SECTOR: BUSINESS SERVICES

SUB-SECTOR: ACCOUNTING

LEVEL 5

ACCPA501 PRINCIPLES OF AUDITING

This module describes the skills, knowledge and attitude required to apply principal of auditing. It is intended for learners who have successfully completed the level 4 in accounting or its equivalent and pursuing level V in accounting or applying for recognition of prior learning or other related qualifications.

At the end of this module, learners will be able:

1. To describe the legal and professional standards required for an auditor,
2. Apply the auditing procedures of organization,
3. Apply auditing techniques and its applicability in organization and
4. Describe range of audit documentation and recognize the appropriateness.

Qualified learners deemed competent to this competency shall have ability to take responsibility for the carrying out of a range of defined activities in accounting under non- directive supervision

LEARNING UNIT 1: DESCRIBE THE LEGAL AND PROFESSIONAL STANDARDS REQUIRED FOR AN AUDITOR

LEARNING OUTCOME 1.1: EXPLAIN LEGAL AND ETHICAL DUTIES OF AUDITORS ACCORDING TO INTERNATIONAL STANDARDS ON AUDITING

Definition of auditing

Auditing: is defined as an independent examination of books of accounts and vouchers of business with view of forming an opinion/ judgment as to whether these have been kept properly according to the company's act and as to whether or not the statements presents a true and fair view of the financial position of a business.

The above definition can be broken down as:

a. **Independent examination/ test or assessment**: This is conducted by qualified accountant according to the company act. The qualified accountant must be independent of all parties on interests in the company.

The audit is conducted on behalf of the owners (shareholders). Owners meet at the annual general meeting and they hear the report from the auditors regarding to the financial performance of the company.

b. **Books of Accounts:** They are many books of accounts that a limited company must maintain such as
   i. Cash book,
   ii. Assets registrar
   iii. Ledger,
   iv. Shareholder's registrar
   v. Vouchers

   A voucher is document which supports transaction in the books of accounts .E.g. Receipts, invoices, debit note, etc

- The Auditor will check the voucher for:
- Authorization: whether it was authorized by high full authorities.
- Date: whether it is for the current period under audit.
- Recording correctly in books of accounts.
- Whether it is for business i.e. whether it relates to company's ordinary transactions

OBJECTIVES OF AUDIT

The main objectives of audit are :

1. Primary or principal objectives

2. Secondary or subsidiary objectives

1. Primary or principal objectives

a) To prove the true and fair view of the company's state of affairs on a given date
b) To confirm that the proper books of accounts are being kept or not.
c) To communicate the findings or to write report to the shareholders of the company.

2. Secondary or subsidiary objectives

- To detect errors and frauds
- To prevent errors and frauds
- To assisit the clients to improve their accounting systems
- To find out whether internal control system is working properly or not

IMPORTANCE OF AUDIT

1. It provides an assurance and credibility to the interested parties
2. Third parties who do not take part in the business organization are protected
3. It acts as detective and preventive measure against errors and frauds
4. It keeps accounting staff vigilant and careful
5. Shareholders are assured that directors and management are acting to the best of their interest
6. Audited accounts can be used as the basis of borrowing money from financial institution
7. Audited accounts help new partner in a business to determine its state of affairs or situation of business.

TYPES OF AUDIT

- **Types of audit according to the nature of work**

1. Private / voluntary audit

This is an audit which is not legally required. The private audit is conducted according to the agreememntbetween auditor and his client and is not governed by any particular law.

The private audit includes the audit of sole trader, audit of partnership, management audit ,etc..

The contract between auditor and his clients is importantbecause :

- It define the scope of audit
- It is the basis of charging the audit fees
- It is the basis of report
- It is the evidence

2. Statutory audit

These are the audits that are a requirement of a law. They are usually conducted for public bodies (government institutions) and limited companies , cooperative societies, audit of bank, imsurance companies, etc.

The statutory audit is that audit which is conducted under the provision of the law of the company.

Distinction between statutory and private audit

Statutory audit	Private audit
It is mandatory for all limited companie	It is not legal obligation for all firms
It aims at proving the fair view of the client's state affairs	It aims at detection of errors and frauds and determining of profit for tax purpose
The auditor is appointed uder the company act	The auditor is engaged on private engagement
The auditor's scope is determined by the company act	The auditor's scope of work is determined by the owners
The auditor performs pure audit work	The auditor may perform both auditing and accounting
The auditor is liable to the third parties	The auditor is not liable to the third parties
The auditor's rights and duties are determined by the statute	The auditor's rights and duties are determined by the client
The auditor is independent from all the parties in the company	The auditor's independence may be limited by the client

Similarities between statutory and private audit

1. In both audits, the auditor's duties and scope of work can be increased by the client.
2. In both audits, the auditor earn 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.

3. Internal audit

The internal audit is conducted by the internal auditor who is an employee of the organization. The main purpose of internal audit is to find out whether the internal control system is successfully working or not.

Although the auditor is an employee of the organization , he is given some form of independence in order to perform his duties more efficiently.

4. External audit

This audit is carried out by an independent auditor who is not an employee of the organization.

The external auditor is appointed by the owners of business.

The main purpose of external audit is to submit to the shareholders an audit report on the financial position of a business.

- **Types of audit according to the time factor**

1. **Final / completed / periodic audit**

The final or completed or periodic audit is that audit which is taken up at the close of financial or trading period when all the accounts have been balanced and the statements have been prepared.

2. **Interim audit**
   Interim audit is an audit which is conducted to a particular date within the accounting period. These are conducted within the accounting period usually half yearly

3. **Continuous audit**

The continuous audit or detailed audit is an audit which involves a detailed examination of the books of accounts at a regular interval say on month , two or three months. The auditor visits his client at a regular or irregular intervals during the financial year and each and every transaction.

- **Types of audit according to the method or approach**
  1. **Procedural audit**

This is an examination and review of the internal procedures and records of an organization. The main purpose of this audit is to ascertain whether the internal procedures are reliable or not.

2. **Management audit**

The management audit is conducted to investigate the management aspect of a business.

The main purpose of this audit is to prepare a report on the effectiveness of the management on the point of profitability and efficient running of the business. This can reveal the strengths and weaknesses of the management.

3. **Balance sheet audit**

The balance sheet audit means the verification of the value of assets, liabilities and the balances of reserves and provisions and the amount of profit and losses incurred by a business during a year.

The balance sheet items are verified for checking : (DOVEPA)

- Description (recordings)
- Ownership (documents of title)
- Value (costs less depreciation)
- Existence (physical existence of assets)
- Presentation
- Authorization

4. **Standard audit**

This is a type of audit which is conducted to ascertain whether the client accounting system complies with the required levels of standard set by the professional bodies

These may include :

- Statement of standards of accounting practices (SSAP)

- Iternational Accounting Standard (IAS)
- Generally Accepted Accounting Principles (GAAPS).

5. Vouching audit

Vouching audit is that audit where the auditor checks each every transaction right from the origin in the books of prime entry till they are posted and the final accountants are prepared from the accounts posted.

Difference between internal auditor and external auditor

internal auditors	external auditors
▪ Auditor work within an organization ▪ He is given some form of independence in order to perform his duties more effectively ▪ They submit audit report to the management ▪ Internal auditor prevents and detects errors and frauds ▪ Auditor may perform not only auditing work but also acts as a consultant to an other departments on matters of control ▪ Internal auditor is more qualified with problems facing the company ▪ Internal auditor conduct audit work continuously over day to day activities of the business	▪ Auditor who is not an employee of the organization ▪ Are independent of the organization they are auditing ▪ They submit audit report to the shareholders. ▪ Auditor detects errors and frauds ▪ Auditor performs a pure audit work ▪ He/she is external person who does not have much experience about the company's culture ▪ External auditor conduct audit work at the end of a given period especially at the end of the financial period

<u>Legal and ethical duties of auditors according to international standards on auditing</u>

<u>Duties to auditorsare:</u>

- Duty to make a report to shareholders as external auditors
- Duty to make a report to the management as internal auditors
- Duty to assist in investigation
- Duty to make income statement
- Duty to provide clear report and clear evidence

<u>Rights of the auditor</u>

- ✓ Right to access to the books of accounts of the organization at any time
- ✓ Right to call for information and explanations from employees, managing agents, company secretaries, etc.
- ✓ Right to receive a 21 day notice to attend the AGM ,and extraordinary meetings
- ✓ Right to make a statement or to express ideas to the AGM
- ✓ Rights to visit the company's branches
- ✓ Right to take a legal and technical advice
- ✓ Right to remuneration
- ✓ Right to sign the audit report

Identify ethical (values) standards of auditor

- ✓ Integrity, objectivity and independence
- ✓ Non assurance services provide to assurance (guarantee) client
- ✓ Long association with the audit engagement
- ✓ Fees ,remuneration and evaluation policy
- ✓ Financial, business, employment And personnel relationship

LEARNING OUTCOME 1.2: DESCRIBE THE AUDIT RISK AND ITS APPLICATION TO AUDIT ACCORDING TO AUDITING STANDARDS

DEFINITION OF AUDIT RISK

Audit Risk is the risk (danger) that an auditor expresses an inappropriate /wrong opinion (judgment) on the financial statements.

Explanation

Audit risk is the risk that an auditor issues an incorrect opinion on the financial statements. Examples of inappropriate audit opinions include the following:

- Issuing an unqualified audit report where a qualification is reasonably justified;
- Issuing a qualified audit opinion where no qualification is necessary;
- Failing to emphasize a significant / important matter in the audit report;

Types of audit risk

- ✓ Inherent risks,
- ✓ Control Risks and
- ✓ Detection Risks.

Inherent Risk

Inherent Risk is the risk of a material misstatement in the financial statements arising due to error as a result of factors other than the failure of controls (factors that may cause a misstatement due to absence of controls are considered separately in the assessment of control risk).

Control Risk

Control Risk is the risk of a material misstatement in the financial statements arising due to absence or failure in the operation of relevant controls of the entity.

Detection Risk

Detection Risk is the risk that the auditors fail to detect a material misstatement in the financial statements.

An auditor must apply audit procedures to detect material misstatements in the financial statements whether due to fraud or error. Misapplication of critical audit procedures may result in a material misstatement remaining undetected by the auditor.

MODEL AND CALCULATION OF AUDIT RISKS

Audit Risk = Inherent Risk x Control Risk x Detection Risk

Audit risk model is used by the auditors to manage the overall (in general) risk of an audit engagement or appointment.

Example

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%.

Working

Audit Risk = Inherent Risk x Control Risk x Detection Risk

10% = 60% x 60% x Detection Risk

0.10 = 0.60 x 0.60 x Detection Risk

0.10 = 0.36 x Detection Risk

$\frac{0.10}{0.36}$ = Detection Risk

Detection Risk = 0.2777777778 = 28%

Definition of auditor's liabilities

Auditor limited liability agreements are contracts designed to ensure that **auditors** are not pursued for excessive losses, just reasonable proportion based on their responsibility

Types of auditor's liability

- ✓ Civil liability
- ✓ Criminal liability

Difference between civil liability and criminal liability

Civil liability of Auditor for **negligence**. The liability of auditor to pay damages is known as **civil liabilities**.i.e potentialresponsibilityforpayment of damages. Auditor must exercise reasonable degree of skill and care in the performance of his **duties.**
If not, the auditor will have to face the consequences.
An auditor can be held liable for **negligence** of his duty if it is proved that:

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

Criminal liability definition: responsibility for any illegal behavior that causes harm or damage to someone or something: whichmeansopen to punishmentfor a crime.

Sources of Legal Liability for an Auditor

- The Legal Liability of Auditors to Third Parties
- Unjustified / unfair Lawsuits
- Successful Lawsuits Against Auditors

Third Parties: A person or group besides the two primarily involved in a situation, especially a dispute.

Learning Outcome 1.3: Identify the relevant legislation and auditing standards according to international standards on auditing

International standards on auditing **(ISA)** are professional standards for the performance of financial audit of financial information .These standards are issued by International Federation of **Accountants** (IFAC) through the international Auditing and Assurance or guarantee Standards Board (IAASB)

International standards on auditing(ISA) or International Auditing Standard(IAS)	**Description of auditing standards**
IAS 200	• Revised and Redrafted, “Overall Objective of the Independent Auditor,
IAS210	• Deals with the auditor’s responsibilities in Agreeing the Terms of Audit

	Engagementswith management
IAS230	• Audit Documentation • Deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements.
IAS240	• Redrafted • The auditor performs risk assessment procedures to obtain information for use in identifying the risks of material misstatement due to fraud
IAS520	• Deals with the auditor's use of analytical/ logical or investigative procedures as substantive procedures.
IAS530	• *Audit* Sampling • Deals to establish **standards** and provide guidance on the use of **audit** sampling and other means of selecting items for testing when designing **audit** procedures to gather **audit** evidence.
IAS540	• Revised • **Auditing** Accounting Estimates, Including Fair Value Accounting Estimates, this should be read in conjunction or combination with **ISA** 200
IAS300	• Planning an *Audit* of Financial Statements • Planning an *Audit* of Financial Statements requires *auditor* to plan the *audit* engagement
IAS315	**d)** Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

The regulation or guideline of auditors

- **Code of ethics**

***code of ethics*:** A written set of guidelines issued by an organization to its workers and management to help them conduct their actions in accordance with its primary values and *ethical* standards.

What are the five codes of ethics?

Code of ethics is made up of five fundamental principles:

- Integrity. Being straightforward, honest and truthful in all professional and business relationships.
- Objectivity.
- Professional competence and due care.
- Confidentiality.
- Professional behavior.

- **International standards on audit**

International Standards on Auditing (ISA) are professional **standards** or **principles** for the performance of financial **audit** of financial information. These **standards** are issued by **International** Federation of Accountants (IFAC) through the **International Auditing** and Assurance **Standards** Board (IAASB).

- **Company low**

Corporate law (also known as **business law** or enterprise **law** or sometimes **company law**) is the body of **law** governing the rights, relations, and conduct of persons, **companies**, organizations and businesses. It refers to the **legal** practice relating to, or the theory of corporations.

- **Government**

A group of people that governs a community or unit. It sets and administers public policy and exercises executive, political and sovereign power through customs, institutions, and laws within a state.

- **Professional accountancy bodies**

A professional accounting body is an organization or association of accountants in a particular jurisdiction or authority.

These bodies include:

- Institute of Certified Public Accountants Rwanda (ICPAR)
- Certified Public Accountants (CPA)
- The Association of Chartered Certified Accountants (ACCA) ...
- Association of Authorized Public Accountants (AAPA) - a subsidiary of the Association of Chartered Certified Accountants (ACCA) ...
- Association of International Accountants (AIA) ...
- Chartered Institute of Management Accountants (CIMA)
- American Institute of Certified Public Accountants (AICPA)
- Association of Accountancy Bodies in West Africa (ABWA)
- Association of Accounting Technicians (AAT)
- Association of National Accountants of Nigeria (ANAN)
- Botswana Institute of Chartered Accountants (BICA)
- Canadian Institute of Chartered Accountants (CICA)
- Certified General Accountants Association of Canada (CGA)
- Chartered Accountants Australia and New Zealand (CAANZ)

The role of international standards on accounting to auditor

1. Facilitates ethics compliance
2. Improve international investment
3. Sets generalized standards
4. Reduces a costs of preparing financial statements destined for international audiences.

LEARNING UNIT 2 : APPLY THE AUDITING PROCEDURES OF ORGANIZATION

2.1: Describe the auditing procedures according to the international standards on Auditing

- **Introduction on auditing procedures**

Definition:

Audit procedures are the processes and technique that auditors perform to obtain **audit evidences** which enable them to make conclusion on the set audit objective and express **their opinion or judgment**. Sometime we call **audit procedures** as **audit programs**.

These two are the same thing. Auditors normally prepare audit procedures at the **planning stages** once they identified audit objective, audit scope (opportunity) , audit approach (method), and risks.

Auditors design audit procedures to detect all kind of risks that they identified and ensuring that the require **audit evidence** are obtained sufficiently and properly.

Importance of auditing procedures?

i. **Audit procedures** are used by **auditors** to determine the quality of the financial information being provided by their clients.

ii. **Audit procedures** are used to decide whether transactions were classified correctly in the accounting records.

- **Types of auditing Procedures**

Types of Audit Procedures

1. Inspection of records and documents
   - Vouching
   - Tracing
   - Scanning
2. Inspection of tangible assets
3. Observation
4. Inquiry
5. Confirmation
6. Recalculation
7. Reperformance
8. Analytical Procedures

Here are List of Five types of Procedures:

1. Analytical view
2. Enquiry
3. Observation
4. Inspection
5. Recalculation

1. Analytical Review:

Analytical review is not the procedure that use to obtain audit evidence, but it is the procedure that used to assess the unusual (uncommon) transactions or event as the principle or basic to perform another procedures.

For example, when auditor found there is unusual transactions or event as the result of using analytical review, then auditor will use others procedures that applicable to obtain evidence.

Analytical procedure could be used for the types of transactions or event that occur regularly or have connection with others transaction or event.

For example, we can use analytical procedure to **assess the reasonableness of depreciation** that records in the financial statements. The main reason is that the depreciation expenses are calculated systematically and occur regularly.

2. Inquiry:

Auditors inquire (ask or request)accountant and related management to gather information and obtain an explanation on the mater that found by auditors.

This is also Asking questions of a company's accountants, managers and other key staff is a common way for auditors to gather information.

Auditors may ask about business processes and how financial transactions are recorded to ensure that the company is guarding against risks.

For example, they may ask a business owner how financial records are stored.

Auditors will not accept the answers alone as confirmation. But they may use the responses to their inquiries to establish additional testing criteria.

3. Observation:

Observationis one of audit procedures that auditors use to obtain an understanding and gather audit evidence mainly to the real process or the ways how clients done some specific business process.

This kind audit procedure is mainly to confirm process that client told, physical confirmation, or sometime use to obtain audit evidence in order to make their own projection which will be used for comparison with client figure.

For example, auditor join client stock take at the year end and observe whether the way that they counts are in the correct procedures or not.

4. Inspection:

Inspection is refer to verification or vouching documents.

This is one of the most importance and it can be 60% of audit work involve with the inspection of documents. For example, auditor examine the sales invoices that records in financial reports.

Auditor might examine whether the invoice issued by client is really based on the goods that receive. And the goods that received is actually the one the company make an order.

Auditors may verify whether security procedures are being followed and if invoices contain the correct amounts, **for example**. An auditor may spend most of their time verifying or vouching documents.

Auditor might also examine the payments voucher against the authority that approve on the payments vouchers. Auditor might also inspecting the supporting documents recording the inventories movement during the year. This is including the documents related to purchasing raw material.

5. Recalculation:

Recalculation is the type of audit procedure that normally done by re-performing the works that done by client in the purpose of assessing if there any different between audit's work and client's work.

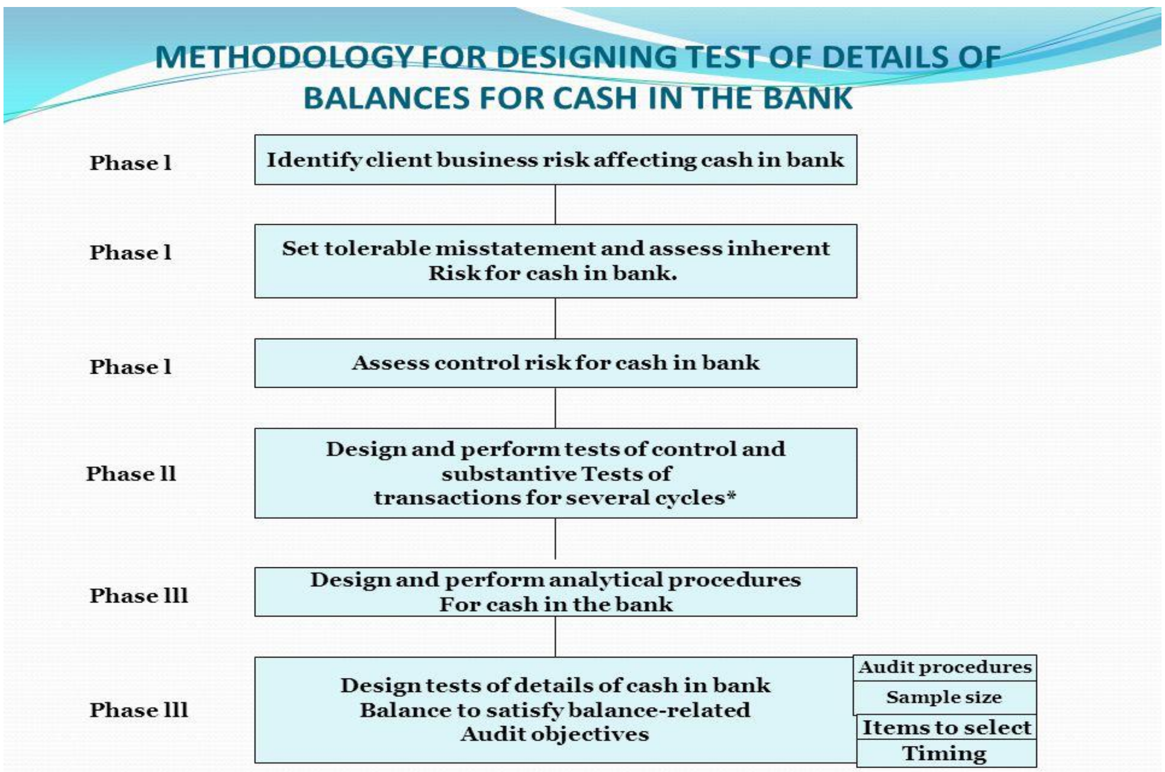
An auditor may check whether calculations are done correctly by doing the calculations themselves. For example, they might prepare their own payroll report by calculating the net wages that employees should receive by accounting for the suppressions and deductions. If there are no differences, they may conclude that the payroll reports are being done properly.

They also may check whether the information is transferred to accounting records correctly to ensure the integrity of the company's financial statements.

Design audit procedure

Audit procedures outline how individuals will conduct an **audit** and compare a company's information to national accounting standards or other rules. **Designing audit procedures** typically includes universal principles or **procedures** specific to a company's operations and individual job functions or tasks.

How to Design Audit Procedures



ACCPA501: PRINCIPLES OF AUDITING

TRAINEE'S NAMES: ……………………………………….

LEVEL 5 ACCOUNTING **TOTAL MARKS: 60 MARKS**

DATE: ……

INSTRUCTIONS: ATTEMPT ALL QUESTIONS

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1. Distinguish between the primary(principal)and secondary (subsidiary) objectives of an audit. **6marks**
2. Define audit .**2marks**
3. Give any five importance of audit .**5 marks**
4. Respond by true or false .**3 marks**
   i. The management audit is not conducted to investigate the management aspect of a business.
   ii. Final audit is performed to know the corporate social responsibility.
   iii. Interim audit is conducted within the accounting period usually six months
5. Define International standards on auditing (ISA) and give any 4 international auditing standard .**5 marks**
6. What are the right of auditor .**8marks**
7. As a manager of a company , compare the internal auditing and external auditing . **10 marks**
8. Discuss about similarities between statutory and private audit. **5 marks**
9. State two Types of auditor's liability .**2 marks**
10. Define audit risk and give Types of audit risk. **4 marks**
11. State types of audit :
    a) According to the nature of work. **2 marks**
    b) According to the time factor. **1.5 marks**
    c) According to the methods or approach .**2.5 marks**
12. Give any two Duties of auditors. **2marks**

Enjoy and Success is the fruit of one's effort

LEARNING OUTCOME 2.2: DETECT AND PREVENT FRAUD ACCORDING TO ORGANISATION POLICY AND PROCEDURES

- **Definition of fraud**

  Fraud means a false representation or entry made intentionally or made without belive in its truth with view to defraud.

- **Objectives of auditing**

The main objectives of audit are :

1. Primary or principal objectives
2. Secondary or subsidiary objectives

1. Primary or principal objectives

i) To prove the true and fair view of the company's state of affairs on a given date
ii) To confirm that the proper books of accounts are being kept or not.
iii) To communicate the findings or to write report to the shareholders of the company.

2. Secondary or subsidiary objectives

i) To detect errors and frauds
ii) To prevent errors and frauds
iii) To assisit the clients to improve their accounting systems
iv) To find out whether internal control system is working properly or not

- **Definition of fraud**

In auditing ,**an error** is defined as an unwilling commited mistake.

- **Difference between fraud and Error**

Error	**Fraud**
An unwilling commited mistake	false representation or entry made intentionally or made without belive in its truth with view to defraud
It is not intentional	It is intentional
It is easy to discover	It is not easy to discover
It may be tolerable	It is not tolerable
It is not a planned stealing	It is a planned stealing
It may not be followed by rules	It is followed by rules

- **TYPES OF ERRORS**

In auditing **, an error** is defined as an uniwilling committed mistake .

There are differents types of errors

1. **Clerical errors**

These errors are commited in posting , In totaling and balancing .

These errors are also subdivided into :

a) **Errors of omission :**

These errors are committed when entries for certain transactions are completely omitted from such that there are no records of such transactions in ledger . In this case , the whole double entry of transactions is ignored.

Briefly ,**Error of omission is when entry missed from accounting record .**

b) **Errors of original entry :**

This is when a transactionhas been recorded but has been wrongly entered in the books of original entry. Such errors may be intentionally or unintentionally.

Example : Purchase invoice for Rwf 1250 was entered in the purchase book as Rwf 1520.

Briefly ,**errors of originalentry is when there is correct accounts but wrong amounts.**

c) **Arithmetical errors :**

These errors resulting from the wrong additions or subtractions of amounts in the books of accounts .

2. **Error of principles:**

Such error arises when the entries are not recorded according to the fundamental principles of accounting .

Example : Treating capital expenditure as Revenue expenditure.

Briefly , error of principle there is correct amount but Wrong type of account.

3. **Compensating error or off-setting error:**

A compensating error or off-setting error is one which is counter balanced by any other error.

Briefly ,**Two or more errors balance each other out.**

Example : If **A**account was to debited for Rwf 100000 but was debited for Rwf 10000

While **B** account which was to be debited for Rwf 10000 was debited for Rwf 100000. Both accounts have been debited for a total sum of Rwf 110000 which amount must to have been debited.

4. **Error of duplication :**

This error arises when any entry in a book of original entry has been made twice and has also been posted twice.

5. **Tolerable error :**

This is the maximum error in the population that the auditor would be willing to accept and still conclude that the result from the sample has achieved his objectives.

6. **Expected errors :**

If the auditor expects errors to be present he will normally have to examine a large sample to conclude either that the population value is fairly stated within the planned tolerable error.

7. **Immaterial error:**

This is insignificant or inconsequential error which can not cause a considerable loss or great negative impact on the business daily performance.

Example : An error of under cast of Rwf 500 in the business whose annual turnover is Rwf 20,000,000.

8. **Material error:**

This is a serious error which can cause a considerable loss or effect on the business daily activities and periformance.

9. **Error of commission :**

There correct amount and type of account but wrong account .

- **MEASUREMENRT OF PREVENTION OF ERRORS**

The following are the measures that can be taken to prevent errors :

1. The company should employ a strong internal control system and efficient internal checking system .
2. A warding employees with reasonable salaries corresponding to their qualification and experience to raise their morale and reduces chances of errors.
3. Employing the qualified workers to prevent error of principle
4. Instituting an internal audit department where possible.
5. Encouraging staff to take their annual leave so that their work performance can be assesesdin their absence
6. Encouraging inter- department transfers and rotation of duties at a surprise moment so as to cut down the continuity of an error.
7. Close supervision of duties particularly in sensitive area of the business.
8. The management should use periodical review of what has taken place in anyone given area
9. Using the machines to record transactions.
10. The management should insist on referees when engaging employees especially accounting staff.

11. Use of computerized accounting system .

- **TYPES OF FRAUD**

In Auditing ,**Fraud** means a false representation or entry made intentionally or made without believe in its truth with view to defraud.

There are differents types of Fraud

1. Embezzlemnt of cash or financial embezelement
2. Misappropriation of Goods
3. Manipulation of Accounts
4. Misappropriation of Cash

1. Embezzlement of cash or financial embezzelement

This is a stealing of money especialy in big business by high authority of the business mainly Directors.

The embezzlement of cash may be done by :

- Omitting or Neglecting to enter any cash which has been received.
- Entering few amounts than what has been received.
- Making fictitious (imaginary or fabricated)entries on the payment side of the cash book.
- Entering more amounts on the payment side of the cash than what actually bas been paid.

2. Misappropriations of goods

This is stealing of an assets in organization.

3. Manupilation of accounts or fraudulent manipulation of accounts

This is falsifying figures in books of accounts. it is also misrepresentations of accounts .

This fraud is commitedby :

- Showing more profits than what actually they are so that :
  - **a)** They get commission on profit
  - **b)** Their services may be retained because of good performance
  - **c)** To obtain further of progress credits
  - **d)** To attract more subscribers for the sale of shares.
- Showing less profits than they actually are in order:
  - **a)** To purchase shares at lower price
  - **b)** To reduce or avoid the payment of income tax
  - **c)** To give wrong impression about the success of the business to competitors.

Other types of frauds include :

4. Misappropriation of cash

5. Misappropriation of accounting policies

6. Falsifying suppliers invoices

7. Disposal of company's property at less market value

8. Thefts of raw materials, etc.

PROCEDURES FOR DETECTING ERRORS AND FRAUDS

a) Control of source documents
b) Physical examination of the credits and material checking .
c) Direct confirmation
d) Analytical examination (using analysis)
e) Examination of the annual accounts.

ADVANTAGES , IMPORTANCE OF DETECTING ERRORS AND FRAUD FOR FINANCIAL STATEMENT

1. Provide Quality of financial information for key stakeholders like investors, bankers,
2. It avoid any penalty that could affect the entity.
3. Auditor will help shareholders to review the financial statements on their behalf. This could reduce the shareholders double on the management team. Auditors have better skill than shareholders in this area.

Audit of financial statements could help improve management's integrity especially when the result of audit prove that the financial statements are true and fair view.

4. Improve internal controls: auditors could help to review accounting system, procedure, people and process of entity. **i.e**It will help entity to improve its key internal control that could minimize the fraud risks and errors.
5. Trust from others organization: Creditors, banks, and government authority.

LEARNING OUTCOME 2. 3: DESCRIBE PRINCIPAL OF AUDIT AND WHEN THEY SHOULD BE USE ACCORDING TO ORGANIZATION POLICY AND PROCEDURES

✓ **THE PRINCIPALS OF AUDITING**

The principals or **leaders**of auditing are such as :

1. Planning
2. Secrecy
3. Honesty
4. Audit evidence
5. Internal control system
6. Skills and competence
7. Work done by other
8. Working paper
9. Legal framework or agenda
10. Audit report

❖ **<u>Definition audit planning</u>**

The audit planning is a detailed schedule of the activities to be conducted in audit and specifying the resources needed.

Importance of audit planning

Audit planning helps the auditor:

- Control and direct audit work;
- Complete the audit work on time for the AGM;
- Concentrate on key areas i.e. sensitive ones;

- To use audit staff optimally and complete work on time;
- Planning facilitates control;
- Use of audit tests requires careful planning to obtain good results;
- Planning assists concentrate audit efforts on problem areas avoiding wastage of time;
- Planning in advance solves the problem of client companies with similar year ends and timing requirements.
- ❖ **Audit evidence**

Audit evidence is a piece of information that support conclusion.

Audit evidence is any information used by the auditor to enable him to arrive at conclusion necessary for the opinion.
Opinion : a statement of advice by an expert on a professional matter .

Qualities of Audit evidence

- **Sufficiency :**This means that the audit evidence should be complete and adequate to prove any material fact.
- **Relevance :** audit evidence should be relevant to the purpose of which it is required .
- **Reliability:** evidence is reliable if it is considered corret and accurate.

Types of audit evidence

1. **Primary audit evidence:** This is the evidence collected within the organization from the accounting records, source documents and other documents.
2. **Secondary audit evidence :** This is the evidence collected from outside the organization by parties confirmation such as debtors, creditors ,etc . this evidence is usually more reliable.
3. **Circumstancial audit evidence :**this is evidence collected from the cirmustances prevailing in an organization at the time of audit
4. **Hearsay audit evidence :**This is the evidence collected with the use of interview, conversation and posting questions to client staff.

Techniques of audit evidence

These are the means for obtaining the audit evidence and to establish its reliability.
Those techniques include :

- **Inspection :**This is physical examination of items shown in the accounts
- **Observation :**This is looking at operation or procedure being performed by others with view to determine the manner of its performance.
- **Confirmation :** The auditor makes an inquiry from person inside or outside the business in order to confirm some facts or information.
- **Computation :**This checking of mathematical accuracy of accounting records or performing independent calculations.
- **Retracing :** The auditor selects few entries in the ledger and checks them with their source documents. This method is used to confirm that the postings made from the books of orginal entries are made correctly .

- **Vouching :** This is the examination of orgianal documents from which entries are made in the books of accounts or it is simply the examination of the vouchers.

- ❖ **Internal control system**

Internal control system is a system of controls, financial or otherwise (non- financial) instituted by the organisation to ensure that the business of the company is run in an orderly manner, and establishes safeguards on assets and promotes efficiency and economical use of the company's resources.

Objectives of internal control system

- To minimize chances of errors and frauds e.g. through segregation of duties, surprise checks,...
- To establish safeguards of the company's assets through: limiting access by use of physical controls, use of proper utilization, routine checks, segregation of keeping and recording of assets, arithmetic and accounting controls
- To increase efficiency and horizontal flow of operations by: supervision of duties, competent and reliable personnel, defined powers, managerial review and supervision.
- To enable the company to achieve its goals through budgetary controls, constant supervision, managerial reviews
- To avail or reward to the management the data for decision making
- To increase control of work and avoid duplication of effort through delegation of duties, defined powers, organization charts
- To motivate employees through routine checks
- To identify inefficiency and outdated polices
- To encourage specialization through segregation of duties
- To allow the company to grow due to less frauds, errors and inefficiency.

❖ **Working papers**

Definition of Working papers

Working papers are all records including information recorded, gathered from third parties, important documents collected during the course of audit.
Working papers provide evidence of work done.

❖ **Audit report**

Definition of the audit report

The audit report is summary of findings or results about financial position of the company as shown by the balance sheet or profit and loss account prepared by the auditor and submitted to the shareholders and other users of the financial statements of company at the end of his audit work.

✓ ADVANTAGES OF PRINCIPAL OF AUDITING TO THE COMPANY

- Enables the Pursuit of Business Objectives
- Assess or measure the Risk of Misstatement
- Fraud Prevention and Detection
- Cost of Capital

Briefly the main principles of auditing are classified under :

1. **Planning :**

It is the basic principle of auditing. The auditor should plan before starting the work. In planning auditor decides accounting about the system and internal control procedure.

2. **Honesty :**

Honesty and sincerity is the second important principle of auditing. The loyalty or faithfulness of auditor to work and profession must be beyond the doubts.

3. **Impartiality :**

In case of audit the attitude of the auditor must be impartial. Keeping in view this principle his personal views may not be included in the audit report.

4. **Secrecy :**

Secrecy must be maintained by the auditor during the process of audit. He cannot disclose any information to the third party.

5. **Evidence :**

During the audit the auditor can collect the evidence through the **working papers**. He can surround his opinion on the audit evidence. The nature and source of evidence must be kept in view by the auditor.

6. **Consistency :**

It is an important principle of auditing. In case of selecting the rates of depreciation and valuation of stock the accountant must follow the rates of the coming years. In this regard there should be consistency and changes are not acceptable.

7. **Legal Frame Work :**

The business activities may run within the rules and legal formalities. To protect the rights of the interested parties rules must be applied.

8. **Working Paper Preparation :**

The auditor collect documents providing evidence that audit was carried out according the principles. The auditor prepares the working paper and kept in this safekeeping as a proof.

9. **Internal Control :**

The auditor will examine the accounting system and inter control.

10. **Report :**

According the principle of auditing a report will be prepared by the auditor at the end. It may be conditional / qualified or unconditional / unqualified . The auditor can draw conclusion and disclose the facts and figures about the business for general information.

LEARNING UNIT 3 : APPLY AUDITING TECHNIQUES AND ITS APPLICATION IN ORGANISATION

LEARNING OUTCOME 3.1: VERIFY TECHNIQUES THAT CAN BE USED ACCORDING TO INTERNATIONAL AUDITING STANDARDS

- **DEFINITION OF AUDITING TECHNIQUES**

Audit techniques: Are tools, methods or processes by **means** of which an **auditor** collects necessary evidence to support his opinion or judgment in respect of the propositions or proclamations submitted by the client to him for his examination.

- **AUDITING TECHNIQUES**

The following are auditing techniques

- ✓ Physical examination
- ✓ Confirmations
- ✓ Documentation
- ✓ Analytical Procedures
- ✓ Inquiries of the Client
- ✓ Performance
- ✓ Observation
- ✓ Audit sampling

Physical examination :

- Includes inspection, counting ,identification and measurement of quantity
- Inspection or count of a tangible
- May observe the process of **stocktaking**.

Stocktaking : The action or process of recording the amount of stock held by a business.

Confirmations :

- To ascertain or determine the correctness of the figures and validity of the client's record
- Confirming the information available with the records of the organization

Documentation :

- Examination of "client's" documents and records to substantiate or validate F/S (financial statement) information ("vouching").

Analytical Procedures :

The purpose of analysis is to ensure consistency or stability of accounting methods and also to evaluate the efficiency of the management by comparing the results of several or some years

Inquiries of the Client :

Inquiry: Seeking or looking for information from persons belonging to the organization or from outside organization is called inquiry.

Client Inquiries: written or oral response or answer to questions – not usually done by itself

Performance :

Refers to an independent examination of a program, function , operation or the management systems and procedures of a governmental or non – profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources.

Observation :

- Observe the various policies and procedures or plans followed by the client
- The auditor observes a particular procedure being carried by the organization.

Examples are observation of the internal control measures that are adopted in transactions involving cash, procedures followed on receipt or issue of material, etc. The auditor makes his observations to evaluate the efficiency and effectiveness of the system followed by the organization.

Audit sampling:

Audit sampling can be defined as the process of applying auditing procedures to under 100% of different items in an organization's account balance in a way that every single unit might have an equal probability of being selected.

LEARNING OUTCOME 3.2: PROPER IDENTIFICATION OF THE SAMPLING TECHNIQUES USED IN AUDITING BASED ON INTERNATIONAL AUDITING STANDARDS

- **INTRODUCTION ON SAMPLING TECHNIQUES OF AUDITING**

Audit sampling can be defined as the process of applying auditing procedures to under 100% of different items in an organization's account balance in a way that every single unit might have an equal probability of being selected.

- **OBJECTIVES AND PURPOSE OF AUDIT SAMPLING:**

Audit sampling is very important part of audit works. No mater it is financial audit, internal audit and others kind of audit, audit sampling still need to be used by auditors. Audit sampling also part of the audit standards requirements and it could help auditors to meet their objective with less effort.

The following are the purposes and objectives of audit sampling:

1. To gathers audit evidences in order to concluded audit opinion.
2. To reduce the works yet audit yet still help audit to reach its conclusion.
3. To provide the basis for auditor to conclusion audit opinion.
4. To detect any kind of error or fraud that could happen in the company as well as financial statements.
5. To prove auditors have done their jobs base on the required auditing standards.
6. Use as the tool for investigations.

- **SAMPLING TECHNIQUES USE IN AUDITING**

Techniques for Audit Sampling are such as :

1. Hazard sampling
2. Stratified sampling
3. Systematic sampling
4. Block sampling
5. Judgment sampling
6. Random sampling

There are certain important sampling techniques that can be adopted by an auditor. These include:

1. **Haphazard sampling**

The haphazard sampling technique is the one adopted by the auditor in cases where the sample does not follow a structured technique.

All items in the population should get a chance of being selected.

2. **Stratified sampling**

This sampling technique involves the auditor to divided items included in a sample into their different sections. For instance, in a payroll sample the auditor might divide the sample in full-time males, full-time females, part-time males, and part-time females thus working out the percentage of sections in the population.

3. **Systematic sampling**

The systematic sampling is also referred as **‘interval’** sampling.

This sampling technique involves the auditor to take the number of sampling units in the population and segregate this into the sample size so as to provide a sampling interval.

In a sales invoice, for example, where the sampling interval is 25, the auditor will determine an initial point for sampling and subsequently sample every 25th sales invoice.

4. **Block sampling**

Block sampling is a sampling technique wherein the auditor applies measures to such items which occur in the same block of arrangement or time. However, the block sampling technique should be used with caution or attention as valid references cannot possibly be made beyond the examined period or block.

5. **Judgment sampling**

This sampling technique allows the auditor to use his judgment in making selection of samples. The basic issues influencing the selection of sample are:

- value of the items
- relative risk involved
- representativeness of the sample

6. **Random sampling**

Is a procedure for sampling from a population in which **(a)** the selection of a sample unit is based on chance and **(b)** every element of the population has a known , non- zero probability of being selected.

LEARNING OUTCOME 3.3: IDENTIFY MANAGEMENT FEEDBACK ACCORDING TO ORGANIZATION POLICY AND PROCEDURES

- **AN AUDITOR'S OPINION**

An **auditor's opinion** is a formal statement made by an **auditor** concerning or regarding a client's financial statements.

- **TYPES OF OPINION OF AUDITOR**

There are four types of **audit opinions**

1. Unqualified Opinion
2. Qualified Opinion
3. Disclaimer Opinion
4. Adverse Opinion

1. **Unqualified Opinion**

An **unqualified opinion** is an independent auditor's judgment that a company's financial statements are fairly and appropriately presented, without any exceptions, and in compliance or agreement with accounting standards.

unqualified opinion ; A "clean" auditor's report. That is, the auditor has concluded that the financial statements present fairly the results of the company's operations and its financial position according to generally accepted accounting principles.

An Unqualified Opinion is a report issued by an auditor where he declares the soundness of a company's financial statement. In other words, the auditor manifests that the statements are accurate.

An unqualified opinion indicates that the information presented in a company's financial report is clean.

2. **Qualified Opinion**

A **qualified opinion** is a statement issued after an audit is completed by a professional auditor, suggesting or telling that the information provided is limited in scope and/or the company being audited has not maintained GAAP (General Accepted accounting principles).

3. **Disclaimer Opinion**

A **disclaimer** of **opinion** is a statement made by an auditor that no **opinion** is being given regarding the financial statements of a client. ... For example, the auditor may not have been allowed or been able to complete all planned audit procedures .

Auditors give a disclaimer when they are unable to express a definite opinion. This can be due to the lack of properly maintained financial records or the absence or insufficient support from the management.

For instance, an auditor may not have had the opportunity to fulfill tasks that they suppose to be crucial to the audit, such as observing operational procedures or reviewing particular procedures.

4. **Adverse Opinion**

When auditors issue an adverse opinion, it indicates that there has been a gross misstatement and, possibly, fraud, in the preparation of the company's financial records.

An adverse opinion shows that the company's records have not been prepared in accordance with **GAAP**. Financial statements with adverse audit opinions are typically rejected by financial institutions or investors.

An **adverse opinion** is a professional **opinion** made by an auditor indicating that a company's financial statements are misrepresented, misstated and do not accurately reflect its financial performance and health .

- **ADVANTAGES OF AUDITOR FEEDBACK TO A BUSINESS ORBENEFITS OF AN EXTERNAL AUDIT**

1. Provides validity of the accounting process
2. Discovers Errors
3. Identifies weaknesses internally (and suggests improvements)
4. Provides assurance or guarantee
5. The management letter

The management letter allows our audit team to provide feedback and ways to improve and rectify deficiencies.

- **ADVANTAGES OF AUDITOR FEEDBACK TO A BUSINESS ORBENEFITS OF AN EXTERNAL AUDIT**

1. Provides validity of the accounting process

An external audit provides an objective overview of a business' accounting process. By giving business owners insight on the accuracy and validity of their company's accounting information, business owners who do not have an in-depth understanding of accounting principles are able to better grasp the financial situation of their business.

Furthermore, an external audit provides business owners with the opportunity to work closely with external auditors to look at their accounting process with a critical eye and work on making improvements.

2. Discovers Errors

Errors in the accounting process may prohibit business owners from making the best decisions.

Audit procedures are designed to detect errors in the system and fraudulent activity.

External audits also ensure that the recording of the financial transactions is according to generally accepted accounting principles (GAAP). This essentially helps business owners cover their back when it comes to following the many rules and regulations that come with accounting within a registered entity.

3. Identifies weaknesses internally (and suggests improvements)

Some companies prefer to sweep their weaknesses under the cover and continue to operate with blinders on. However, business owners always have the option of taking anself-assured approach by giving underperforming areas within their company the attention they're due.

Since internal auditors cannot effectively critique their company's internal processes because they form part of it, external auditors can observe the operations from the outside and recommend ways to promote efficiency and refine the accounting process.

4. **Provides assurance**

An audit assures company directors who are not involved in the accounting functions on a day-to-day basis that the business is running in accordance with the information they are receiving, and helps reduce the scope for fraud and poor accounting.

So, not only does an audit enhance the credibility and reliability of the figures being submitted to various stakeholders (shareholders, employees, customers, suppliers, investors and tax authorities), but it also provides assurance to shareholders that the financial figures show a true and fair view.

5. **The management letter**

Auditing standards require the auditor to write a management letter addressed to the directors. Some business owners question the value of such a letter, and may get a little sensitive when confronted with a management letter that details the areas within a business that require further assessment. Once again, it’s all about perspective!

Firstly, a management letter is addressed to the management of the company and is not submitted to any of the authorities – therefore its contents are purely confidential. Secondly, a management letter brings to the attention of the management particular control deficiencies that could result in the inappropriate collection of data for financial reporting or compliance purposes. This means that the management of a company is actually being given a value-added service where the weaknesses within the business have been identified and can be addressed moving forward.

Why and when does the external auditor present a management letter?

Our professional standards do not require the auditor to offer advice to clients. The management letter allows our audit team to provide feedback and ways to improve and rectify deficiencies. An auditor is required to assess the financial and compliance risks found within an organisation. Once the financial and compliance risks are identified, then, it is the duty of the auditor to report a control deficiency, so management can address the risk appropriately as part of its risk assessment process. It is then suggested that control deficiencies should be reviewed and corrected without delay.

A management letter can be viewed as a formal communication intended to help improve theorganisations. Arguably, the most value added final step of the audit.

LEARNING UNIT 4 : DESCRIBE RANGE OF AUDIT DOCUMENTATION AND RECOGNISE THE APPROPRIATENESS

LEARNING OUTCOME 4.1: DESCRIBE THE FEATURES OF RECORDING AND EVALUATION OF TASK ACCORDING TO INTERNATIONAL STANDARDS ON AUDITING

- **INTRODUCTION ON FEATURES OF AUDITING**

6 Essential Features of an Audit

There are six essential features or characteristics of auditing are;

1. Systematic process.
2. Three-party relationship.
3. Subject matter.
4. Evidence.
5. Established criteria.
6. Opinion.

The essential features of Auditing are explained below;

1. **Systematic process** :Auditing is a systematic and scientific process that follows a sequence or order or arrangement of activities, which are logical, structured, and organized.
2. **Three-party relationship** :The audit process involves three parties, that is, shareholders, managers, and the auditors.
3. **Subject matter** :Auditors give assurance or guarantee on a specific subject matter. However, the subject matter may differ considerably, such as – data, systems or processes and behavior.
4. **Evidence** :Auditing process requires collecting the evidence, that is, financial and non-financial data, and examining thereof.
5. **Established criteria** :The evidence must be evaluated regarding established criteria, which include International Accounting Standards, International Financial Reporting Standards, Generally Accepted Accounting Principles, industry practices, etc.
6. **Opinion** :The auditor has to express an opinion as to the reasonable assurance on the financial statements of the entity.

Conclusion on Audit Features

Audit Features influences the objectives of the audit to refer to the security of the information and systems, the protection of the personal data, the access to some data bases with an informational sensitive character.

- **The key / main / important features of audit**
    - ✓ Engagement.
    - ✓ Audit Plan & Programs.
    - ✓ Risk based systematic approach.
    - ✓ Competency.
    - ✓ Independence.
    - ✓ Objectivity.
    - ✓ Due professional care.
    - ✓ Planning
    - ✓ Supervision and
    - ✓ Sufficiency

LEARNING OUTCOME 4.2: PREPARER AUDIT REPORT ACCORDING TO INTERNATIONAL STANDARDS ON AUDITING

- **DEFINITION OF AUDIT REPORT**

The audit report is summary of findings about financial position of the company as shown by the balance sheet or profit and loss account prepared by the auditor and submitted to the shareholders and other users of the financial statements of company at the end of his audit work.

- **FORMAT AND CONTENT OF AUDIT REPORT**

1. Introduction
   - Title
   - Address
   - History of the audited company
2. Development
3. Conclusion
   - Opinion
   - Address of the auditor

Title	**Audit report**
Address	Addressed to shareholders of ABC Ltd
Scope or Possibility	Mentions scope and extent of the audit and mentions the financial statements covered, period of audit, etc.
References	Gives references to the companies auditing standards, auditing guidelines that were considered in carrying out the audit.
Opinion	The auditor's opinion is given in the report regarding the financial statements and accounting records
Auditor's address	The auditor gives his address
Date of report	The date the auditor submit his report

- **SIX STEPS IN AUDIT PROCESS**

  1. Requesting Documents
  2. Preparing an Audit Plan
  3. Scheduling an Open Meeting
  4. Conducting Fieldwork
  5. Drafting a Report
  6. Setting Up a Closing Meeting

- **COMPONENTS OF AN AUDIT REPORT**
  1. Introductory Section
  2. Financial Section
  3. Required Supplemental Section
  4. Findings and Recommendations Section

- **TYPES OF AUDIT REPORT OR OPINION IN AUDIT REPORT**

  ✓ **Modified opinion**
    - Qualified
    - Disclaimer
    - Advise

- ✓ **Unmodified opinion**
  - Uniqualified

Unqualified Opinion / report or *good report*

An **unqualified opinion** is an independent auditor's judgment that a company's financial statements are fairly and appropriately presented, without any exceptions, and in compliance or agreement with accounting standards.

unqualified opinion ; A "clean" auditor's report. That is, the auditor has concluded that the financial statements present fairly the results of the company's operations and its financial position according to generally accepted accounting principles.

An Unqualified Opinion is a report issued by an auditor where he declares the soundness of a company's financial statement. In other words, the auditor manifests that the statements are accurate.

An unqualified opinion indicates that the information presented in a company's financial report is clean.

Qualified Opinion/ report or bad report

A **qualified opinion** is a statement issued after an audit is completed by a professional auditor, suggesting or telling that the information provided is limited in scope and/or the company being audited has not maintained GAAP (General Accepted accounting principles).

Disclaimer Opinion

A **disclaimer** of **opinion** is a statement made by an auditor that no **opinion** is being given regarding the financial statements of a client. ... For example, the auditor may not have been allowed or been able to complete all planned audit procedures .

Auditors give a disclaimer when they are unable to express a definite opinion. This can be due to the lack of properly maintained financial records or the absence or insufficient support from the management.

For instance, an auditor may not have had the opportunity to fulfill tasks that they suppose to be crucial to the audit, such as observing operational procedures or reviewing particular procedures.

Adverse Opinion

When auditors issue an adverse opinion, it indicates that there has been a gross misstatement and, possibly, fraud, in the preparation of the company's financial records.

An adverse opinion shows that the company's records have not been prepared in accordance with **GAAP**. Financial statements with adverse audit opinions are typically rejected by financial institutions or investors.

An **adverse opinion** is a professional **opinion** made by an auditor indicating that a company's financial statements are misrepresented, misstated and do not accurately reflect its financial performance and health .

- **IMPORTANCE OF THE AUDIT REPORT**

➢ **For the audited company**

The audited company can use an audit report for some benefits. These include:

1. Negotiate loans from financial institutions
2. To raise funds from the public either by selling shares of debentures in a case the company has unqualified report
3. The Earning Price per Share can increase in a case the company has a better performance
4. It can be used in case of amalgamation or selling or liquidation of the company to determine the value of the assets

➢ **Shareholders;**

1. It assures the shareholders that directors and managers are acting on behalf of their interest.
2. The audit report can be used to determine the extent of errors and frauds in the company
3. Shareholders who are not taking active part in the daily running activities of the business are protected.

➢ **Employees:**

The audit report can show the general management how efficient they are in the daily running activities of the company and they can take adequate measures

➢ **The state:**

1. Audit report is acceptable as a basis of determining tax liability.
2. Audit report assures that statutory requirements have been observed by the business or not.

➢ **Third parties: (banks, insurance companies..)**

1. Audit report provides credibility or trustworthiness or integrity and assurance to the accounts for the interested parties
2. Audited report minimize disputes between the third parties and the organization
3. In case of catastrophic loss audited report can be used by insurance companies

LEARNING OUTCOME 4.3: DESCRIBE IMPORTANCE OF AUDIT FILES AND WORKING PAPERS AND THEIR ROLE IN THE AUDIT PROCESS

- **DEFINITION OF AUDIT FILE AND WORK PAPER**

AUDIT FILEmeans one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement

- **TYPES OF AUDIT FILE**
  1. **The permanent audit file**
     - **a)** Copies of the company's incorporation documents
     - **b)** Chart of accounts
     - **c)** Organization chart
     - **d)** Accounting procedures manual
     - **e)** Copies of important leases or contracts
     - **f)** Internal control documentation
     - **g)** Prior years' analytical procedures
     - **h)** Stock and bond issuances

  2. **The current audit file**
     - **a)** Audit plan
     - **b)** Working trial balance and work papers
     - **c)** Journal entries for the client

- **Definitions of types of audit file**

  1. **The current audit file**

Current audit files are files that keep all information related to current year audited.
Those documents include the current year financial statements, general ledger, management accounts , and supporting documents .

This contains information about the accounts being audited **i.e.** information about current year. The file is closed at the end of the audit.

  2. **The permanent audit file**

Permanent audit files are the files that use to keep the information that use by auditor continuously .
Those information include engagement later or future , long term contract or agreement as well as board meeting minute.

This contains information of continuing importance to the auditor i.e. can be used beyond a given financial period.

<u>DEFINITION OF WORKING PAPERS</u>

Working papers are all records including information recorded, gathered from third parties, important documents collected during the course of audit. Working papers provide evidence of work done.

- **PURPOSE OF WORKING PAPERS**

1. Reviewed by auditors with supervisors noted
2. Signed, dated and approved by relevant level of audit staff with sufficient cross reference.
3. With evidence of effective audit planning, work done, sufficient and quality evidence.
4. Outstanding orUnresolved matters are cleared in due course

FEATURES OF GOOD WORKING PAPERS

1. Should be properly headed
2. Should indicate period covered or when collected and recorded
3. Properly indexed for cross checking
4. Comprehensive enough
5. Symbol used should be explained
6. Kept safely to avoid misuse or destruction
7. Preserved in current files for at least five years in the permanent files for at least 15 years
8. Periodically updated especially in the permanent file
9. Where the auditor uses personal judgement this must be explained

ADVANTAGES FOR COLLECTING WORKING PAPERS

1. Used as a basis for planning the current audit file
2. Means of controlling the current years audit by reviewing them
3. Enable the auditor to form an opinion on the true and fair view and whether the company has complied with statutory requirements
4. Those collected in one part of an audit can be used in another part
5. They are used to assist in investigations in the company's financial affairs
6. Can be used as evidence of work done if the auditor is sued for negligence
7. Are collected as evidence of work done by each audit clerk who can be questioned in case of omissions.
8. Facilitate the final review
9. Used by auditor as a basis of charging fees.
10. Minimize the risk of duplicating the auditor's effort
11. In cases of catastrophic losses e.g. fire in the client business working papers can be used in determining insurance claims.

- **INVESTIGATION**

Definition of the investigation : An investigation can be defined as an enquiry (query) commissioned for a client for some purpose.

CHARACTERISTICS OF THE INVESTIGATION

1. An investigation is a process. There are a number of steps and procedures required to carry out an investigation.

2. It involves searching and enquiring into the company's affairs.

3. It covers all areas of the business not just the accounting function.

4. Conducted with suspicion or doubt of fraud

5. It can be conducted by any competent professional e.g. lawyers, tax assessors.

Reasons for investigation

1. Purchase (Acquisition) of a company
2. Admission of new partners
3. Fusion of the companies
4. Prospective investments

5. Prospective lending
6. Suspicion / doubt of Fraud
7. Legal Investigation (Statutory) / Company Act investigation

Steps / Stages of the investigation

All investigations are carried out in the same way; therefore one must remember these sections.

Stage 1: Instructions from the client

Stage2: Professional courtesiesor considerations

Stage3: Organization of the investigations

Stage 4: Obtain the background information

Stage 5: Gathering preliminary information

Stage6: Preparing the report outline:

Stage7: The investigation proper

Stage 8: Drafting and discussing the report with the client

Stage 9: Being available for further enquiries and investigations.

COMMON TYPES OF INVESTIGATION

1. Investigation on acquisitions;
2. Investigation on request for loans;
3. Fraud investigation
4. Legal investigation (statutory) / Company Act investigation/ Investigation by the registrar of Companies.

DIFFERENCE BETWEEN THE AUDIT AND THE INVESTIGATION

Auditing	**Investigation**
Involves examination of books of accounts to ascertain whether they show a true and fair view.	Involves searching and enquiring into the company's affairs.
Covers one financial year	May cover more than one financial year.
Conducted for the owners of the business	Can be conducted for outsiders e.g. the government for taxation purposes.
Restricted to the books of accounts	Covers all areas of the business not just the accounting.
Conducted to prove a true and fair view.	Conducted usually to investigate the extent of fraud
Conducted a by a qualified auditor according to relevant regulation	Can be conducted by any competent professional e.g. lawyer, tax assessor,,..
Conducted without suspicion or doubt of fraud	Conducted with suspicion of fraud

Difference between audit and accounting

Auditing	**Accounting**
It involves examination of books of accounts to ascertain whether they show a true and fair view.	It involves the preparation of books of accounts as an aid to management decision making.
It is conducted usually at the end of the year.	It is a continuous process through the year.
Auditing depends on prepared accounts.	Accounting is not conditional i.e. it doesn't have a precedent to happen.
Conducted with vigilance or care from professional bodies.	No vigilance except management review.
Conducted independently of all parties with a financial statement in the business.	Conducted without an independent approach as management influences the work of accountants.
Conducted through programs and tests.	Not conducted through programs and tests but through ledgers.
Auditing is a statutory requirement for limited company.	Accountancy is essential to all business regardless of type.