

# Tutorial letter 201/1/2016

## AUDIT PLANNING AND TESTS OF CONTROL

### AUE3701

#### Semester 1

#### Department of Auditing

**IMPORTANT INFORMATION:**

This tutorial letter contains important information about your module.

BAR CODE

**QUESTION 1**

**30 marks**

<b>No.</b>	<b>Answer</b>	<b>Reference</b>	<b>Explanation of answer (the correct answer is explained, and a reason(s) is also provided why incorrect options are incorrect)</b>
1	2	Study unit 3.9	<p>Audit documentation, or working papers, comprise the principal record of audit procedures performed, evidence obtained and conclusions reached (refer to ISA 230.6(a)). Working papers must reflect the nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements (refer to ISA 230.8(a)). Working papers must reflect the audit work performed (for example, work performed on bank reconciliations). Reviewing the working papers allows a supervisor to understand the work performed and the evidence obtained, and to evaluate whether the audit was performed adequately. Therefore, option 2 is correct.</p> <p>Options 1, 3 and 4 are incorrect. Checklists/bank reconciliations/financial statements may be used as part of the audit documentation to supplement the work performed and to verify the existence of the information used, but on their own, they would not provide a comprehensive record of the audit procedures performed and conclusions reached by the auditor.</p>
2	3	Study unit 3.7 and 3.8	<p>The audit plan sets the nature, timing and extent of audit procedures (ISA 300, paragraph .09) and therefore option 3 is correct. The audit strategy sets the scope, timing and direction of the audit (ISA 300, paragraph .07).</p>
3	1	Study unit 3.3	<p>Firstly, it is important that you understand the definitions of audit risk, the components of audit risk and the definition of risk of material misstatement to be able to answer this question. (Refer to ISA 315, ISA 200 and the glossary of terms in your SAICA Handbook, volume 2.)</p> <p>The audit risks related to a new audit client can be classified as detection risk. The audit risks can be described as follows:</p> <p>The annual financial statements may be materially misstated as the opening balances might be incorrect since there were different auditors in the prior year.</p> <p>The annual financial statements may be materially misstated as material misstatements could go undetected as we are not familiar with the client.</p>

No.	Answer	Reference	Explanation of answer (the correct answer is explained, and a reason(s) is also provided why incorrect options are incorrect)
4	1	Study unit 3.3	<p>Firstly, it is important that you understand the definition and components of audit risk and the definition of risk of material misstatement to be able to answer this question. (Refer to ISA 315, ISA 200 and the glossary of terms in your <i>SAICA handbook</i>, volume 2.)</p> <p>When applying your knowledge to the question, it is important to identify the risk first. The risk is that a newly qualified chartered accountant was appointed during the year under review. This newly appointed accountant is also in charge of the internal control system of the company.</p> <p>Let's consider each of the options separately:</p> <p>Option 1: Before consideration of any related controls, bear in mind that the annual financial statements may be materially misstated. This is because errors might occur in the preparation of financial records owing to a newly appointed accountant who may not have the experience to record complex transactions. Therefore, this risk could be classified as inherent risk in terms of its definition. The risk will increase inherent risk.</p> <p>In addition, the annual financial statements may be materially misstated as the control environment might be compromised by an inexperienced, newly appointed accountant. This could lead to errors in the annual financial statements. Therefore, this risk could be classified as control risk in terms of its definition. The risk will increase control risk.</p> <p>Option 2: As discussed previously, inherent and control risk will <b>increase</b>. Therefore, option 2 is incorrect.</p> <p>Options 3 and 4: This question relates to risk of material misstatement and if you look at its definition, you will see that risk of material misstatement consists of two components only, namely inherent risk and control risk. Therefore, these options are incorrect as they refer to detection risk.</p>
5	1	Study unit 3.5	<p>Refer to ISA 250.</p> <p>1 Correct: ISA 250.A13</p> <p>2 Incorrect: ISA 250.A16</p>

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			<p>3 Incorrect: ISA 250.A18</p> <p>4 Incorrect: ISA 250.A21</p>
6	2	Study unit 3.2	<p>Refer to ISA 315.A58 and A60. From these references it is evident that options 1, 3 and 4 should be considered when obtaining an understanding of the client's internal control. Please note that conducting extensive tests of controls is performed by the auditor during the fieldwork phase. Therefore, option 2 is the correct alternative.</p>
7	1	Study unit 5.1	<p>Controls in an automated (computerised) environment are categorised as either general controls or application controls. General controls are those controls implemented over the overall framework of automated activities before any processing of transactions takes place. For example, control procedures to ensure that staff is competent and trustworthy would be regarded as general controls. Application controls are those controls relevant to a specific task within the automated system such as input, processing and output.</p> <p>When transactions are captured onto the automated system, the relevant task is called input. Processing takes place when information that has been captured is used to update existing information on a computerised file. Output is a product of processing and is sometimes converted to a hard copy.</p> <p>The scenario relates to capturing of personal details on the automated system. This refers to a specific task within the automated system and therefore it is regarded as an application control and not a general control. Capturing relates to input and therefore option 1 is correct.</p>
8	4	Study unit 3.4	<p>Refer to ISA 240.</p> <p>1 Incorrect: ISA 240.43</p> <p>2 Incorrect: ISA 240.A16</p> <p>3 Incorrect: ISA 240.32</p> <p>4 Correct: ISA 240.A4 &amp; A5</p>

No.	Answer	Reference	Explanation of answer (the correct answer is explained, and a reason(s) is also provided why incorrect options are incorrect)
9	4	Study unit 1.1	The correct alternative for this question is 4. Please read ISA 200.A23-A27. Calculating and assessing the audit risk components as lower, medium or higher is based on professional judgment. After the auditor has performed the audit the auditor will evaluate whether he has gathered sufficient appropriate audit evidence to base the auditor's opinion on. To make this evaluation the auditor will use professional judgment.
10	4	Study unit 3.7	<p>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.</p> <p>All the other alternatives occur at another point in time during the audit.</p>
11	1	Study units 3.1	<p>Refer to ISA 300.</p> <p>1 Correct: ISA 300.2. There are also other benefits resulting from adequate audit planning. These benefits are listed in ISA 300.2.</p> <p>2 Incorrect: ISA 300.A14. If there is an increase in the assessed risk of misstatement for an account balance and/or class of transaction, various assertions may be affected. To obtain sufficient, appropriate audit evidence regarding those assertions, the audit team members responsible for auditing the specific account balance and/or class of transaction should increase their sample size. The audit engagement partner and/or manager should also provide prompt direction and supervision to the audit team members and conduct a more detailed review of their work.</p> <p>3 Incorrect: ISA 300.A2. Planning is a continual and iterative process.</p> <p>4 Incorrect: ISA 300.5. The engagement partner and other key members should be involved in planning the audit.</p>

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12	4	Study unit 3.6	<p>Refer to ISA 320.</p> <p>1 Incorrect: ISA 320.11</p> <p>2 Incorrect: ISA 320.5</p> <p>3 Incorrect: ISA 320.A3</p> <p>4 Correct: ISA 320.13</p>
13	4	Study unit 3.2	<p>Control risk is the risk that a misstatement that occurs will not be prevented, detected or corrected by the accounting and internal control system. When there is a good, effective system of internal control, it means the control system will prevent, detect or correct misstatements, hence the control risk will be low.</p> <p>If control risk is reduced, the acceptable level of detection risk will increase.</p>
14	3	Study unit 1.1	<p>Refer to ISA 200.</p> <p>1 Incorrect: ISA 200.3</p> <p>2 Incorrect: ISA 200.4</p> <p>3 Correct: ISA 200.5</p> <p>4 Incorrect: ISA 200.13</p>
15	2	Study unit 2.1	<p>1 Incorrect: Rescheduling of staff does not pose a risk if properly planned.</p> <p>2 Correct: A client-imposed scope limitation might be hiding errors or irregularities that could result in a material misstatement in the financial statements.</p> <p>3 Incorrect: The hiring of a specialist is an acceptable practice.</p> <p>4 Incorrect: The fact that a client's financial reporting system has been in place for ten years might be indicative that the system's errors have been resolved and the system has integrity.</p>

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16	3	Study unit 2.1	<p>Refer to ISA 210.A23.</p> <p>The sampling plan is the item that is least likely to be discussed at such a meeting. This meeting between the auditor and the engagement client presents the opportunity to discuss the content of the engagement letter. The sampling plan will not be discussed, as it will not be determined until the preliminary understanding and evaluation of controls has been completed.</p>
17	4	Study unit 3.3	<p>Alternatives 1 – 3 are mentioned in Appendix 2 to ISA 315 as conditions and events that may indicate risks of material misstatement. Do you understand why? Remember that risk of material misstatement relates to inherent risk and control risk.</p> <p>Personnel without appropriate accounting skills may capture transactions incorrectly, which may lead to material misstatements.</p> <p>A loss of significant customers may lead to a company trying to overstate sales figures to make stakeholders believe that prospects are better than what they are.</p> <p>When a business expands into new locations, the accounting system may not be geared to process new types of transactions, which can also lead to material misstatements.</p> <p>Therefore, option 4 had to be chosen as the incorrect alternative.</p>
18	3	Study unit 3.2	<p>When reliance cannot be placed on general controls, this will have an impact on all applications, hence it will be unlikely that a control testing approach will be followed. When reliance cannot be placed on general or application controls, these controls will not be tested and a substantive approach will be followed. It is most likely that a system based approach will be followed when reliance can be placed on general and application controls.</p>
19	2	Study unit 1.1	<p>The correct option for this question is 2. Why is option 2 false? Please read ISA 200.15. What does professional scepticism mean to us as auditors? It means that we as the auditors will plan and perform an audit with the attitude</p>

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			<p>that there is a possibility that circumstances may exist that cause the financial statements to be materially misstated. You can therefore never just trust management and those charged with management. Please refer to ISA 200.A18 for examples on what the auditor should be alert to as part of professional scepticism.</p> <p>Now read ISA 200.A19. Maintaining professional scepticism throughout the audit is necessary if the audit is to reduce the risks of overlooking unusual circumstances. Why is this true? If you exercise professional scepticism you will most likely not just believe what management tells you. You will make sure that answers to enquiries from management make logical sense and tie up to other answers to enquires.</p>
20	3	Study unit 3.2 and 3.3	<p>An auditor's priority is to assess risk (i.e. the auditor performs risk assessment procedures). This enables the auditor to perform further procedures in response to the risk, hence deciding which audit approach to follow. In this scenario, it is evident that the control which prevents discounts from being granted is not operating effectively. This will contribute to an increase in the auditor's estimation of control risk. The correct alternative is therefore 3.</p> <p>The scenario provides evidence of a lack of good internal control, which will ultimately increase the auditor's estimation of control risk.</p> <p>As a result of increased control risk, the sales planning materiality figure will actually be set at a lower value, in order to perform more work to obtain reasonable assurance.</p>

**(1½ marks per question)**