unmodified auditor's report Modified opinions	1	Unmodified auditor's report	Explain the unmodified auditor's report	2
	2	Modified opinions	Explain the modified auditor's report	2
	3	Emphasis of matter and other matter paragraphs in the auditor's report	Describe the emphasis of matter paragraphs and other matter paragraphs in the auditor's report	1
<b>End Unit Assessment</b>				<b>1</b>
<b>Total number of periods</b>				<b>11</b>



## Lesson 1: Auditor's report

### a) Learning objective

Describe audit report elements and report on financial statements

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chinks, flipchart, computer resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous unit 9, Students studied the audit documentation. That will help them to discuss and understand how to prepare of audit in this lesson. Remember the learning objectives are linked to the key unit competence.

### d) Learning activities

#### Activity 14.1

Exploit and use appropriate learning methods that can foster collaborative learning for (example small groups or pairs, gallery walk). Provide students with the activity in the student's book, and give instructions to the activity to be done.

During grouping or pairing, ensure a balance between boys and girls and students' different abilities. During this activity ensure that students have understood the instructions, prompt and probe them through question-and-answer approach to make sure they are active and their curiosity in learning and discovery is aroused. Encourage students to work together, value each other's contributions, share ideas, etc.

Students present their findings, results, answers through an appropriate method such as pair-share, small group presentations on the introductory activity. Encourage different students from the groups to share the group's work to avoid just a few students dominating. Also encourage other students to listen and not disturb when other teams are sharing unless it is a question. Encourage students to appreciate each other's work especially the presentation. Appreciate the team's presentations and remind them that this activity was not meant to come to the very right answers but to help them become aware of what to expect in the lesson. Answers to the activity will be got as the lesson progresses. You can support students' answers by referring to possible answers to the activity below:

### Answers to learning activity 14.1

Those documents are the following: Audit note book, current and permanent audit files.

#### e) Application activities 14.1

Students analyse and discuss about the questions either in groups or in pairs and come up with possible answers. This activity may be given as a research question or homework.

Depending on the purpose of the application activity, choose an appropriate method to assess student's findings, answers or responses. Depending on the performance or results, you may decide to give remedial or extension activities.

### Answers to learning activity 14.1

1. The importance of audit report for John as a member of ABX Ltd company are:
  - Helps them to ensure if their shares are earning interest by the company and if it is profitable to continue to invest in the company
  - Helps to know if the statutory requirements are being implemented by the company
2. Qualities of a good audit report are:
  - It should not be biased to any party with financial stake in the business.
  - It should be not forceful.
  - It should be biased on constructive criticism.
  - It should offer constructive and timely suggestions to the management so as to solve problems highlighted in the report.
  - It should be clear and concise.

## Lesson 2: unmodified auditor's report and modified opinions

### a) Learning objective

Describe unmodified, modified auditor's report and emphasis of matter paragraph

### b) Teaching resources

**Basic materials for a class/ lesson to be conducted:** Students books, internet and projector, case studies, text books, chalks, marker pen, flipchart, computer, resourceful person and any other trustworthy and reliable resources to enhance learning.

### c) Prerequisites/Revision/Introduction (Guidance on how to start the lesson)

In previous lesson, lesson 1 Students discussed about the basic elements on audit report. This will help them to understand unmodified, modified auditor's report and emphasis of matter paragraph.

### d) Learning activities

#### Activity 14.2

- Put students in small groups and give clear instruction about the activity
- Ask them to read carefully the word in the picture and give the opposite of the word.
- Guide students' discussions and make sure that everyone is participating
- Invites students to share their findings.
- Harmonize their findings or answers, and link the findings to the learning objective, help them draw conclusions/summary. Answer or address any questions or challenges about the activity. Guide them to make notes in referring in their students' book.

#### Answers to learning activity 14.2

The opposite of the word unmodified audit report is modified audit report.

### e) Application activities 3.2

Students can be given an activity to discuss about the questions in groups, give clear instructions and ensure a balance in the groups for both gender and capability. Students are to give a report of their findings. Monitor the activity to ensure students are on track and actively participating.

Students share their findings to the large group. Assess their answers depending on the purpose of the application activity. Refer to the possible answer below as you assess their work.

### Answers to application activity 14.2

1. An unmodified audit report is an audit report containing an audit opinion not modified in any way – either by changing the unmodified opinion or by adding an extra paragraph such as an ‘emphasis of matter’ or ‘other matters’ paragraph after the opinion paragraph.
2. Three types of modified opinion are:
  - A qualified opinion.
  - An adverse opinion.
  - A disclaimer of opinion.

### Skills lab activity 14

#### Guidance on the skills lab activity:

In conducting this skills lab activity, present an unmodified audit report to the students in which some elements are missing, ask them to discuss about it, tell them to discover the missing elements and request them to rewrite the appropriate report.

#### i. Build

Given that students work on the activity,

- Remind students on the expected objective of the task
- Help them to be grouped and remember to mix both boys and girls
- Let each team have the representative
- Ensure they have where to keep necessary notes from the findings
- Distribute questions for their research
- Check their understanding of the assignment
- Remind them that everybody full participation is mandatory.

#### ii. Practice

During the discussion, care about the following concerns:

- Guide students on accessing the question

- Ensure that are available for all of them
- Respond to any questions for clarification and support accordingly

To facilitate the presenter to prepare his presentation, send him a concept note describing what has been covered during the class lesson and state what are students and teacher's expectations.

### **iii. Present**

During the group presentation, the teacher must assess whether the student participation in the skills lab activity was effective by:

- Selecting randomly anyone in all groups to present the report on behalf of team members.
- Allowing students to ask question to their fellows.

All team members being presenting are expected to contribute to the plenary by answering some questions that the presenter is not covering as well as expected.

### **iv. Conclusion**

The teacher emphasizes on the objective of the research reminding students that they were expected to be able to discover the missing elements.

## **14.6. Summary of the unit**

### **1. Auditor's report**

#### **1.1 Meaning of audit report**

An audit report is document that expresses an auditor's opinion on a company's financial performance and compliance with generally accepted accounting principles (GAAP).

An audit report is a document from the auditor of a company that is the end result of the audit process. It states the auditor's opinion on whether the company's financial statements such as the balance sheet are in compliance with the generally accepted accounting principles (GAAP) and if they are free from material misstatement.

#### **1.2. Basic elements of an audit report.**

- Title
- Address
- Introduction/ Scope

- Responsibilities of directors and auditors
- Refernces/ Basis of opinoin
- Opinion
- Other reporting responsibility
- Auditor's Address
- Date and place of report
- Signature of the auditor

#### ▪ **Qualities of a good audit report**

Qualities of a good audit report are:

- It should not be biased to any party with financial stake in the business.
- It should be not forceful.
- It should be biased on constructive criticism.
- It should offer constructive and timely suggestions to the management so as to solve problems highlighted in the report.
- It should be clear and concise.

#### ▪ **Importance of audit report**

##### **For the audited company**

- a. Helps to reveal a true and fair view of the company's financial statements
- b. Reveals errors and frauds committed or inherent in the company's books of accounts

##### **For the shareholders or associates**

- a. Helps them to ensure if their shares are earning interest by the company and if it is profitable to continue to invest in the company
- b. Helps to know if the statutory requirements are being implemented by the company

##### **For the tax authorities**

- a. The audit report ensures to the government if the taxes due by the company are properly given by the company
- b. Ensures if other legal requirements like social security contributions are being implemented

##### **For the thirds parties**

- a. For employees audit report helps them to ensure the continuity of the company's activities so as to ensure their job security and continuity of employment



- b. For the customers their proud of their relationships with their supplier (audited company) if good management and fair and true image is revealed by the audit report

### **1.3. The auditor's report on financial statements**

The auditor is required to produce an audit report at the end of the audit which sets out his opinion on the truth and fairness of the financial statements. The report contains a number of consistent elements so that users know the audit has been conducted according to recognized standards

## **2. Unmodified auditor's report and Modified opinions**

### **2.1. Unmodified audit's report**

#### **Definition**

An unmodified audit report is an audit report containing an audit opinion not modified in any way – either by changing the unmodified opinion or by adding an extra paragraph such as an 'emphasis of matter' or 'other matters' paragraph after the opinion paragraph.

An unmodified opinion is the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

If the auditor concludes that the financial statements as a whole are not free from material misstatement or cannot obtain sufficient appropriate audit evidence to make this conclusion, the auditor must modify the opinion in accordance with ISA 705 Modifications to the opinion in the independent auditor's report.

We discuss modifications to the opinion in the following sub heading

### **2.2. Modified opinions**

A modified opinion is required when:

The auditor concludes that the financial statements as a whole are not free from material misstatements or

The auditor cannot obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Types of modifications

There are three types of modified opinion:

- **A** qualified opinion

- An adverse opinion
- A disclaimer of opinion

The following table summarizes the different types of modified opinion that can arise:

Nature of circumstances	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	qualified opinion	adverse opinion
Auditor unable to obtain sufficient appropriate audit evidence	qualified opinion	disclaimer of opinion

### 2.3. Emphasis of matter and other matter paragraphs in the auditor's report

#### a. Emphasis of matter paragraphs

An emphasis of matter paragraph is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Emphasis of matter paragraphs are used to draw readers' attention to a matter already presented or disclosed in the financial statements that the auditor feels is fundamental to their understanding, provided that the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated.

#### b. Other matter paragraphs

Other matter paragraphs are used where the auditor considers it necessary to draw readers' attention to a matter that is relevant to their understanding of the audit, the auditor's responsibilities or the auditor's report.

The other matter paragraph must be included immediately after the opinion paragraph and any emphasis of matter paragraph, or elsewhere in the auditor's report if the content of it is relevant to the other reporting responsibilities section.

## 14.7. Additional information for teachers

Illustration 1:

An auditor's report containing a qualified opinion due to a material misstatement of the financial statements

Illustration 1:

Circumstances include the following:

- Audit of a complete set of general purpose financial statements prepared by management of the entity in accordance with International Financial Reporting Standards.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in ISA 210.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

### **INDEPENDENT AUDITOR'S REPORT**

**(Appropriate Addressee)**

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of ABC Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance

about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

### **Basis for Qualified Opinion**

The company's inventories are carried in the statement of financial position at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from International Financial Reporting Standards. The company's records indicate that had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

### **Qualified Opinion**

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of ABC Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### **Report on Other Legal and Regulatory Requirements**

(Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.)

**(Auditor's signature)**

**(Date of the auditor's report)**

**(Auditor's address)**

## 14.8. End unit assessment

### Answers to end unit assessment activities

1. For the audited company the importance of audit report is:
  - Helps to reveal a true and fair view of the company's financial statements
  - Reveals errors and frauds committed or inherent in the company's books of accounts
  - Traces the strength and weaknesses of the internal control system
  - Show if the internal auditing function is working properly
  - Helps to ensure if the company fulfils legal requirements

2.
  - An unmodified audit report is an audit report containing an audit opinion not modified in any way – either by changing the unmodified opinion or by adding an extra paragraph such as an 'emphasis of matter' or 'other matters' paragraph after the opinion paragraph.

An unmodified opinion is the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

- Modified opinion

A modified opinion is required when:

The auditor concludes that the financial statements as a whole are not free from material misstatements or

The auditor cannot obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

3. The basic elements of an audit report

No	Section/Heading	Description
1	Title	Independent Auditor's Report. The title of the audit report should be simple and include the word "independent".
2	Address	The report should clearly state to whom it is addressed. It is addressed to the shareholders or board of directors of a company.

3	Introduction/ Scope	This would be a statement that states the name of the company that is being audited, the dates of the financial period that the audit covers, which is usually the fiscal year.
4	Responsibilities of directors and auditors	This section clearly states the responsibilities of the directors of the company being audited, and the responsibilities of the auditor. It states that the management and directors of the company accept the duty of providing the auditor with all the financial documentation required for the audit. It also states that the documentation provided is true and accurate to the best of the director's knowledge. It is stated that the auditor's role is to audit the financial statements given by the company. It also states that the auditor must form his opinion based on the information provided.
5	Refernces/ Basis of opinoin	The section states that the audit was conducted in compliance with the standards and describes the audit process and resources. This section may be longer than the rest.
6	Opinion	This section clearly states the auditor's opinion. The auditor's opinion is given in the report regarding the financial statements and the words "the accounts show a true and fair view" are normally used.
7	Other reporting responsibility	If there are any other reporting responsibilities such as legal or regulatory requirements they are mentioned here.
8	Auditor's Address	The auditor gives his address
9	Date and place of report	The date and city where the report was signed by the auditor.
10	Signature of the auditor	Signed by the auditor

4. An audit report is a document that expresses an auditor's opinion on a company's financial performance and compliance with Generally Accepted Accounting Principles (GAAP). An audit report is a written opinion of an auditor regarding an entity's financial statements.



An audit report is a document from the auditor of a company that is the end result of the audit process. It states the auditor's opinion on whether the company's financial statements are in compliance with the Generally Accepted Accounting Principles (GAAP) and if they are free from material misstatement.

The audit report is the end-product of the external audit process. It is the document in which the auditor expresses his/her professional judgment on whether the financial statements present a 'true and fair view'.

It is a document prepared by an auditor at the end of auditing process that consolidates all of his/her findings and observations about a company's financial statements

5. Emphasis of matter paragraphs are used to draw readers' attention to a matter already presented or disclosed in the financial statements that the auditor feels is fundamental to their understanding, provided that the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated
6. Qualities of a good audit report

Qualities of a good audit report are:

- It should not be biased to any party with financial stake in the business.
  - It should be forceful.
  - It should be based on constructive criticism/ideas.
  - It should offer constructive and timely suggestions to the management so as to solve problems highlighted in the report.
  - It should be clear and concise.
7. The audit report refers to financial statements and you need to know what these are. They consist of the following:
    - The statement of financial position (or balance sheet).
    - The statement of profit or loss (Income statement)
    - The statement of changes in equity.
    - The cash flow statement.
    - The notes to the account

## 14.9. Additional activities (Questions and answers)

### 14.9.1. Remedial activities (Questions and answers)

**Question 1.** What is the meaning of audit report?

**Answer 1.**

An audit report is document that expresses an auditor's opinion on a company's financial performance and compliance with generally accepted accounting principles (GAAP).

An audit report is a written opinion of an auditor regarding an entity's financial statements.

Is a document prepared by an auditor at the end of auditing process that consolidates all of his findings and observations about a company's financial statements?

**Question 2.** Give the quality of a good audit report

**Answer 2: Qualities of a good audit report are:**

- It should not be biased to any party with financial stake in the business.
- It should be not forceful.
- It should be biased on constructive criticism.
- It should offer constructive and timely suggestions to the management so as to solve problems highlighted in the report.
- It should be clear and concise.

### 14.9.2. Consolidation activities (Questions and answers)

**Question 1.** Explain what you understand by Emphasis of matter paragraphs

**Answer 1.** An emphasis of matter paragraph is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Emphasis of matter paragraphs are used to draw readers' attention to a matter already presented or disclosed in the financial statements that the auditor feels is fundamental to their understanding, provided that the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated.

**Question 2.** State basic elements of an audit report.

## **Answer 2.**

- Title
- Address
- Introduction/ Scope
- Responsibilities of directors and auditors
- Refernces/ Basis of opinoin
- Opinion
- Other reporting responsibility
- Auditor's Address
- Date and place of report
- Signature of the auditor

### **14.9.3. Extended activities (Questions and answers)**

**Question1.** Explain the importance audit report for:

- 1 The audited company
- 2 The shareholders or associates
- The tax authorities
- The thirds parties

## **Answer 1.**

### **For the audited company**

- Helps to reveal a true and fair view of the company's financial statements
- Reveals errors and frauds committed or inherent in the company's books of accounts
- Traces the strength and weaknesses of the internal control system
- Show if the internal auditing function is working properly
- Helps to ensure if the company fulfils legal requirements

### **For the shareholders or associates**

- Helps them to ensure if their shares are earning interest by the company and if it is profitable to continue to invest in the company
- Helps to know if the statutory requirements are being implemented by the company

### **For the tax authorities**

- The audit report ensures to the government if the taxes due by the company are properly given by the company

- Ensures if other legal requirements like social security contributions are being implemented
- Ensures that the company respect accounting principles, company's act and other regulations in application
- Ensures if the public funds are being used properly by government institutions and other private institutions

### **For the thirds parties**

- For employees audit report helps them to ensure the continuity of the company's activities so as to ensure their job security and continuity of employment
- For the customers their proud of their relationships with their supplier (audited company) if good management and fair and true image is revealed by the audit report
- For suppliers them ensure their market with the audited company if true and fair view is revealed by the auditor's report
- For banks and financial institutions their ensure refund of their loans granted to the audited company

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