SOLUTION 1

(a) -An audit is the independent examination of financial statements or related financial information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is so conducted with a view to expressing an opinion thereon.

Importance of Audit

- Assurance of its investment returns
- For investment and disinvestment decisions
- Tax revenue assessment

(b) Expectation gap symbolizes the gulf, which is purported to exist between what users of financial statements expect of auditors and what auditors themselves perceive as being their statutory responsibilities. The expectation gap exist because of the public including the investment community are unclear about the role of the auditor.

For example many people believe and expect the auditor to take responsibility for the detection of fraud.

(c) These are some of the expectations of users of audited accounts;

1. Auditors must ensure that appropriate accounting policies are applied and audit accounts are not misleading.
2. Auditors must detect and report all major instances of fraud and errors.
3. Auditors must offer some sort of guarantee that the company will continue as a going concern.
4. The auditor's unqualified opinion is a guarantee that the business is being run efficiently and is making profit.

(d) The assurance that auditors will expect from management are:

(1) Management accept its responsibility for the use of appropriate accounting policies and has done everything possible to ensure completeness, accuracy and reliability of financial information.

(2) That management accept its responsibility for the prevention and detection of fraud and irregularities and has instituted

(3) To formally accept the terms of engagement

(4) It makes it clear that the auditors duties are statutory and cannot be changed

(5) It specifies that Auditors report to members and not directors

(6) It clarifies the responsibilities of directors to prepare financial statements, prevent fraud and error and to institute proper Internal Control Systems.

SOLUTION 2

(a) (i) On-line systems are those systems where input and output devices are directly linked to and controlled by the central processing unit such that data can **continuously and immediately be fed into the computer or extracted from it**. Usually, files can be accessed by enquires such that data can be displayed on a visual display unit (VDU) or printed out at any time. On-line systems contrast with batch systems where data is fed in and output taken at particular time only.

Real-time systems are those systems where on line input and output facilities exist but where in addition processing of the input occurs immediately.

A good example might be in banking. An on line system would enable transactions (e.g. deposits or withdrawals) to be input as they occur and for files (e.g. of account balances) to be interrogated at will. However, if processing of the input (e.g. Updating of customer accounts) does not occur instantly then enquiry may not elicit the balance updated for all transactions. If, however, a real time system was employed so that any input caused the files to be immediately updated then any enquiry would reveal the balance updated for all transactions. The benefit of this would be that decisions (e.g. to refuse to honour a cheque) could be made with the benefit of knowledge of the completely up-to-date position.

(ii) The major problem of such systems lies in the loss of audit trail. When files are updated, obsolete information is usually deleted and the auditor is not able to trace through transactions and files after relatively short intervals of time.

Further problems that can occur include:

1. Absence of some documents. An object of on line input is to do away with paper.
2. Authorisations are frequently program based (e.g. credit control) and cannot be inspected later.
3. Output is often on to VDU's and hard copy is not available to the auditor.

(iii) In one way, the auditor is unlikely to find the problems, in that they occur also to the client who also must have control over his system. Audit trails are often built in for internal audit and management supervision purposes.

However, where the problems do occur then an auditor can:

1. Persuade his client to implement an audit trail, for example by frequent print outs of transaction and master file data.
2. Gain closer acquaintance with the client's system and programs so that the auditor can gain evidence of the effectiveness of program based controls.
3. Make detailed examinations of organisational controls particularly of the program and systems development controls. By this means the auditor can gain assurance on the effectiveness and reliability of systems and programs.

(b) (i) Teaming and lading

This is also known as “covering over fraud” is a method used to substitute later cash collected for earlier ones misappropriated.

Receipts from debtors may be “switched” between ledgers. For example, a cheque from a debtor – AA might be substituted for the same amount of cash received from a different person.

Control Measures

1) Recording the amount and nature of all receipts (cash, cheques, postal orders, etc).
2) Listing all cheques banked by date and amount.
3) Identifying the pay-in-slip by date, amount and number in the cash book.
4) Cross-referencing individual debtors/receivables ledgers to the cashbook.
5) Limiting cash balances held by cashiers.
6) Operating a system of internal checks e.g. daily banking of cash, regular unannounced checks on the cashier.

SOLUTION 3

Ethical requirements are:

1. Integrity
   An accountant should be straight forward, honest and sincere in his approach to his professional work.

2. Objectivity
   An accountant should be fair and must not allow prejudice or bias to override his objectivity.

3. Independence
   When in public practice an accountant should both be and appear to be free of any interest which might be regarded, whatever its actual effect as being incompatible with integrity and objectivity.

4. Confidentiality
   An accountant should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose. He should also not use this information to his advantage or for the advantage of third party.

5. <u>Technical Standard/Professional Duty of Care</u>
   An accountant has a duty to carry out his work with care and skills and in conformity with the professional and technical standards promulgated by his professional body and in the legislation of his country and instructions of the client insofar as they are not incompatible with the requirements of integrity, objectivity and independence.

   In the light of these, the accountant must be conversant with GNSA, GAS, IFRS and Company's Code, 1963 Act 179.

6. <u>Professional competence</u>
   An accountant who accepts a professional engagement implies that he has the necessary competence to carry out the work and will apply his knowledge, skill and experience with reasonable care and diligence. He should therefore refrain from undertaking or continuing any assignments which he is not competent to carry out unless he obtains such advice and assistance as will enable him carry out his task satisfactorily.

7. <u>Ethical Behaviour</u>
   An accountant should conduct himself in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession. The obligation to refrain from any conduct which might bring discredit to the profession requires the professional body of the country to consider, when developing ethical requirements, the responsibilities of an accountant to clients, third parties and the general public. Some specific matters that require considerations are:

   (a) The financial liability of an accountant for the acts and defaults

   (b) Advertising, publicity and solicitation by accountants in public practice

   (c) Receipts and payment of commission by an accountant

   (d) The basis on which fees are charged by an accountant in public practice.

(b) **Need for engagement letter**

1. Under statutory audit: The scope of the audit and the auditor's responsibilities as well as the responsibilities of the management is defined by law. But even under statutory audit the auditor may agree to render other services to the client. The scope of these services must be refined in defined in writing.

2. Under non- statutory audit: The scope of the audit as well as other services to be performed by the auditors must be the subject of an agreement between the client and the auditor. This agreement must be set out in the engagement letter.

3. Furthermore, the Company's Code 1963 Act 179 (Sub-Section 1 of Section 143) states that no person can be appointed as an auditor of a company unless he has first consented in writing to be appointed.

4. The professional accountancy bodies also require that their members should send Engagement Letters to clients before the commencement of any professional work.

5. The auditor need to send an engagement letter to all new clients and to existing client when a substantial change has occurred in the scope of the audit on other services to be performed or in the change of the management of the client.

6. It is in the interest of both client and the auditor that the auditor send an engagement letter, to help in avoiding misunderstanding with respect to the engagement.

(c) Internal Controls relating to instituted to achieve the following:

1. Transactions are executed in accordance with management's general or specific authorisation.

2. All transactions are promptly recorded in the correct amount, in the appropriate accounts and in the accounting period in which it relates so as to permit preparation of financial information within a framework of recognised accounting policies and to maintain accountability of assets.

3. The records of assets are compared with the physical assets at reasonable intervals and appropriate action taken on any differences.

SOLUTION 4

(a) Factors affecting audit risk:

(1) Probability of an error occurring

(2) Potential size (Materiality) of an event

(3) Internal control strengths and degree of compliance

(4) Size of departments

(5) Usage of cash or other negotiable instruments

(6) Portability, attractiveness, unit value of stocks

(7) Size and hence possibility of collusion in department's staff

(8) Previous experience

(9) Experience on other audits

(10) Discussion with staff especially internal audit

(11) Assessment of managerial competence

(12) Ratio analysis (especially gross profit)

(13) High stock level department

(14) Relation of credit notes to sales

(15) Staff turnover especially of managers

(16) Budget variances

(b) Five Responsibilities/Functions of Audit Committee

(i) To review (formally and regularly) the financial results shown by both management accounts and those presented to shareholders.

(ii) To make recommendations for the improvement of management control

(iii) To ensure that there are adequate procedures for reviewing 'rights' circulars, interim statements, forecasts and other financial information before distribution to shareholders.

(iv) To assist external auditors in obtaining all the information they need and in resolving difficulties experienced by them in pursing their independent examination

(v) To deal with any material reservations of the auditors regarding the company's management, its records and its final accounts, including the manner in which significant items are presented.

(vi) To facilitate a satisfactory working relationship between the management and auditors, and between the internal and external audit functions.

(vii) To be responsible for the appointment of auditors as well as fixing their remuneration.

(viii) To be available for consultation with the auditors at all times, if necessary, without the presence of management to discuss regularly and review the procedures employed by the auditors.

(ix) To be concerned with all matters relating to the disclosure by the accounts of a true and fair view for the benefit of all users.

(c) (i) An officer of the company or of any associated company;

(ii) A person who is a partner or in the employment of an officer of the company, or of any associated company; save that partnership with a person acting as a Secretary or Registration Officer of the company or any associated company shall not constitute a disqualification;

(iii) An infant;

(iv) A person found by a competent court to be of unsound mind;

(v) A body corporate except that members of an incorporated partnership may be appointed;

(vi) Anyone in respect of whom an order has been made under section 186 of the Code so long as such order remains in force unless leave to act as auditor of the company concerned has been granted by the court in accordance with the said section;

(vii) An un-discharged bankrupt, unless he shall have been granted leave to act as an auditor of the company concerned by the court which adjudged him bankrupt.

SOLUTION 5

(a) (i) Planning the Audit

The following is a description of desirable planning procedures for the audit of LAMPS LTD.

(1) Read the previous years audit files paying particular attention to points raised and difficulties encountered. Apart from giving the new auditor an opportunity of becoming familiar with the audit, this will enable him to form a view on the extent to which the current audit may be affected by items recorded in the previous year's audit file.

(2) Assess the effects of changes in legislation (Companies Code) or in accounting practices.

(3) Review interim accounts, management accounts statements issued in connection with stock exchange requirements.

(4) Consult with senior staff of the client

The object of the two procedures above, it to enable the auditor to appraise himself of the current trading circumstances and significant changes to the business, its personnel, its locations and accounting procedures.

(5) List the timing requirements of the audit. This will involve considerations of work division between interim, year-end and final audits. It will also be necessary to consider the clients requirements and abilities in connection with the preparation and printing of accounting statements and the dates of meetings.

(6) Consider the degree of co-operation that can be experienced with internal audit.

(7) Determine he need for the preparation of audit working schedules and the degree to which they can be supplied by the client.

(8) Assess the availability of staff of the different levels of experience and ability and endeavour to match the available staff with the particular needs of this audit.

(9) Brief the staff on the particular problems of this audit. They should be made aware of the existence of related parties and the need for investigation of all matters where they are put upon enquiry.

(10) Prepare a memorandum setting out the approach to be adapted to the audit. This memorandum should state in outline:

(a) Each item on the financial statement and how, when and by whom, it will be verified.

(b) The timing requirements that need be met.

(c) Staff usage with a time budget for each section of the audit.

(ii) <u>Controlling the Audit</u>

The following procedures could be used to control the audit:

(1) Allocation of work to staff who are capable of performing the work given to them satisfactorily. This means staff of adequate training, experience, age and ability.

(2) Full briefing of staff as to the work expected from them, the problem they may expect to meet and the matters to which they should direct their particular attention.

(3) Precise instruction to audit staff to bring to the attention of more senior staff any problems encountered and any "put upon enquiry" situations.

(4) Completion of working papers in such a meticulous and complete manner that all audit actions are recorded.

(5) Reviews of the work performed and the working papers completed by each audit assistant, by more senior staff. Acknowledgement of such review should be incorporated into the working papers.

(6) Use audit completion check lists with sections for completion by each level of staff including the final review by the partner in charge,. This should ensure that all work has been completed and that opinions have been formed on each item in the accounts.

(7) Facilities for consultation with other partners and personnel with specialist knowledge when second opinions or specialist knowledge are required.

(8) Overall quality control by means of a 'hot' review or other techniques of investigation or monitoring of audits by senior people not connected with the audit.

(b) Source of Knowledge

(i) Previous experience with the entity and of its industry.

(ii) Discussion with people within the entity (eg. junior and senior managers).

(iii) Discussion with internal audit personnel and review of internal audit reports.

(iv) Discussion with auditors (including predecessor auditors) and with legal and other advisors who have provided services for the entity or within the industry.

(v) Discussion with knowledgeable people outside the entity, (for example industry economists, industry regulators, customers, suppliers, competitors).

(vi) Publications related to the industry (from government, banks and securities dealers, financial newspapers) etc.

(vii) Legislations and regulations that significantly affect the entity.

(viii) Visits to the entity's premises and plant facilities.

(ix) Documents produced by the entity (for example minutes of meetings, materials sent to shareholders, promotional literature, prior-years annual and financial reports, budgets, management policies, accounts, job descriptions, marketing and sales plans.

(x) Industry-specific guidance.