**REVISION QUESTIONS**

**Question 1**

**The following are the limitations of an external audit**

1. Auditing is **not objective** as judgment has to be made on risk assessment, what to test, how much to test, whether errors are representative of the population and in making an audit opinion.
2. Not all items in the financial statements are tested as auditors use **sampling** that has sampling risk**.**
3. Limitations in **accounting and control systems** like human error, the possibility of collusion in fraud and the possibility of controls override
4. Audit evidence is **persuasive** rather than conclusive like a delivery note may not always prove that goods were actually delivered.
5. An audit report may be issued a **long time after** the end of the reporting period and the up-to-date and historic positions may be different.

**Question 2**

**The following are the threats and appropriate safeguards**

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| **Ethical threat** | **Appropriate safeguard** |
| Mr Okello, the engagement partner has been involved with the client for the last seven years. This may lead to a familiarity threat as he may not make objective decisions due to this long association | Mr Okello should be rotated from being engagement partner. He can still contact the client but should not be in position of signing the audit report. |
| Mr Okello recommending Brenda his sister to be included in the audit team for Norris. Brenda being a relative of the engagement partner, may lead to a self-interest threat as she could be tempted not to identify errors if this negatively affect Okello’s relationship with the client. | Brenda should not be part of the audit team. However, if Mr Okello is no longer the engagement partner then this removes the ethical threat and Brenda could be included in the audit team. |
| As long as Tom paid a full fee to Norris for the investment advice, then there is no ethical threat. This would be a normal commercial transaction and Tom would not gain any benefit.  However, continued use of client services could imply a lack of independence especially if Tom is not paying a full fee and therefore receiving a benefit from the client. | To show independence from the client, Tinka could be asked not to use the services of Norris again unless this is first agreed with the engagement partner. |
| The audit team has been offered business class tickets to Zanzibar. Acceptance of gifts from a client, unless of an insignificant amount, is not allowed. This may lead to a self- interest threat | The tickets should not be accepted. |
| Accepting taxation work on a percentage of the tax saved is essentially accepting a contingent fee. This may create a self-interest threat as there will be pressure to gain the highest tax refund for the client and this could tempt the audit firm to suggest illegal tax avoidance schemes. | The audit firm must confirm that assistance with taxation work is acceptable, although the fee must be based on time and experience for the job, not the contingent fee. |
| Kagame & Co. representing the client in court could be seen as an advocacy threat as it is promoting the position of the client. Objectivity could be compromised as the audit firm may be seen as to taking the position that the client is correct, thus affecting judgment on the tax issue. | The audit firm should decline to represent the client in court. |

**Question 3**

**Audit risk and auditor's response**

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| **Audit risk** | **Auditor's response** |
| BK has incurred Shs 50m on updating, repairing and replacing a significant amount of the production process machinery. If this expenditure is of a capital nature, it should be capitalised as part of property, plant and equipment (PPE) in line with IAS 16 PPE. However, if it relates more to repairs, then it should be expensed to the statement of profit or loss If the expenditure is not correctly classified, profit and PPE could be under- or overstated. | The auditor should review a breakdown of these costs to ascertain the split of capital and revenue expenditure, and further testing should be undertaken to ensure that the classification in the financial statements is correct. |
| At the year end there will be inventory counts undertaken in all 15 warehouses. It is unlikely that the auditor will be able to attend all 15 inventory counts and therefore they need to ensure that they obtain sufficient appropriate audit evidence over the inventory counting controls, and completeness and existence of inventory for any warehouses not visited. | The auditor should assess at which of the inventory sites they will attend the counts. This will be any with material inventory or which have a history of significant errors. For those not visited, the auditor will need to review the level of exceptions noted during the count and discuss with management any issues which arose during the count. |
| Inventory is stored within 15 warehouses; some are owned by BK and some rented from third parties. Only warehouses owned by BK should be included within PPE. There is a risk of overstatement of PPE and understatement of rental expenses if BK has capitalised all 15 warehouses. | The auditor should review supporting documentation for all warehouses included within PPE to confirm ownership by BK and to ensure noncurrent assets are not overstated. |
| A new accounting general ledger system has been introduced at the beginning of the year and the old system was run in parallel for two months. There is a risk of opening balances being misstated and loss of data if they have not been transferred from the old system correctly.  In addition, the new accounting general ledger system will require documenting and the controls over this will need to be tested. | The auditor should undertake detailed testing to confirm that all opening balances have been correctly recorded in the new accounting general ledger system.  They should document and test the new system. They should review any management reports run comparing the old and new system during the parallel run to identify any issues with the processing of accounting information. |
| BK has incurred expenditure of Shs 45 million on developing a new brand of drink. This expenditure is research and development under IAS 38 Intangible Assets. The standard requires research costs to be expensed and development costs to be capitalised as an intangible asset (IAS 38). If BK has incorrectly classified research costs as development expenditure, there is a risk the intangible asset could be overstated and expenses understated. | Obtain a breakdown of the expenditure and undertake testing to determine whether the costs relate to the research or development stage. Discuss the accounting treatment with the finance director and ensure it is in accordance with IAS 38. |
| A large batch of products has been damaged in the production process and will be in inventory at the year end. No adjustment has been made by management. The valuation of inventory as per IAS 2 Inventories should be at the lower of cost and net realisable value (IAS 2). Hence it is likely that this inventory is overvalued. | Detailed cost and net realisable value testing to be performed to assess how much the inventory requires writing down by. |
| Due to the damaged products, a number of customers have complained. It is likely that for any of the damaged goods sold, BK will need to refund these customers. Revenue is possibly overstated if the sales returns are not completely and accurately recorded. | Review the breakdown of sales of damaged goods, and ensure that they have been accurately removed from revenue. |
| The management of BK receives a significant annual bonus based on the value of year-end total assets. There is a risk that management might feel under pressure to overstate the value of assets through the judgements taken or through the use of releasing provisions. | Throughout the audit, the team will need to be alert to this risk. They will need to maintain professional scepticism and carefully review judgemental decisions and compare treatment against prior years. |