

Tutorial letter 201/1/2013

ADVANCED THEORY OF AUDITING AND THE PERFORMING OF THE AUDIT PROCESS

AUE303R

Semester 1

Department of Auditing

IMPORTANT INFORMATION:

This tutorial letter contains important information
about your module.

BAR CODE

Please note

This tutorial Letter contains the key to and comments on Assignment 01.

I wish to emphasise that the purpose of the questions in the International Standards on Auditing (ISAs) is to encourage you to read through the particular ISAs, to become familiar with the text and to understand what the standard setters are trying to achieve. The multiple-choice questions are not difficult and you will be able to find all the answers in the text. Therefore, I am of the opinion that I am denying you the opportunity to do independent research and to engage with the text by substantiating each alternative. I would have preferred for you to battle with the text and, through that experience, teach you to become an independent researcher and thinker. I want you to eventually develop into a confident chartered accountant (CA) who can make independent decisions in the boardroom where you are on your own. **I would therefore urge you not to read the explanations set out below but to go to the ISAs, search for the answers yourself and not to give up easily.** It would be great if you struggled – nothing comes easy and the text is difficult to understand. However, through perseverance, you will eventually become competent. Remember, at Certificate in the Theory of Accounting (CTA) level you are allowed to bring the ISAs into the examination – so it will be expected of you to be **really** familiar with the text. Use this as an opportunity to become familiar with the text.

1. ISA 210 Agreeing the terms of audit engagements

1. Incorrect: ISA 210.13

2. Incorrect: ISA 210.A7. If the framework becomes deficient, then the auditor cannot be obliged to follow it.

3. Correct: ISA 210.11

4. Incorrect: ISA 210.9

2. ISA 300 Planning an audit of financial statements

1. Incorrect: ISA 300.5

2. Incorrect: ISA 300.6 & ISA 300.A7

3. Correct: ISA 300.A10

4. Incorrect: ISA 300.A12

3. Reference: ISA 300

Alternative 4 is correct. Before commencing fieldwork, the auditor would establish an understanding with the client regarding the services to be performed and the overall audit strategy. The understanding may include arrangements involving the conduct of the engagement, such as timing, client assistance, and the availability of documents.

All the other alternatives occur either during the performance of the fieldwork or at the evaluating stage of the audit, and they are therefore incorrect.

4. ISA 320 Materiality and performing an audit

1. Incorrect: ISA 320.11
2. Incorrect: ISA 320.5
3. Incorrect: ISA 320.A3
4. **Correct: ISA 320.13**

5. **Reference: ISA 500**

Alternative 3 is correct. Strong, effective internal controls improve the reliability of data. None of the other alternatives deal with the reliability of data; however, they provide the basis to account for or to capture the data.

6. 1. **Correct: ISA 450.14**

2. Incorrect: ISA 450.6
3. Incorrect: ISA 450.4 & ISA 450.A1
4. Incorrect: ISA 450.15

7. **Reference: ISA 230**

Alternative 2 is correct. Audit documentation or working papers, comprise the principal record of audit procedures performed, evidence obtained, and conclusions reached. Reviewing the working papers allows a supervisor to understand the work performed and the evidence obtained, and to evaluate whether the audit was adequately performed.

Checklists may be used as part of the audit documentation, but on their own, they would not provide a comprehensive record of the audit procedures performed. Alternative 1 is therefore incorrect. The same principle applies to the other alternatives.

8. **Reference: Auditing Notes, Chapter 12 paragraph 5.2.1**

Alternative 1 is correct. By tracing observed counts to the client's records, the auditor is verifying that the physical inventory has in fact been recorded. The direction of testing is important. The auditor wants to ascertain whether the inventory that has been physically inspected does in fact appear in the records.

Alternative 2 is incorrect, but it might have been correct if the auditor had examined the paid invoices, or inspected consignment agreements and contracts for any rights (ownership) or obligations pertaining to the client.

Alternative 3 is incorrect, but it might have been correct if the auditor had inspected the condition of the inventory.

Alternative 4 is incorrect. Understandability and classification are assertions relating to presentation and disclosure.

9. Reference: ISA 530

Alternative 1 is correct. Attribute sampling is used to estimate a rate of errors, and it often involves a yes or no question. Attribute sampling could be used to determine the error rate in posting journal entries by asking, "Is the entry posted to the proper account?"

Alternatives 2 and 3 involve variable sampling, as variable sampling is typically used to estimate a numerical quantity.

Alternative 4 is the selection of a sample and not the estimate of a rate of errors.

10. Reference: ISA 620

Alternative 2 is correct. While an expert, who is unrelated to the client, will provide the auditor with greater assurance of reliability, an expert, who is related to the client, may be acceptable in certain circumstances. In such situations, the auditor would probably perform additional procedures to verify objectivity. Note that it is important to the auditor that the expert is objective, but the expert does not have to be independent of the client.

If a standard, unmodified (unqualified) opinion is expressed, no reference would be made to the specialist; therefore, alternative 1 is incorrect.

Alternative 3 is incorrect. While a specialist, who is unrelated to the client, will provide the auditor with greater assurance of reliability, a specialist, who is related to the client, may be acceptable in certain circumstances.

Alternative 4 is incorrect. The fact that the actuary has a relationship with the client is not considered a significant deficiency in internal control.

11. Reference: ISA 540

Alternative 4 is correct.

Read ISA 540.A1-A8 as a whole then refer to: Alternative 1, ISA 540.A2. Alternative 2, ISA 540.A3. Alternative 3, ISA540.A5.

12. Reference: ISA 550

Alternative 2 is correct. In order to determine the existence of related parties, the auditor must first request that management provide a list of related parties. The direction of testing is important for existence. The auditor will vouch the information contained on the list to source documents.

Alternative 1 is incorrect. Before an auditor examines invoices, contracts and purchasing orders for evidence of related-party transactions, the auditor must first inquire of management regarding the identity of related parties.

Alternative 3 is incorrect. Reviewing the company's business structure is unlikely to provide information about the existence of related parties.

Alternative 4 is incorrect. The tax return filed with SARS may provide evidence of related-party transactions. However, the auditor must first inquire of management regarding the identity of related parties.

13. Alternative 1 is correct in terms of ISA 580.12; ISA 210.A16 & ISA 240.39A.

Alternative 2 is incorrect. This matter is not communicated in a representation letter to the auditor, as it relates to communication with the employees.

Alternative 3 is incorrect. The management representation letter is concerned with representations made by management to the auditors, and not with representations made by management to the audit committee.

Alternative 4 is incorrect. This is a risk factor associated with fraudulent financial reporting and it would not be communicated in a management representation letter.

14. Reference: ISA 520

Alternative 1 is correct. If you are not sure what analytical procedure entail please refer to ISA 520 A1-A3.

15. Reference: ISA 450

Alternative 1 is correct. The auditor should document the errors in the summary of uncorrected errors and should document the conclusion that the errors will not cause the financial statements to be misstated.

Alternative 2 is incorrect. The auditor is required to document both his/her conclusion and uncorrected errors in the working papers.

Alternative 3 is incorrect. The auditor is required to summarise the uncorrected errors in the working papers and document whether the errors are causing the financial statements to be misstated.

Alternative 4 is incorrect. The auditor is required to perform both procedures.

16. Reference: ISA 500 & ISA 510

Alternative 3 is correct. Professional reasons for not accepting the engagement should be provided in order to identify and understand audit risk.

Alternative 1 is incorrect. The successor auditor may not rely on the predecessor's evaluation of audit risk and judgement about materiality but must rather form his/her own opinion.

Alternative 2 is incorrect. The predecessor auditor would not necessarily be aware of subsequent events that had occurred since the predecessor's audit report was issued.

Alternative 4 is incorrect. The predecessor auditor is not obliged to answer detailed questions and the successor will need to collect the evidence in this regard him/herself.

17. Reference: ISA 450

Alternative 4 is correct. The disclosure of unexpected differences by the analytical procedures increases the risk that the financial statements may be materially misstated.

Alternative 1 is incorrect. Management are not obliged to disclose to auditors whether or not they have used consultants.

Alternative 2 is incorrect. The management representation letter is typically signed on the last day of the auditor's fieldwork.

Alternative 3 is incorrect. If the audit trails of computer-generated transactions exist only for a short time, the auditor should adjust the timing of his/her audit procedures.

18. Reference: ISA 501

Alternative 1 is correct. As part of the process of observing a client's physical inventory count, an auditor should be alert to the inclusion of any obsolete or damaged goods, which may need to be written down or written off.

Alternative 2 is incorrect. An auditor cannot determine whether changes have occurred in pricing methods simply by observing a client's physical inventory count.

Alternative 3 is incorrect. An auditor cannot determine whether outstanding purchase commitments exist simply by observing a client's physical inventory count.

Alternative 4 is incorrect. An auditor cannot determine what inventory values are assigned to goods in process by observing a client's physical inventory count.

19. Reference: ISA 540

Alternative 1 is correct.

Refer to ISA 540 A6-A7 that will facilitate you in selecting the correct alternative.

20. Reference: ISA 540

Alternative 1 is correct. In evaluating accounting estimates, one of the auditor's responsibilities is to determine whether the estimates are reasonable in the circumstances.

Alternative 2 is incorrect. Accounting estimates should be used when data concerning past events **cannot** be accumulated in a timely, cost-effective manner.

Alternative 3 is incorrect. Management's listing of accounts receivable outstanding for longer than 90 days is not an estimate, as it is based on objective, verifiable information.

Alternative 4 is incorrect. Accounting estimates **should** be used when the outcome of future events related to the estimated item is unknown.