# Section one TWO Compulsory Questions

## Question No. One

**1.** You are an audit manager in Gabra, (G) Certified Accountants and . You are about to commence the audit of Medani Ltd for the year ended 31 March 2017. Medani has 12 shops in the Gazira area and another 35 widely dispersed throughout the country.

Medani are discount retailers which, literally, sell everything in their shops for 5 SDG.

The first shops in the chain opened in 2014 and G has been the auditor since 2007. Medani operates on tight margins and places a heavy emphasis on cost control. The gross margin has fluctuated only between 36.7% and 37.2% over the past 5 years. Marginal swings in the gross profit percentage of 0.1% or 0.2% are considered significant.

The year just past was not a very good year for retailing. Large retailers have blamed the poor turnout in their stores on the weather over the summer period, , and the increasing significance of online shopping.

For Medani, though, the situation was worse. It does not claim to be a multi-channel retailer with a go-to website. It launched a web shop during the year but this has not had a significant overall effect on performance. Occasionally, it gets a boost from products that become fads. However, there was no such good fortune during the year under review. Inventory is considered a particularly high-risk area on this audit. Medani engages a professional inventory counting company to attend every branch so that the inventory can be counted quickly and efficiently. The inventory counting company sent a count team to every branch to commence the count at the close of business on 31 December. The count teams prepared a detailed set of count records which were then valued by Medani's accounts staff.

For the last four years, G has attended six branch inventory counts. The branches are chosen at random each year but, because the client is very sensitive to increases in the audit fee, G has always restricted its visits to those branches that are within a two-hour travelling time from the Medani office. There are 19 branches within that geographical area.

For this year's audit, it was decided that G would also visit the two branches furthest from its office, plus five others within normal travelling distance. The members of staff who attended the most distant branches
had to travel during the day of 31 December, attend the inventory count in the evening and stay overnight in a hotel before returning next day. This slightly increased the fee charged to the client but is considered to provide valuable additional audit evidence.

The following are the reports from audit personnel who attended the inventory counts in 2017 in branches where a representative from G was not present during previous years' counts.

I attended the inventory count at the Cab Eljidad branch on 31 December 2017. The store closed at 18:00 (instead of the usual 21:00) to facilitate the count. The count was conducted by Baraka ltd Count Ltd, an independent firm of professional inventory counters. The count commenced at approximately 18:30 and concluded at about 23:30. I remained at the premises throughout; observed the proceedings; and carried out such other duties as were required by the attached audit program. Details of the specific tests carried out and the like are in the attached section of the audit file.

In conclusion, I observed nothing that would suggest that the count was any other than proper and the figures resulting from it can be relied upon as fair and accurate.

Elhadi Babiker Elbashir,
Audit Junior
23-01-2018

I attended the inventory count at Masuadia branch. The count was conducted by Baraka ltd Count Ltd, an independent firm of professional inventory counters. Four counters attended. These counters worked as two pairs and took approximately three hours to complete the count.

Baraka ltd Count's employees were assisted by the branch manager, who acted as an overall supervisor and by two shop assistants who assisted with the location and identification of items. I was not entirely satisfied with the count procedures employed by the staff of Baraka ltd Count Ltd. They did not open any cartons, even on a sample basis. The entire bulk inventory in the shop's storage area was boxed in cartons and remained unchecked apart from confirming the number of cartons. Also, the count staff did not check the 'best before' dates on any of the inventory on the shop's shelves, apart from items at the very front. The branch manager assured them that the shop staff refilled all shelves by placing fresher goods at the back and so older inventory was always closest to the front.

I queried these matters with the staff of Baraka ltd Count Ltd and pointed out that they were in breach of the count instructions and were also failing to do their work in the manner which G had observed at other counts that I had attended in previous years. The response was that it would take too long for two pairs of counters to complete the count in the manner that I had suggested.

Sufian  Abd Eljaeel
Audit Senior
01-01-2017

You realise from these reports that there may be difficulties and so decide to discuss these matters with Mutasim, who is currently the Head of the Business Services Division of G, having been an audit manager

for many years (although she never had any involvement with this particular client). The Business Services Division deals with matters pertaining to non-assurance clients only.Mutasim's rank in the overall firm is that of "senior associate", just one step below partner level. You went to college with Mutasim several years ago and both trust and value her professional judgement. Mutasim quickly realises the dilemmas that you face. She understands how sensitive the client is likely to be to any sudden increase in the fee and suggests that a possible solution (for this year only) would be to budget for extra audit work around the area of inventories but to refrain from charging the client for it. The whole question of the fee for subsequent years could then be discussed with the client as part of normal "client continuation" procedures in respect of the year ended 31December 2018.

## REQUIREMENT:

**(a)** Critically analyze the audit risks at both the financial statement level and the assertion (or account balance) level applicable to the audit of Medani.

**(12 marks)**

**(b)** Critique G's approach to the audit of Medani's inventory for both the year ended 31 March 2017 and for previous years.

**(12 marks)**

**(c)** Recommend relevant additional work regarding the existence of inventories, which may be necessary in order to obtain sufficient, appropriate evidence in respect of the year ended 31 March 2017.

**(6 marks)**

**(d)** Appraise Mutasim suggestion that the fee should be waived in respect of any extra work that would be undertaken in relation to inventories (for this year only).

**(5 marks)**

**[Total: 35 Marks]**

## Question No.Two

You are Sami SCCA, and you work as an Audit Senior with Nabil & Co. Registered Auditors. You arrive at your desk one morning to find the following e-mail waiting for you.

To: Sami@Nabilandcoauditors

From: Kamil@Nabil and co auditors

Hi Sami,

As you have probably seen from the schedule, you are the Audit Senior in charge of the audit of Gari Manufacturing Ltd. which is due to commence next Monday.You might also have noticed that the audit planning meeting is scheduled for 2:30pm on Sunday and that the two juniors scheduled for the job are a bit inexperienced. Since I'm sure none of you will want to be here any longer than necessary on Friday evening, I have done some preparatory work and I hope that you might be able to help me. Firstly let me tell you a little about the company.

Gari Manufacturing Ltd. (GARI) began operations five years ago producing the "Haliab", a new type of instrument it hoped to sell to doctors, dentists, and hospitals. The demand for the Haliab far exceeded initial expectations,

and the company was unable to produce enough to meet that demand. GARI was manufacturing Haliab on equipment it built at the start of these operations, but needed more efficient equipment to meet demand. Company management decided to design and build the new equipment because no equipment was available on the market that was suitable for producing Haliab. In 2010, a section of the plant was devoted to the development of the new equipment and personnel were hired.

Within six months, a machine was developed at a cost of SDG17million and put into operation. It increased production and reduced labour costs substantially. Sparked by the success of the new machine, the company built three more machines of the same type, at a cost of SDG8 million each. All of these amounts are material in the context of the financial statements.

I would like you to prepare some briefing notes in time for our meeting on Friday afternoon in which you consider the answers to the questions set out below.

See you Sunday.

Best Regards,

Kamil,

Audit Manager

**REQUIREMENT:**

Prepare a memo in response to Kamil's email in which you:

**(a)** Consider other reasons which might cause a firm to construct tangible non-current assets for its own use, in addition to satisfying a need that outsiders cannot meet within the desired time.

(5 marks)

**(b)** Advise what costs should be capitalised for a self-constructed asset.

(4 marks)

**(c)** Discuss the specific audit problems that an auditor might expect to encounter in a situation where an entity has been involved in the self-construction of assets (i.e. property, plant and equipment) to a material extent.

(5 marks)

**(d)** Set out the principal audit procedures to be performed (in the particular case of GARI) in relation to the construction of the machines which were used for the production of the Haliab

(6 marks)

**(e)** Discuss how an auditor would decide on the appropriateness or otherwise of including the increase in overhead caused by the self-construction of non-current assets in the capitalized cost of self-constructed non-current assets.

(5 marks)

**[Total: 25 Marks]**

# Section Two
# Answer Two Questions only

## Question Three:

You are the leader of a small team from the Head Office of a medium-sized firm, WARDI & Partners, which has been asked to conduct a 'cold review' of a particular office's audit files, concentrating on the extent to which that office has fulfilled its obligations (or otherwise) to collect "sufficient, appropriate audit evidence" as required by ISA 500 - *Audit Evidence* and by the firms internal procedures manuals.

Your team has specifically reported on the following situations which it has uncovered and considers may warrant further examination:

**(a)** While auditing the production cycle of Halfia Manufacturing Ltd, Ahmed selected four purchase orders in respect of raw materials and traced each one through the accounting system from beginning to end. He examined the Goods Requisition Forms, the Goods Received Notes and confirmed these were appropriately initialled by the respective responsible clerks, the supplier's invoices (now stamped 'paid'), the payment requisition forms and electronic bank transfer confirmation forms. As a result of this work, he noted in the audit documentation that he was now extremely familiar with the payment system in relation to the production cycle and felt confident about understanding related questions in the Internal Control Evaluation Questionnaire which he later completed.

**(8 marks)**

**(b)** The Tarig Co. Ltd acquired seven material items of property, plant, and equipment on finance leases during the year, under review in the case of one particular audit. Amjed confirmed the obligation under each lease with the lessor company, carefully studied all seven finance lease agreements and traced all related entries to the accounting records.

**(6 marks)**

**(c)** At the completion of the audit of EZERGAB Ltd, Alhady obtained written management representations as required by ISA 580 (UK and Ireland) - *Written Representations* from the Senior Executive Officer, the Senior Finance Officer, and the Financial Controller. He did not ask the company chairperson, the chief accountant at headquarters, or the plant controllers in the four respective divisions for any written confirmations, although he worked closely with them during the audit and made considerable use of information supplied by them.

**(6 marks)**

## REQUIREMENT:

Write a briefing note to your team in which you appraise the extent to which the office under review has complied with International Standards on Auditing and accepted best practice in the three cases detailed above. Provide any relevant additional information that may be required.

**(Total 20 marks)**

## Question four:

In the ongoing debate on the future of audit and the skills needed to meet that vision, commentators have suggested that the following specific areas will require significant attention if the capabilities of auditors are to live up to future requirements:

- Structure of audit practices
- Increased competition
- Additional complexities
- Information technology
- Need for specialisation
- The role of internal audit
- Wider assurance
- Globally regulated environment
- Ethical values of society
- The need to warn of corporate collapse

**REQUIREMENT:**

**(a)** In light of the above, discuss the future of auditing, including the knowledge and skills needs of those currently entering the profession.

**(15 marks)**

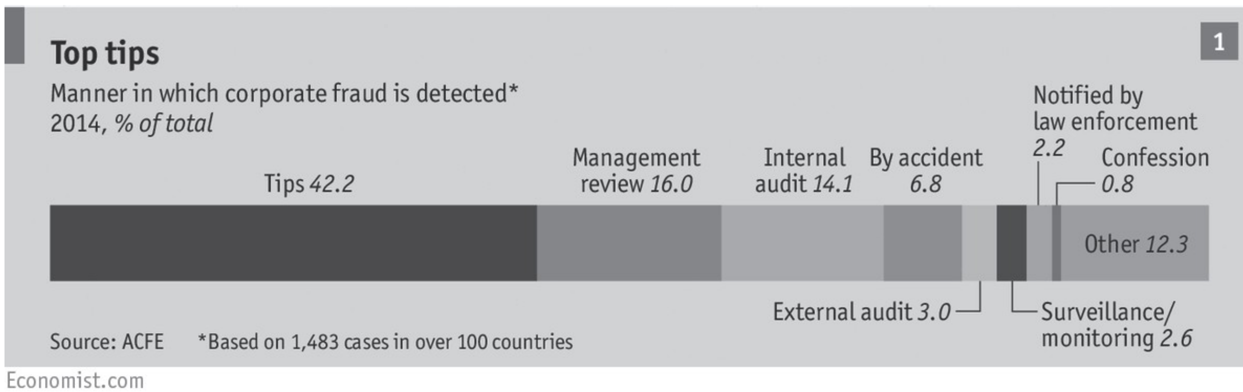
**(b)** How might an academic and training program best meet the future requirements as outlined above?

**(5 marks)**

**[Total: 20 Marks]**

**Question Five:**

The following table illustrates how corporate fraud was detected in 2014 (according to a survey by the Association of Certified Fraud Examiners, as reported in the Economist newspaper on 5 December 2015).
This




This table demonstrates that only 3% of frauds worldwide were detected by external audit.

**REQUIREMENT:**

(A)Critique a suggestion that this research illustrates the view that external audit is serving neither clients nor the general public satisfactorily.

**(10 marks)**

**(b)** You are an audit manager in the firm of Adli Certified Accountants .
You are preparing for the audit of Prince Pharma Ltd, a wholesaler of pharmaceutical and chemical products for both human and agricultural use.
This is the third year Adli have performed the audit. In previous years, you placed reliance on the work of Internal Audit in auditing the purchases, sales, property, plant and equipment, and wages and salaries. During the course of this year's audit the following has come to light:

• The Head of Internal Audit (HIA) is the father of the wife of the Finance Director. The HIA was appointed very quickly after leaving previous job and there appears to be minimal evidence in relation to the appointment process.
• The HIA had instructed the internal audit team not to query transactions with certain customers or payments to certain specific employees, but to refer any questions to him personally.
• The firm appears to be employing consultants in various developing countries and paying them a commission based on sales in those countries, but it is unclear precisely what services these individuals

or entities provide. When asked, the finance director refused to supply specific answers saying that it would be “a breach of confidence” to do so. Other members of the finance team appear to be genuinely unaware of these arrangements.

• Regulations require the use of protective clothing by employees handling some chemical products. Observations by the audit team suggest that adherence to these regulations is inconsistent. However, management insist that staff are instructed to wear protective clothing and that failure to do so, if observed, would be regarded as a disciplinary matter.

• All of these matters were present during our firm’s previous audits but were neither noted nor acted upon.

**REQUIREMENT:**

Analyse the implications of these discoveries for:

(i) The internal auditors

(ii) The external auditors.

**(10 marks)**

**[Total: 20 Marks]**

**ANSWER Question One**

**(a)** It is convenient to divide audit risks into Inherent and Control risks on the one hand and detection risk on the other hand. We can identify the following risks:

Inherent and control risks at the financial statement level:

(i) This is a high volume retailer which operates at relatively low margins in an intensely competitive industry. It could be susceptible to external shocks such as the variation during the year in exchange rate. It is also liable to suffer from changes in fashion and fads.

Any of these could leave it holding excess inventory and needing to dispose of it.

(ii) It is a cash business which is susceptible to misappropriation and/or inaccurate recording. Strong controls are needed to ensure accurate and complete recording of all cash balances.

(iii) It is always liable to possible incorrect inventory valuations Misappropriation of inventory by staff or by shoppers is always a risk and given the relatively low value of individual items in inventory the cost of controls will be an issue.

(iv) It is likely that the shops will employ a relatively high proportion of part-time staff and/or staff who are paid at, or close to, the minimum wage. Control over these staff will be more difficult since they have no real “stake” in the business and some may be unlikely to regard even dismissal as particularly serious.

At the account balance level the most risky balances are probably inventory, cash, and accounts payable.

Completeness of accounts payable may be an issue especially if individual branches have accounts with local suppliers. Tight controls will be required to ensure that appropriate valuations appear in the financial statements.

The client appears particularly sensitive to the audit fee. This poses a detection risk for the auditor since it means the auditor is always concerned about the cost of collecting the audit evidence. The attitude of the client in this regard is quite worrying. It could even be seen as casting doubt over the integrity of the client or it may be that the client is always attempting to minimize costs. On the other hand we are now into our second decade as auditors and so we should have good cumulative auditing knowledge and experience of the client which mitigates the risk somewhat.

**(b)** The approach to the audit of inventory appears to have been questionable (to say the least) in previous years.

There are 47 shops in total and, although not addressed in the case study, it is probably reasonable to assume that there is no huge disparity in size between them. In each of the last four years, we have attended only six counts each year. These shops probably represent only 10-20% of the total inventory. ISA 501 *Audit Evidence – Specific Consideration for Selected Items* requires that the auditor attend the inventory count and, while this does not mean every count of every last item, not attending the count for 80-90% of the inventory would appear questionable. This is mitigated somewhat by the use of an independent firm as inventory counters and may be further mitigated if there is a strong internal audit team Medani company.

Another weakness in previous years is that fact that branches far away from Medani were never visited at all.

They would presumably have known this (or have figured it out) and might, at worst, have interpreted this as an invitation to laxity in the counting and valuation procedures.

The situation this year has improved only a little – we are now attending at seven rather than six branches and we are covering branches further away from our offices. There still have to be question marks about whether this level of coverage is adequate but it is certainly better than in previous years. The audit senior appears to have discovered specific issues at the Cab Eljidad branch. This would suggest that the count may not be providing sufficient, appropriate evidence in relation to the inventory.

It may be noteworthy that is was the audit senior (by definition, a more senior member of the audit team) who discovered the difficulties. The report from the Cab Eljidad branch is bland and appears to indicate no difficulty. However, this was filed by a junior member of the audit team who may not have exercised sufficient professional skepticism in respect of the process. Furthermore, the report is dated more than three weeks after the attendance at the count and the reason for the delay in filing the report should be investigated.

**(c)** for a myriad of reasons it is now evident that we have potentially serious issues in relation to the existence and valuation of inventories. first of all we need to consider the position in respect of the Cab Eljidad branch.

In this case additional work should be planned in order to establish the risks that are being addressed. The audit senior (Sufian) is unsure whether inventory has been overstated by counting empty cardboard boxes as full and also whether inventory on store shelves could have remained unsold and gone beyond its “sell by” date. These concerns relate to inventory at the Cab Eljidad branch and, by implication, to other branches that lie outside the area that we traditionally visited.

The first step would be to gather as much evidence as possible from other sources. for example, Medani inventory management system should be capable of generating useful analytical review information so that

Sufian can target specific stores. He should identify stores that have slow inventory turnover ratios, which generally implies that closing inventory may be overstated. The reports from the various count teams should be reviewed to establish whether Masoodia was the only branch at which there were too few staff to conduct an adequate investigation. Notwithstanding, the positive report received from Sufian it would be prudent to include Masoodia in the analysis also.

There should be follow up visits to the Masoodia branch and also a sample of other branches outside the usual selection area. These visits should target the specific matters of concern. For example, we should consider the possibility that empty containers being used to conceal the theft of inventory and that old items of inventory being held. The visits should be organized as quickly as possible and store managers should not be notified in advance. All visits should, as far as practicable, be conducted simultaneously so that stores are not warned that a visit may be imminent.

During the visits, the count teams should check that a large sample of cartons is full. A sample should be opened to check that the contents correspond to the inventory records. The audit staff should also conduct

spot checks on the inventory rotation by checking that shelves are filled with the older inventory to the front.

These checks should be supplemented by inquiry of store staff to gather evidence that staff rotate inventory as a matter of routine. Having completed all this, there should be an overall review of the reasonableness of inventory for each individual branch and for the business a whole. There should be a careful and detailed comparison with previous years, with budgets and forecasts, and with industry averages. In a retail business such as this there should be a large amount of information available to support the reasonableness of the figures and considerable professional skepticism should be exercised during the review. Gross profit has fluctuated by only 0.5% over the past five years so any unexpected fluctuations should be fully explained.

**(d)** The decision to discuss the matter with Mutasim is, at the very least, not entirely appropriate. Normally, clients' affairs should be confidential to the audit team conducting the audit. Sometimes, for ethical and possibly even legal reasons it is necessary to insist upon information barriers (informally referred to as "Chinese Walls") within professional firms. This case study does not suggest that any such barriers exist in this particular case so the audit manager could argue that was no specific reason why he could not discuss the case with Mutasim.

Also, Mutasim can be completely objective in this case and is, evidently, very experienced. Nevertheless, the more appropriate forum for such discussions would be either the audit partner or, arguably, the firm's ethics partner. It could be inferred from the case study that the audit manager trusts Mutasim more than other people in the firm. It may also be appropriate to consider a Quality Control review on this audit although it is not formally required. This would provide another forum for the audit manager to discuss any concerns.

## Answer question Two

*To:* Kamil @Nabil
*From:* Sami
Thanks for your recent e-mail. Set out below are my replies to the points you raise. See you Saturday.

Regards,
Sami.

**(a)** A firm may wish to construct its own non-current assets rather than acquire them from outsiders to utilize idle facilities and/or personnel. In some cases non-current assets may be self-constructed to effect expected
cost savings. In other cases the requirements for the asset demand special knowledge, skills, and talents not readily available outside the firm. Also, the firm may want to keep the manufacturing process for a particular product as a trade secret.

**(b)** Costs which should be capitalized for a self-constructed non-current asset include all direct and indirect material and labor costs identifiable with the construction. All direct overhead costs identifiable with the asset being constructed should also be capitalized. Examples of costs elements which should be capitalized during the construction period include charges for licenses, permits and fees, depreciation of equipment used in the construction, taxes, insurance, and similar charges related to the assets being constructed.

**(c)** The existence of significant self-constructed assets adds to audit risk in a number of ways. Some of these are as follows:

1. For most entities, the self-construction of assets is likely to be a once-off, or at least irregular event. Hence, it may not be fully or properly covered by the entities normal internal control procedures.
2. The costing of self-constructed assets is likely to present relatively complex management accounting issues and entities may not have the systems in place to capture all the necessary data.
3. Even with the best will in the world, it can be difficult to decide exactly what costs should be allocated to the self-construction of assets. Materials and direct labor should be straight-forward enough but the distinction between direct and indirect overheads may not be clear; even knowing exactly when an entity is operating at full capacity is not always clear-cut.
4. There is, of course, always the suspicion that entities will try to capitalize expenditure on self constructed assets as a way of increasing profits (or reducing losses) and there have instances of this type of fraud.

5. Deciding on the stage of completion of self-constructed assets can be problematic for the auditor as the usual builder's certification is unlikely to be available so it may be necessary to rely on the opinion of an expert and/or obtain written representations from management. The exact course of action in any particular case would depend upon the auditor's assessment of risk and materiality.

**(d)** The audit team should carry out the following tests:

1. Confirm the decision to self-construct assets with the appropriate board minutes or relevant authorization
2. Agree a sample of material costs to invoices
3. Review the budget for the capitalizations. Compare this to the actual costs incurred and discuss any differences with the management.
4. Agree the interest rate of any finance costs capitalized under IAS 23 to terms of the finance.
5. Agree the period of capitalization by reference to the date of the completion of the machines.
6. Review the list of items capitalized to confirm that they are all capital in nature.
7. Review the list of repairs and maintenance for any other items that should have been capitalized.

**(e)** The basic principle that an auditor should apply is that the increase in overhead caused by the self construction of non-current assets should be capitalized. These costs would not have been incurred if the assets had not been constructed. This proposition holds regardless of whether or not the plant is operating at full capacity. It is improper to increase the cost of finished goods with costs which were not incurred in their manufacture and which would not have been incurred if non-current assets had not been produced.

However, if the total construction costs on self-constructed non-current assets were substantially in excess of their business and economic usefulness, the excess cost should not be capitalized but should instead be
recorded as a loss.

**Answer Question Three 3**
**To: Quality Control Review Team for Nabil and Partners**
**From: Team Leader**
**Date: 30/06/2018**
**Briefing Note**

Thank you for your report on the various matters about which you are concerned in relation to practices and procedures at the X branch. I will comment on each case in turn.

(a) In this case Ahmed appears to have been carrying out “walk-through tests” as part of his examination of the production cycle. Walk-through tests involve following a small number of transactions from initiation to completion for the purpose of confirming the auditors understanding of the system and/or the appropriateness of the system description(s) including flowcharts. In this case, Ahmed followed four such transactions which would be an appropriate number for a walk-through test.

The problem is that Ahmed appears to have relied on this result in order to complete the subsequent Internal
Control evaluation Questionnaire (ICeQ). This should only have been completed by Ahmed after he had much more information than he could possibly have obtained from the examination of just four transactions. each
key control question in an ICeQ should be supported by detailed control points and there should be evidence that key controls have been applied consistently during the period under review. This would require testing
of controls (compliance tests) in much more detail than walk-through tests. Therefore, it would appear quite likely that there is a deficiency in the quantum of evidence obtained in respect of this client. These points require further information.

**(b)** Amjad appears to have done as much as she could reasonably be expected to in this case. It would also be worth clarifying if the following was also done perhaps elsewhere on the file;

• A written representation from management to the effect that the lessor company is unrelated to lessee  Co Ltd. This is hardly necessary if the lessor is a large and well-known national or international financial institution.

• A physical inspection of the assets obtained under finance lease.

• An appraisal of the appropriateness of treating the leases as finance leases under IAS 20.
• Written confirmation from management that no other such transactions were entered into during the year.

**(c)** The point at issue here is who sign the written representations from management should letter (the Letter of representation) at the conclusion of the audit. The matter is addressed in ISA 580 .This stems from the fact that responsibility for the financial statements rests ultimately with those who are charged with governance. Therefore, it is sufficient to have the representation from those charged with governance. It is probably sufficient to have the signatures of the senior executive officer and the senior finance officer although it should be clear that they are signing on behalf of the board of Directors and having made enquiries of relevant persons before signing. Conceivably there is a case for requesting the Chair of the board of Directors to sign the Letter of representation butt the ISA does not appear to specifically require it. There is no need for responsible officials at lower levels of the organization to sign.

## ANSWER Question Four

**(a)** Professions are always debating their own evolution and their own future and the auditing profession in 2017 is no different. All of the matters noted are indeed likely to influence the profession even in the near future. Also, some of the trends noted can move in different directions at different times e.g. the trend towards a globally regulated environment may now go somewhat into reverse.

The structure of the profession is also coming under close scrutiny. Many commentators feel that having just four big firms is detrimental to the profession and that it mitigates against other trends in the industry such as an increasing requirement for audit rotation. This has led to more calls for the use of joint audits (Big Four and Mid-Tier firms coming together for audits, for example). However, the legal concept of "joint and several" liability may dissuade some firms from participating.

Information technology has had a huge effect on the conduct of audits over, say, the last 30 years. Some fundamental changes may now be possible. For example, with the use of Computer Assisted Audit Techniques (CAATs) it may now be realistic to audit 100% of transactions in a category and so the use of sampling may be less necessary. On the other hand, if it is necessary the use of "proper" statistical sampling may be easier. However, notwithstanding this it is unlikely the fundamental characteristic of an audit as an exercise in professional judgment will ever be altered.

The issue of wider assurance has come much to the fore. However, there are problems in this area also. For example legal standards are largely absent in the area of environmental and social reporting (notwithstanding examples of Best Practice such as the Global Reporting Initiative). This raises the question as to why companies commission such reports in the first place and whether they will continue to do so in the future or if they fizzle out as a "fad". Moreover, comparisons are also difficult between companies because of the vastness of the topics that could potentially be covered within the area of environmental and social reporting. It would be very difficult to measure the social and environmental impact of one company against another. Financial reports have, literally, a common currency but social and environmental reports do not.

The ethical values of societies also evolve over time and there is little doubt that the ethical environment in the current climate is very challenging indeed. On the one hand, long and complex supply chains make it very difficult for entities to ensure that their products are ethical in whatever way that is defined (e.g. no exploitation of the labor of children or). On the other hand, far more people are now potentially seen as “stakeholders” and the question of the auditors’ duty to such “stakeholders” may well be reassessed over time.

**(b)** This is obviously a question on which individual students will have their own ideas but there some points they could probably agree on/suggest

• All of the accounting bodies require both rigorous academic training plus extensive practical experience.

This should ensure that qualified candidates are well fit for their roles.

• Pre-qualification training is required to be updated by mandatory Continuing Professional Development.

• The syllabi of the professional bodies are kept under constant review and so should be up to date.

• More innovative training and assessment methods are used all the time. e.g. online and blended learning.

• There is typically a requirement for experience with only one firm before qualification. This can limit the training available to an individual trainee so, for example, an individual who trains in a small practice may find it difficult to adopt to a larger practice or vice-versa.

• Some academics would argue that there is too much emphasis on the technical aspects during accounting training as the expense of other, arguably, more important skills such as critical thinking or research literacy.

• The high level of demand for accountants across many sectors would suggest that the training is perceived to be useful by the business community as a whole.

## Answer question Five

**(a)** Although the fact that only 3% of frauds are detected by external audit appears to be surprising it is not fair to conclude that, as a result, external auditors are not satisfactorily serving either their clients or society in general.

First of all, it is not the primary duty of an auditor to search for or to discover fraud. According to ISA 240 auditors have a responsibility to design their tests in such a way as to have a reasonable expectation of detecting fraud especially if that fraud has a material impact on the financial statements. Other duties of auditors in this area include the duty to enquire of management and those charged with governance (TCWG) if any fraud has occurred during the period subject to audit and to ensure that there is a discussion amongst the engagement team as to the susceptibility of the entity to fraud. This should form part of the audit planning process. Additionally, auditors who discover fraud have a responsibility to inform TCWG as soon as possible and may, depending on circumstances, have a duty to inform certain third parties if, for example, money laundering is suspected.

The audit may itself prevent or discourage fraud because potential fraudsters may be deterred by the knowledge that an independent third party will be examining the books and records. Additionally, the auditor will usually test the system of controls and report any deficiencies to management and TCWG as required by ISA 265. This should help strengthen the control system which will also deter potential fraudsters. Internal audit is, of course, part of internal control and that too will be reviewed and critiqued by external audit. This may contribute to the fact that 14.1% of frauds are detected by internal audit and a further 16% by management review itself also a part of internal control.

Another reason why the rate of fraud detection is so low may be because external audit is, in most cases, a purely retrospective exercise. In other words, one would expect most frauds to be detected well in advance of the annual audit. For example, if a fraud is perpetuated early in a financial year it could easily be more than 12 months before the external auditors would examine the applicable transactions or controls in the period. One would expect material frauds to be discovered much sooner than that. If they are not, this could suggest a worryingly weak system of internal controls within the entity.

A case could, of course, be made for increasing the role of external audit in fraud detection. However, there is not much evidence to suggest that either clients or society in general would benefit very much. At the moment auditors are required to exercise “professional skepticism” but generally accept information and documentation that comes from the auditee unless there is some reason to be suspicious. Although the language used to describe this state of affairs has evolved over the years the basic tenet underlying it has not really changed since

it was articulated by Lopes LJ in the Kingston Cotton Mill Case at the end of the nineteenth century when he said that an auditor should be “a watchdog, but not a bloodhound”.

Changing the basis of audit would also make it much more expensive and would introduce an element of forensic auditing into a standard audit. The cost of this would need to be weighed against any potential benefit.

**(b)** The information in this scenario suggests a very weak control environment in Amir Ltd a fact which appears not to have been recognized in the two previous audits. The fact that it was not so recognized or, worse still, was recognized but was then ignored suggests that Chaps and Grant have inadequate quality control and were failing to comply with ISA 220 and probably also ISQC 1. Even the comparatively simple issue that the employees are not always wearing the required protective clothing would reinforce the point that this company does not have a culture of taking regulation seriously.

The fact that the HIA is related (albeit by marriage) to the finance director and appears to have been appointed in a less than transparent way undermines her independence and calls into question the reliability of her work and that of the whole IA team. IA is not regulated by statute or by regulatory bodies in the same way as external audit but in many instances the role itself is at least as important to the governance of the entity concerned. In the circumstances, it would seem wholly inappropriate for the EA to be relying on the work of the IA because under ISA 610 the scope of the work and the independence of the IA should be of paramount importance in deciding on the extent of reliance by the EA on the IA.

It is also very concerning that the HIA has instructed members of her team not to query certain transactions but to refer them to her personally. At the very least, this implies a complete lack of trust in the audit team but, more seriously, suggests the possibility of misconduct on her behalf. It is slightly ambiguous as to whether the payments that the HIA does not want queried include, or are limited to, those in developing countries but again these payments are very concerning and may be of an improper nature. At the very least it would seem wholly inappropriate that only the Finance Director (FD) is aware of them. The FD is required by law to supply any information the EA requires and the failure to do so is a most serious matter which could undermine the relationship to the extent that the EA might have to consider resigning.