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ACCA AA | Express Notes

Audit and Assurance

SBL

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Steve Crossman
CEO The ExP Group

Hello

Thank you for downloading a copy of these ExPress notes and I hope you find them useful for your studies.

We provide these ExPress notes free of charge to individual students as part of our CSR initiatives. The notes are designed to help students assimilate and understand the most important areas for the exam as quickly as possible.

A word of warning though in that they have not been designed to cover everything in the syllabus so you should only use these notes for either an overview of the key areas before you start your main studies or as part of your final revision in the run up to your exams.

Importantly though, we want you to be successful in your exams so good luck with your studies and please do let us know how you get on.

All the best,

Steve

About The ExP Group

We were born with one passion, with one aim, with one desire. To use technology the way it should be used. To use technology to open up education, and in particular financial education, to whoever needs it regardless of their income, wealth, race, sex, religion or location.

We wanted to use technology to empower individuals to develop themselves through financial expertise, organisations to improve their performance through enhanced human capital and ultimately communities and families to benefit as a result.

We're on target and since our birth we have had the privilege of working with and learning from inspirational individuals and organisations from all 4 corners of the world in countries as varied as the UK in the north, Singapore in the east, South Africa in the south and the Cayman Islands in the west.

We're only part way through our journey but we're doing better than we expected. The best is yet to come though,

Education + Technology = Ethical Empowerment.

Thank you for being part of our story.

01

Audit Reports

The Big Picture

The one thing all statutory audits of limited liability companies have in common is that at the end of the day an independent auditor has to issue a report to the shareholders as the owners of the company.

ISA 700 states that the objectives of the auditor are:

- (a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) To express clearly that opinion through a written report.

Although the auditor's report is produced after all the detailed field work has been completed, it is perhaps important to give it consideration at a fairly early stage in your studies. After all, if you know exactly what you are aiming at, it is perhaps that much easier to hit the target!

Key Knowledge

ISA 700 The Auditor's Report on Financial Statements identifies the key elements of the auditor's report (these must be learned and you should be prepared to give a brief explanation of the purpose of each element):

1. Title
2. Addressee
3. Auditor's Opinion
4. Basis for Opinion
5. Key Audit Matters (for listed companies only)
6. Other Information
7. Responsibilities of Management and Those Charged with Governance

8. Auditor's Responsibilities for the Audit of the Financial Statements
9. Report on Other Legal and Regulatory Requirements
10. Name of the engagement partner
11. Signature
12. Auditor's address
13. Date of report

Key Knowledge – Modified Audit Reports

The standard audit report may be modified, such modification may or may not result in the auditor giving a qualified opinion. It is important to remember that modification of the audit report will only be required if there is some material issue.

It is also important when assessing materiality to remember that this must be considered so far as the user and not the preparer of financial statements is concerned. A useful working definition of materiality may be taken as

'transactions and other events are likely to be seen as material in the context of a company's financial statements if their omission, misstatement, obscurement, or non-disclosure would matter to a proper understanding of such financial statements on the part of a potential user.'

Key Knowledge – Modified Audit Reports with Unqualified Opinion

Sometimes there may be matters relating to the financial statements which, whilst fully and adequately disclosed within the financial statements, the auditor considers worthy of bringing to the particular attention of users.

The auditor achieves this by including in the audit report an additional paragraph known as an 'emphasis of matter' paragraph. This paragraph will be 'self-contained' and will NOT otherwise impact on the standard wording of an unmodified report.

An emphasis of matter paragraph should be positioned AFTER the basis for opinion paragraph

Past examiners' reports have indicated that many candidates have been unclear as to how and when to make proper use of an emphasis of matter paragraph. It is important, therefore, that you are totally happy with this aspect of audit reports.

An example of where the use of such paragraph would be appropriate includes where there the financial statements have been prepared on a going concern basis, but this is dependent upon some significant uncertainty which is fully and adequately disclosed in the notes to the financial statements

Key Knowledge – Modified Audit Reports with Qualified Opinion

According to ISA 700, there are two main circumstances which might give rise to the auditors deciding that is necessary for them to qualify their audit opinion:

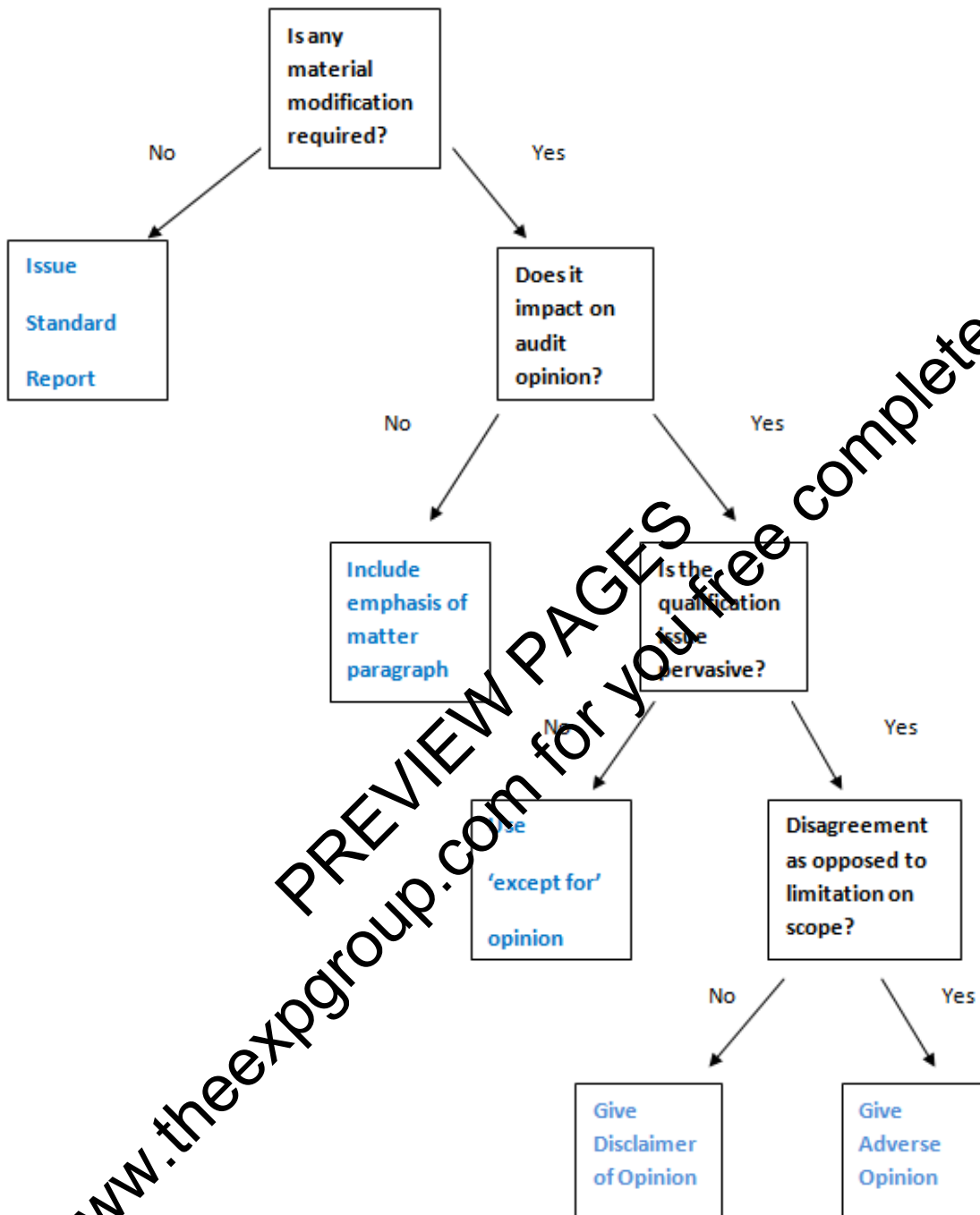
1. Limitation on scope which arises where the auditor has been unable to carry out some audit work which normally they would have expected to perform and/or where the circumstances are such that audit evidence which the auditor would normally expect to be available for some reason does not exist (the auditor is unable to obtain sufficient appropriate evidence).
2. Disagreement exists between the auditors and client management in relation to some aspect of the financial statements (the financial statements are materially misstated).

The type of qualified opinion to be given will depend not just on the circumstances as indicated above, but also on how serious the limitation on scope or disagreement is namely is it:

1. Material but not pervasive, that is to say that the limitation on scope or disagreement is confined to one particular aspect of the financial statements, such that the auditor is able to say that 'except for' this matter the financial statements give 'a true and fair view etc'.
2. Material and pervasive, that is to say that the nature of the limitation on scope or disagreement is such that it will impact on the overall view given by the financial statements. In such situation if it is caused by limitation on scope, the auditor should give a Disclaimer of Opinion, whereas if it is because of disagreement, they should give an Adverse Opinion.

The circumstances giving rise to a qualified audit opinion should be described in a separate paragraph. Wherever possible, the auditor should quantify the qualification circumstances as this should make it easier for the reader to appreciate its significance.

SUMMARY DIAGRAM OF APPROACH TO PRACTICAL AUDIT REPORT QUESTIONS



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02

Ethics

The Big Picture

Ethics is at the heart of the ACCA examination syllabuses featuring to a greater, or lesser extent in over half of the papers that you take on route to qualification as a Chartered Certified Accountant.

Whilst not necessarily appearing as a question every time in the real exam, it must be seen as a key area for your studies.

The fundamental principles of professional ethics as outlined by IFAC have been adopted by ACCA and must be learned. It is important to appreciate that ACCA have adopted a principles-based approach to ethics so whilst there are specific recommendations in some areas (which must be learned) if you are faced with a practical question where you are not aware of any specific guidance having been issued, you must always go back to basics and apply the fundamental principles.

Of particular importance to the auditor are the provisions relating to auditor independence.

Key Terminology

The fundamental principles of professional ethics as outlined in the IFAC Code of Ethics is a very important **TOPIC**. You might like to use **TOPIC** as a useful mnemonic to help you remember these principles.

Technical (professional) competence and due care must be exercised by all members at all times. Members have a responsibility to act in accordance with best practice and to keep themselves technically up to date.

Objectivity must be demonstrated by not allowing personal interest or influence of others to affect a member's professional judgement.

Professional behaviour must be demonstrated by members at all times, in both their private and business life, so as not to be seen to take any action which might bring the profession into disrepute.

Integrity requires that members are always honest and do not knowingly allow themselves to be associated with anything dishonest so far as others are concerned.

Confidentiality requires that under normal circumstances members should at all times respect confidentiality with regard to a client's affairs so far as third parties are concerned and that members should not make use of client information for personal gain.

Key Knowledge – Threats to Ethical Behaviour

The ACCA Code of Ethics recognises a number of threats to a member's ethical professional behaviour. Whilst such threats apply generally, they are particularly relevant when considering the question of auditor independence.

It is always worth remembering the following "It will never be sufficient for an auditor to claim that they were independent in fact, they must always be clearly seen to have been independent in practice."

The five threats are:

1. Self-interest - e.g. owning shares in a client company
2. Self-review - e.g. providing accounting services to an audit client
3. Familiarity - e.g. acting as auditor to a company where a close relative is the CEO
4. Intimidation - e.g. continuing to act as auditor to a company which has started legal proceedings against the audit firm
5. Advocacy - e.g. acting on a client's behalf in negotiations to raise new finance for the company

Safeguards against threats

As part of its quality control procedures, a professional firm must establish its own formalised procedures for the identification and management of such threats. Additionally, general safeguards may be seen as being:

- Those created by the ACCA e.g. requirement for potential members to complete an ethics module
- Those created by members themselves e.g. ensuring that CPD requirements are met

03

Auditor Appointment

The Big Picture

In that you are taking the International variant of the AA exam, you are not required to have a knowledge of any specific company law requirements relating to auditors.

However, using the UK legislation as an example of best practice you need to be aware of provisions relating to:

- Appointment of auditors
- Auditors' rights
- Auditors' duties
- Auditors' resignation
- Removal of auditors

Key Knowledge – Appointment of Auditors

Key points to note are:

- Normally made by members at company's AGM
- Initial appointment can be made by directors, who may also fill a casual vacancy
- Under corporate governance provisions approval of audit committee required
- If previous financial statements were audited by some other auditors, 'professional clearance' should be obtained
- Before accepting nomination, auditors should consider quality control matters such as independence, potential conflicts of interest, professional competence etc.

Key Knowledge – Auditor Rights

Often provided under local statute, where not, sort of thing that should be covered by engagement letter, usual matters covered being rights to:

- have access to all company books, records etc. at all times
- obtain all information and explanations considered necessary from company management and staff
- receive notice of, to attend and be heard at all general meetings of the company on matters relating to the financial statements and/or their own appointment
- to resign and request directors to convene GM of company where there are 'surrounding circumstances' connected with the resignation
- to make representations to shareholders where there is attempt to remove them from office with which they do not concur

Key Knowledge – Auditor's Duties

Once again may vary from country to country, but main duties and responsibilities would normally be seen as being:

- to report to shareholders whether financial statements give a true and fair view and have been properly prepared in accordance with relevant legislation and/or relevant accounting standards
- to consider implications for audit reporting on financial statements of consistency of 'other financial information' published together with the financial statements
- to review and report on effectiveness of company's internal control systems under corporate governance /stock exchange provisions in the case of listed companies
- to qualify audit opinion where necessary
- to provide proper notice on resignation
- to detect material fraud and other irregularities
- to maintain independence

Key Knowledge – Auditors' Resignation

The main concern here is that auditors should not be able to just 'fade away quietly' in order to avoid an awkward situation, leaving shareholders and others who place reliance upon their work, in the dark about important issues of which the auditors are aware.

Taking UK provisions as an example therefore, the key points are:

- auditors must deposit formal written notice of their resignation at the company's registered office
- such notice must be accompanied by a positive/negative statement as to whether in their opinion there are any surrounding circumstances requiring communication to the members or loan creditors of the company
- where there are surrounding circumstances, the auditors may request the directors to convene a GM so that the members may have the opportunity of questioning them further

Key Knowledge – Removal of Auditors

Once again, we can take the UK provisions as being a good example of good practice:

- special notice must be given of the resolution proposing a change in auditors
- auditors must be notified of resolution and, if they wish to contest, have the right, at the company's expense, to pre-circularise their representations to the members as to why they should remain in office
- at the meeting auditors may again put forward their position before the vote takes place
- removal will require the passing of an ordinary resolution (simple majority)

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