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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 14

AUDIT FINALISATION – REPORTING

Key References: ISA 700 (Revised), ISA 701, ISA 705, ISA 706, Companies Act, 2017

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Objective: To understand the purpose, structure and types of audit report and how the auditor communicates his opinion on the financial statements.

1 PURPOSE OF THE AUDIT REPORT

- Communicates the auditor's opinion to the intended users.
- Provides assurance about whether the financial statements are free from material misstatement.
- Enhances credibility and usefulness of financial statements.

2 FORMING AN OPINION (ISA 700)

Auditor shall:

- Obtain sufficient appropriate audit evidence.
- Evaluate identified misstatements.
- Conclude whether financial statements are prepared in accordance with the applicable financial reporting framework.
- Form an opinion: Unmodified, Modified or Disclaimer/Adverse.

3 KEY AUDIT MATTERS (ISA 701)

- Matters that were of most significance in the audit of financial statements.
- Included in the auditor's report (except in rare circumstances).
- Communicated in a separate section after the opinion section.

4 AUDIT REPORTING & COMPANIES ACT, 2017 (PAKISTAN)

- Auditor's report must be in the form prescribed by the Act.
- Must include matters stated in section 406.
- Report to be attached with financial statements and laid before members.

5 MODIFICATING TO AUDIT OPINION (ISA 705)

When appropriate, modify the opinion due to:

- **Scope Limitation** – auditor unable to obtain sufficient evidence.
- **Material Misstatement** – financial statements materially misstated.
- **Pervasiveness** – whether the effect is pervasive or not.

6 EMPHASIS OF MATTER & OTHER MATTER PARAGRAPHS (ISA 706)

Emphasis of Matter Paragraph:

- Draws users' attention to a matter presented or disclosed in the financial statements.

Other Matter Paragraph:

- Provides information other than that presented in the financial statements.

7 TYPES OF AUDIT OPINIONS

TYPE OF OPINION	WHEN ISSUED	WHY ISSUED	KEY PHRASE (ISA 700)
Unmodified Opinion (Clean Opinion)	When FS are prepared in all material respects in accordance with the applicable FR framework.	Sufficient appropriate evidence obtained; no material misstatement.	"...present fairly, in all material respects..."
Qualified Opinion	When misstatement is material but not pervasive, or scope limitation is material but not pervasive.	Departures from FR framework or limitation affects some but not all of FS.	"...except for the possible effects of the matter described in the basis for qualified opinion paragraph..."
Adverse Opinion	When misstatement is both material and pervasive.	FS do not present fairly.	"...do not present fairly..."
Disclaimer of Opinion	When scope limitation is both material and pervasive.	Unable to obtain sufficient appropriate evidence.	"...do not express an opinion..."

PRACTICE QUESTION (SAQ)

Under what circumstances would an auditor include an Emphasis of Matter paragraph in the audit report?

TUTORIAL NOTES

- Do not repeat information already disclosed in FS.
- Key Audit Matters ≠ Qualified Opinion.
- Modification depends on both nature and pervasiveness.
- Follow the exact order and wording of ISA 700.

EXAM TIPS

- Learn structure of auditor's report by heart.
- Practice case-based reporting questions.
- Know differences between ISA 705 & ISA 706.
- Use headings and underline key phrases in answers.

KEY TAKEAWAYS

- Report communicates the auditor's opinion to users.
- Opinion depends on evidence, misstatements and scope.
- KAMs help users understand significant audit matters.
- Follow ISA format and legal requirements strictly.
- Clear, accurate and timely reporting builds trust and professional value.

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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 15 & 16

AUDIT FINALISATION – FINAL EVALUATION & REVIEW & ASSURANCE ENGAGEMENTS

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Key References: ISA 580, ISA 450, ISA 510, ISA 220 (Revised), ISRE 2400, ISAE 3000 (Revised)

Objective: To ensure the audit is properly completed and reported, and to understand review engagements and sustainability assurance engagements.

15 AUDIT FINALISATION – FINAL EVALUATION

FINAL REVIEW
- Review work papers and conclusions.
- Ensure audit objectives achieved.

OVERALL EVALUATION
- Evaluate effect of identified misstatements.
- Ensure FS are free from material misstatement.

GOING CONCERN
- Evaluate management's assessment.
- If material uncertainty exists, ensure adequate disclosure.

SUBSEQUENT EVENTS
- Perform procedures up to the date of report.
- Adjust or disclose as required.

WRITTEN REPRESENTATIONS
- Obtain written representations from management.
- Essential before issuing the report.

16 REVIEW & ASSURANCE ENGAGEMENTS

REVIEW ENGAGEMENTS (ISRE 2400)
- Moderate assurance.
- Primarily inquiries and analytical procedures.
- Provide limited assurance report.
- Negative conclusion (nothing came to our attention...).

ASSURANCE ENGAGEMENTS (ISAE 3000 – REVISED)
- Reasonable / Limited assurance.
- Evaluate subject matter using suitable criteria.
- Provide assurance report (Positive conclusion).
- Includes sustainability assurance engagements.

COMPARISON: AUDIT vs REVIEW vs ASSURANCE ENGAGEMENTS

FEATURE	AUDIT (ISA 200)	REVIEW (ISRE 2400)	ASSURANCE (ISAE 2000)
Objective	Obtain reasonable assurance that FS are free from material misstatement.	Obtain moderate assurance that nothing has come to attention.	Obtain reasonable or limited assurance on subject matter information.
Work Performed	Test of controls + Substantive procedures (detailed).	Inquiries + Analytical procedures (limited).	Evaluate evidence against criteria (more extensive than review).
Level of Assurance	High (Reasonable).	Moderate (Limited assurance).	Reasonable or Limited (depends on engagement).
Report Type	Positive opinion (Clean / Modified / Adverse / Disclaimer).	Limited assurance report (Negative conclusion).	Assurance report (Positive conclusion or limited assurance).
Example	Statutory audit of financial statements.	Review of interim financial information.	Sustainability assurance, compliance reports, ESG reports.

IMPORTANT POINTS
- Completion review ensures quality and adequacy of audit work.
- Management representations are mandatory (ISA 580).
- Subsequent events may require adjustment or disclosure (ISA 560).
- Going concern is evaluated up to report date (ISA 570).

COMMON MISTAKES TO AVOID
- Issuing report without completing all audit procedures.
- Ignoring identified misstatements.
- Not obtaining written representations.
- Not evaluating going concern properly.
- Missing subsequent events.

EXAM TIPS
- Write steps in correct order for finalisation.
- Differentiate clearly between audit, review and assurance.
- Write ISA numbers in answers.
- Use diagrams/tables for comparisons.
- Practice report drafting.

KEY TAKEAWAYS
- Complete the audit thoroughly.
- Evaluate and review before issuing the report.
- Obtain written representations from management.
- Consider subsequent events and going concern.
- Understand review vs assurance engagements clearly.
- Sustainability assurance is the future of assurance.

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CHAPTER 1

CONCEPT AND NEED FOR AUDIT

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1 MEANING OF AUDIT

An audit is an official examination of the accounts (or accounting systems) of an entity by an independent auditor.

OBJECTIVE OF AUDIT

To enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

COMPONENTS OF FINANCIAL STATEMENTS (AS PER IAS 1)

- Statement of Financial Position (Balance Sheet)
- Statement of Profit or Loss and other Comprehensive Income
- Statement of Changes in Equity
- Cash Flow Statement
- Notes to the Financial Statements
- Comparative Information

2 ADVANTAGES OF STATUTORY AUDIT

- Increases the credibility of published financial statements.
- Confirms to management that they have performed their statutory duties correctly.
- Provides assurance of compliance with non-statutory requirements (e.g., corporate governance).
- Provides feedback on the effectiveness of internal controls.
- Even where audit is not required, it increases credibility and may be important for potential lenders (e.g., banks may require it as a pre-condition for lending).

3 LIMITATIONS OF STATUTORY AUDIT

- Cost of audit can be very high.
- Disruption to staff as they assist auditors.
- Estimates involve judgment; future outcomes uncertain.
- Most frauds involve deliberate concealment or misrepresentation.
- Sampling is used to balance cost and efficiency.
- Systems have inherent limitations; not foolproof.
- Audit evidence is persuasive, not conclusive.

PRACTICE QUESTION (SAQ)

Your friend invested in Ascender Limited shares. After reading the annual report, he said:

"The auditor has given an unqualified opinion. Since the auditor must have tested majority of the transactions, the financial statements are correct in all respects. As no control deficiencies or fraud were reported, I can safely invest more as there is no risk of losing money due to fraud or misstatements."

Required:

Write a letter to your friend removing his misconceptions about audit of financial statements and explain your viewpoint.

TUTORIAL NOTES

- Audit is performed on a sample basis and focuses on areas of higher risk or materiality.
- An unqualified opinion provides "reasonable assurance", not absolute correctness of every figure.
- Auditor's responsibility is limited to material misstatement in financial statements, not prevention of all frauds.
- Users should consider other information and their own due diligence before making investment decisions.

KEY TAKEAWAYS

- Audit builds trust and confidence in financial reporting.
- It is based on evidence, judgment and professional skepticism.
- It has limitations; understand them before relying fully on audit.
- Unqualified opinion ≠ Guarantee of accuracy or fraud-free financial statements.

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CHAPTER 4
EVIDENCE AND SAMPLING

Key References: ISA 500, ISA 505, ISA 530

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The auditor must obtain Sufficient and Appropriate Audit Evidence to reduce audit risk to an acceptably low level.

1 WHAT IS AUDIT EVIDENCE?

Audit evidence is information used by the auditor in arriving at the conclusions on which the audit opinion is based.

SUFFICIENT	APPROPRIATE
Quantity of evidence.	Quality of evidence.
Enough evidence to support the auditor's conclusions.	Relevant, reliable and authentic to support the conclusions.

2 TYPES OF AUDIT PROCEDURES

Inspection
Examining records or assets (such as documents, contracts, physical verification).

Observation
Watching a process or procedure performed by others.

Inquiry
Seeking information from management or other knowledgeable persons.

Confirmation
Obtaining written confirmation from third parties.

Recalculation
Checking the mathematical accuracy of documents or records.

Re-performance
Independently performing procedures or controls.

3 CHARACTERISTICS OF RELIABLE AUDIT EVIDENCE

Relevant
Related to the assertion being tested.

Reliable
From a credible and trustworthy source.

Authentic
Original source or true copy.

Timely
Obtained at or before the date of the auditor's report.

4 AUDIT DOCUMENTATION (ISA 230)

The auditor must document:

- The nature, timing and extent of procedures performed.
- The results of the procedures and evidence obtained.
- Significant matters discussed with management.
- Conclusion reached.

5 AUDIT SAMPLING (ISA 530)

Sampling is the application of audit procedures to less than 100% of the items in a population.

ADVANTAGES	LIMITATIONS
Saves time and cost.	Sampling risk exists.
More efficient than examining all items.	Results need proper evaluation.
Allows auditor to focus on high-risk areas.	Not suitable for all types of assertions.

6 TYPES OF SAMPLING

STATISTICAL SAMPLING
- Based on probability theory.
- Each item has a known chance of selection.
- Results can be projected to the population.

NON-STATISTICAL SAMPLING
- Based on auditor's judgment.
- Items selected for specific purposes.
- Results cannot be projected.

PRACTICE QUESTION (SAQ)

Scenario:
While auditing inventory, you plan to verify existence through physical verification. Due to time and cost constraints, you decide to use sampling.

Required:
Explain the factors you will consider before deciding the sample size for this audit.

TUTORIAL NOTES

- Evidence must be both sufficient (quantity) and appropriate (quality).
- More reliable evidence allows less reliance on other evidence.
- Sampling is useful, but auditor must control sampling risk.
- Always document procedures and conclusions in detail.
- Professional skepticism is key while evaluating evidence.

EXAM TIPS

- Focus on requirements of the question.
- Use headings and bullet points.
- Write purpose of each procedure.
- For sampling, explain design, selection and evaluation.
- Always conclude clearly.

KEY TAKEAWAYS

- Obtain Sufficient and Appropriate Audit Evidence.
- Use the Right Audit Procedure for the Assertion.
- Document Everything – It's Your Audit Trail.
- Sampling Saves Cost & Time – But Has Sampling Risk.
- Quality Evidence Leads to a Reliable Opinion.

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CHAPTER 5
INTERNAL CONTROL

Key Reference: ISA 315 (Revised)

A strong system of internal control helps an entity achieve its objectives, ensure reliable financial reporting and comply with laws and regulations.

1 WHAT IS INTERNAL CONTROL?

Internal control is a process, effected by those charged with governance, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

2 THE FIVE COMPONENTS OF INTERNAL CONTROL

3 COMPONENTS EXPLAINED

1. Control Environment
Sets the tone of the organization. Includes integrity, ethical values, competence of staff, management's philosophy and organizational structure.

2. Risk Assessment
Identification and analysis of relevant risks to the achievement of objectives, including risks of material misstatement.

3. Information and Communication
Relevant, quality information is identified, captured and communicated in a form and timeframe that enables people to carry out their responsibilities.

4. Control Activities
Policies and procedures (approvals, authorizations, verifications, reconciliations, segregation of duties, physical controls).

5. Monitoring of Controls
Ongoing evaluations, separate evaluations or both to ensure controls remain effective over time.

4 OBJECTIVES OF INTERNAL CONTROL

- Safeguard assets from unauthorized use or loss.
- Ensure accuracy and completeness of accounting records.
- Promote efficiency in operations and compliance with policies and laws.

5 LIMITATIONS OF INTERNAL CONTROL

- Only provides reasonable, not absolute, assurance.
- Human error can occur.
- Collusion can override controls.
- Cost of control should not exceed the benefit.
- Controls can become inadequate due to changes in environment or business.

6 CONTROL ACTIVITIES – EXAMPLES

Authorization	Segregation of Duties	Physical Controls	Reconciliations	Verification
Transactions are approved by authorized persons.	No single person handles a transaction from start to finish.	Restricting access to assets, records and systems.	Regular comparison of records to ensure accuracy.	Independent checks and reviews of performance.

TUTORIAL NOTES

- Understand and evaluate each component of internal control.
- Focus on key controls in major cycles (sales, purchases, payroll, inventory, cash).
- Weak control environment = weak overall control system.
- Control deficiencies increase audit risk.
- Always document understanding and evaluation.

PRACTICE QUESTION (SAQ)

XYZ Limited is a trading company. During your audit planning, you observed that:
- One person raises purchase requisition, places order and also approves payment.
- No physical count of inventory is performed during the year.
- Bank reconciliations are not reviewed by anyone.

Required:
Explain the deficiencies in internal control in the above scenario and suggest controls that should be implemented.

KEY TAKEAWAYS

- Strong internal control supports reliable financial reporting.
- Five components work together as a system.
- No control system is 100% foolproof.
- Management is responsible; auditor evaluates and tests.

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CHAPTER 7
INTRODUCTION TO SUBSTANTIVE PROCEDURES

Key References: ISA 330, ISA 500, ISA 520

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Substantive procedures are designed to detect material misstatements in the financial statements at the assertion level.

1 WHAT ARE SUBSTANTIVE PROCEDURES?

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level.

MAIN PURPOSE

- To obtain evidence about the amounts and disclosures in the financial statements.
- To detect material misstatements due to error or fraud.

2 TYPES OF SUBSTANTIVE PROCEDURES

TESTS OF DETAILS

Examine transactions, account balances and disclosures in detail.

Examples:
- Vouching
- Recalculation
- Confirmation
- Physical verification

SUBSTANTIVE ANALYTICAL PROCEDURES

Evaluate financial information through analysis of plausible relationships.

Examples:
- Ratio analysis
- Trend analysis
- Reasonableness checks

3 ASSERTIONS TO BE TESTED

Assertions are claims made by management in the financial statements.

- **Existence / Occurrence** – Transactions and events recorded have occurred.
- **Completeness** – All transactions and disclosures have been recorded.
- **Valuation / Accuracy** – Amounts and other data are recorded appropriately.
- **Rights and Obligations** – Entity holds or controls rights to assets; liabilities are obligations.
- **Presentation & Disclosure** – Transactions are classified, described and disclosed appropriately.

4 COMMON TESTS OF DETAILS (EXAMPLES)

VOUCHING
- Trace transactions to supporting documents.
- Check documents for authorization.
- Ensure accuracy, completeness and validity.

RECALCULATION
- Recompute figures, amounts or totals.
- Check mathematical accuracy.
- Ensure correct application of rates, formulas, etc.

CONFIRMATION
- Obtain direct confirmation from third parties.
- Used for receivables, payables, bank balances, loans, etc.

PHYSICAL VERIFICATION
- Physically inspect assets or inventory.
- Verify existence, condition and ownership.

RE-PERFORMANCE
- Independently perform procedures or controls.
- Used where original evidence is not available or reliable.

EXAMINATION OF DOCUMENTS
- Examine agreements, contracts, invoices, minutes, etc.
- Check terms, compliance and consistency.

5 SUBSTANTIVE ANALYTICAL PROCEDURES (ISA 520)

Apply analytical procedures to evaluate financial information.
Identify unusual fluctuations or relationships.

Includes:
- Ratio Analysis (e.g., GP %, NPM, Current Ratio)
- Trend Analysis (e.g., Sales trend, Expense trend)
- Reasonableness Checks (e.g., Rent vs. Size of Building)
- Expected Values (e.g., Depreciation based on useful life)

6 FACTORS AFFECTING NATURE, TIMING AND EXTENT

- Assessed risks of material misstatement
- Effectiveness of internal controls
- Materiality of the account balance or transaction class
- Complexity of the transactions
- Reliability of the records and data
- Results of previous audit procedures
- Use of IT and automated controls
- Likelihood of fraud

PRACTICE QUESTION (SAQ)

You are auditing inventory.
List the substantive procedures you would perform to obtain audit evidence about existence, valuation and completeness of inventory.

Tip: Link each procedure with the assertion being tested.

TUTORIAL NOTES

- Always link procedure with the relevant assertion.
- Use a mix of tests of details and analytical procedures.
- Increase extent of procedures when risk is high.
- Document the results and conclusions clearly.
- Professional skepticism is key while evaluating evidence.

EXAM TIPS

- Read the requirement carefully.
- Write tests in a systematic manner.
- Use headings and bullet points.
- Mention the assertion with each test.
- Give practical and specific audit procedures.
- Manage time and attempt all questions.

KEY TAKEAWAYS

- Substantive procedures detect material misstatements.
- Tests of details provide direct evidence; analytical procedures provide indirect evidence.
- Focus on assertions while designing procedures.
- Proper timing and extent depend on assessed risks and control effectiveness.
- Document everything – it's your audit evidence trail.

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CHAPTER 2

OBTAINING AN ENGAGEMENT

ISA 210 – Agreeing the Terms of Audit Engagements

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Obtaining an engagement ensures that the auditor and the client have a clear understanding of the terms, responsibilities and ethical requirements before starting the audit.

1 PURPOSE OF OBTAINING AN ENGAGEMENT

To establish that:

- The engagement is appropriate.
- There is no conflict of interest.
- The terms are understood by both parties.
- The auditor has the competence, capability and resources.
- Ethical requirements can be met.

2 KEY CONSIDERATIONS BEFORE ACCEPTANCE

- **Integrity of management** (assess honesty and ethical values).
- **Competence** (auditor must have required skills and knowledge).
- **Client's business and reputation** (ensure it does not damage auditor's reputation).
- **Independence** (no relationships that impair objectivity).
- **Predecessor auditor** (communicate where necessary).

3 ETHICAL REQUIREMENTS

- Follow fundamental principles: **Integrity, Objectivity, Professional Competence, Confidentiality and Professional Behaviour.**
- Identify threats and apply safeguards.
- Comply with ICAP Code of Ethics and IFAC Code.

4 ENGAGEMENT LETTER (ISA 210)

A written agreement helps avoid misunderstandings and sets clear expectations.

Should include:

- Objective and scope of the audit.
- Responsibilities of management and auditor.
- Identification of applicable financial reporting framework.
- Reference to expected form and content of report.
- Access to records and persons.
- Fees and billing arrangements.
- Limitation of liability (where applicable).
- Duration of the engagement.
- Other terms as required.

5 RECURRING AUDITS

- Re-confirm acceptance procedures each year.
- Update engagement letter if terms change.
- Independence must be re-evaluated annually.

6 ISA 220 (REVISED) – QUALITY MANAGEMENT

- Firms must have a system of quality management.
- Leadership responsibilities for quality.
- Ethical requirements, acceptance and continuance of clients.
- Engagement performance, resources and monitoring.

PRACTICE QUESTION (SAQ)

You are the audit senior of ABC & Co. Your firm is approached by XYZ Limited for the first time to audit its financial statements. Management is offering a very high audit fee and wants the audit report within a very short time.

Required:
Explain the procedures you will follow before accepting the engagement. Also state the key matters that should be included in the engagement letter.

TUTORIAL NOTES

- ✔ Never accept an engagement without proper evaluation.
- ✔ Independence comes first, fee comes later.
- ✔ Engagement letter protects both auditor and client.
- ✔ Quality management is the responsibility of the firm.
- ✔ Good beginning = smooth audit and strong report.

KEY TAKEAWAYS

- Clear terms build strong relationships.
- Ethics and independence are non-negotiable.
- Document everything in writing.
- Evaluate before you accept the engagement.
- Quality today, trust and credibility tomorrow.

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CHAPTER 3
PLANNING AND RISK ASSESSMENT

ISA 300, ISA 315 (REVISED) & ISA 240

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Effective planning and proper risk assessment help the auditor focus on areas where material misstatement is more likely to occur.

1 PURPOSE OF PLANNING

- To give direction to the audit engagement.
- To help in proper allocation of audit resources.
- To ensure that important matters are given appropriate attention.
- To assist in the selection of team members and supervising their work.

2 PLANNING ACTIVITIES INCLUDE

- Establishing overall audit strategy
- Discussing with team members
- Developing the audit plan
- Coordinating the work of experts
- Assigning work to engagement team
- Updating the plan as needed

3 RISK ASSESSMENT (ISA 315 REVISED)

Identify and assess the risks of material misstatement at the financial statement level and assertion level.

RISKS AT FINANCIAL STATEMENT LEVEL

Affect the financial statements as a whole and the related disclosures.

Examples:
- Industry risk
- Economic conditions
- Changes in law and regulation
- Financial stability of the entity

RISKS AT ASSERTION LEVEL

Relate to classes of transactions, account balances or disclosures.

Examples:
- Completeness
- Existence
- Valuation
- Rights & obligations
- Presentation & disclosure

4 RISK OF MATERIAL MISSTATEMENT DUE TO FRAUD (ISA 240)

Fraud risk is present in all entities and cannot be assumed low even if the client is an existing one or no issues were found in the past.

Fraud Risk Factors

- Pressure / Financial targets
- Opportunities in the environment
- Attitude / Rationalization
- Management override
- Complex transactions
- Ineffective monitoring

Planning Stage Procedures for Fraud Risk

- Make enquiries of management about fraud risk and their processes.
- Discuss the risk of fraud within the engagement team.
- Evaluate management's integrity and ethical values.
- Consider the results of previous audits and other information.
- Incorporate unpredictability in the nature, timing and extent of procedures.
- Focus on journal entries, estimates, related parties and unusual transactions.

5 AUDIT STRATEGY VS AUDIT PLAN

AUDIT STRATEGY (ISA 300)

- Sets the scope, timing and direction of the audit.
- Prepared by engagement partner.
- Includes key decisions and resources.

AUDIT PLAN (ISA 300)

- Details the nature, timing and extent of procedures.
- Prepared by engagement team.
- More detailed and updated as needed.

TUTORIAL NOTES

- Good planning saves time and improves audit quality.
- Risk assessment drives the nature and extent of audit procedures.
- Fraud risk is always relevant and needs professional skepticism.
- Document planning decisions for clear audit trail.
- Review and update the plan as circumstances change.

PRACTICE QUESTION (SAQ)

You are the audit senior for XYZ Limited. Draft an email to your audit team explaining the importance of planning and risk assessment in the audit. Also list the key activities that should be performed during planning.

KEY TAKEAWAYS

- Plan the audit before starting field work.
- Identify and assess risks at financial statement and assertion levels.
- Fraud risk exists in every entity – stay alert and skeptical.
- Audit strategy sets direction; audit plan sets details.
- Review and update planning throughout the audit.

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CHAPTER 13
PROFESSIONAL ETHICS & CODE OF CONDUCT

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Key References: IESBA Code, IFAC Code, IFAC Fundamental Principles

Objective: To understand ethical principles, identify threats to compliance, apply safeguards and act with integrity and professional skepticism.

1 THE PURPOSE OF ETHICS

- Builds public trust in the profession.
- Ensures quality and credibility of audits and assurance services.
- Promotes ethical behavior and professional values.
- Protects the reputation of the profession and individual.

2 FUNDAMENTAL PRINCIPLES (IESBA)

- Integrity – Be honest and straightforward.
- Objectivity – Do not compromise professional judgment.
- Professional Competence & Due Care – Maintain knowledge and skill.
- Confidentiality – Respect confidentiality of information.
- Professional Behavior – Comply with laws and act in good faith.

3 THREATS TO COMPLIANCE

- Self-Interest Threat
- Self-Review Threat
- Advocacy Threat
- Familiarity Threat
- Intimidation Threat

If threats cannot be eliminated, apply safeguards.

4 SAFEGUARDS TO ELIMINATE OR REDUCE THREATS

Firm Safeguards
- Strong system of quality control.
- Ethical policies and procedures.
- Appropriate supervision and review.
- Consultation processes.

Work Environment Safeguards
- Ethical culture.
- Open communication.
- Support from leadership.
- Performance evaluation based on quality.

Engagement Safeguards
- Engagement partner review.
- Involve another partner in complex decisions.
- Use of experts.

Personal Safeguards
- Professional skepticism.
- Independence of mind.
- Continuous professional development.

Other Safeguards
- Rotation of key audit partners.
- Not accepting certain types of clients.
- Not providing prohibited non-assurance services.

5 PROHIBITED NON-ASSURANCE SERVICES

- Bookkeeping & accounting services
- Internal audit services
- Designing or implementing IT systems
- Aptuarial services
- Management functions
- Brokerage services

6 INDEPENDENCE IN AUDIT

- Mental independence – Independence in mind.
- Appearance of independence – Avoid facts and circumstances that may impair independence.
- Follow regulatory & professional requirements.

7 RESPONSIBILITIES OF A PROFESSIONAL ACCOUNTANT

- Act with integrity, objectivity and competence.
- Maintain confidentiality of client information.
- Comply with relevant laws and regulations.
- Report breaches of laws and unethical acts.
- Continuously improve professional knowledge.

PRACTICE QUESTION (SAQ)

You were the audit senior last year on the audit of ABC Limited. This year you are proposed as engagement partner.
Identify the threat created and suggest a safeguard.

TUTORIAL NOTES

- Identify threat first, then evaluate its significance.
- Not every threat is at an unacceptable level.
- Safeguards must be appropriate and effective.
- If threat is significant and no safeguard is available, withdraw from the engagement.
- Always act in the public interest.

EXAM TIPS

- Learn all 5 Fundamental Principles.
- Understand each type of threat with examples.
- Remember safeguards for each threat.
- Focus on Independence requirements.
- Use headings and points in answers.

KEY TAKEAWAYS

- Ethics builds trust and protects the profession.
- Follow Fundamental Principles in every situation.
- Identify threats and apply safeguards appropriately.
- Independence is not only in fact but also in appearance.
- Act with integrity, always in the public interest.

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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 11
RELATED PARTY TRANSACTIONS

Key References: ISA 550, ISA 505, IFRS 24

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Objective: To obtain sufficient appropriate audit evidence about identification, authorization, accounting and disclosure of related party transactions.

1 WHAT ARE RELATED PARTIES?

A related party is a person or entity that is related to the reporting entity.
Relationships may be through:

- Control
- Joint control
- Significant influence
- Key management personnel
- Close family members
- Entities controlled or significantly influenced by the above

2 RISKS OF MATERIAL MISSTATEMENT

- Transactions not identified or improperly recorded.
- Transactions on terms other than arm's length.
- Incomplete or inaccurate disclosures.
- Management override through related parties.
- Complex structures used to conceal relationships.

3 AUDITOR'S OBJECTIVES (ISA 550)

- Identify related party relationships and transactions.
- Obtain sufficient appropriate audit evidence.
- Evaluate whether transactions are properly authorized, recorded and disclosed.
- Ensure disclosures are complete and in accordance with IFRS 24.

4 AUDIT PROCEDURES FOR RELATED PARTY TRANSACTIONS

AREA	KEY PROCEDURES	AUDIT EVIDENCE	FOCUS POINTS
Identification	• Inquire management and those charged with governance. • Review organizational structure and ownership. • Inspect minutes and legal documents.	• Management representation letter • Shareholder register • Board/AGM minutes • Related party register	• Consider direct & indirect relationships. • Include key management and close family members.
Transactions	• Review all major transactions. • Test unusual or significant transactions. • Confirm balances and terms.	• Contracts and agreements • Invoices and correspondence • Bank statements • Third party confirmations	• Check terms are at arm's length. • Review pricing and settlement terms.
Accounting & Recording	• Check proper classification and recording. • Verify valuation and measurement. • Review journal entries for completeness.	• General ledger • Supporting calculations • Journal entries	• Ensure no off-balance sheet arrangements. • Check reclassification if needed.
Disclosure (IFRS 24)	• Review completeness of disclosures. • Check quantitative and qualitative information. • Compare with prior year and industry.	• Notes to financial statements • Related party transactions summary • Draft financial statements	• Disclosure of nature of relationship. • Volume, terms and outstanding balances.
Analytical Procedures	• Compare related party balances and transactions with prior year. • Perform ratio and trend analysis.	• Comparative financial data • Budget and forecasts • Industry benchmarks	• Identify unusual movements. • Focus on large or non-recurring items.

5 IMPORTANT DISCLOSURES (IFRS 24)

- Nature of relationship
- Description of transactions
- Outstanding balances
- Provisions for doubtful debts
- Commitments
- Compensation of key management personnel

6 COMMON RED FLAGS

- Unusual large transactions
- Transactions not in normal course of business
- Transactions not approved by those charged with governance
- Incomplete or vague disclosures
- Frequent changes in related parties

PRACTICE QUESTION (SAQ)

You are auditing a company.
During the year, the company purchased raw material from a company owned by its director.
List the audit procedures you would perform to identify, verify and ensure proper disclosure of this related party transaction.

TUTORIAL NOTES

- Always start with identification of relationships.
- Do not rely only on management representation.
- Use multiple sources to confirm transactions.
- Disclosure is as important as transaction itself.

EXAM TIPS

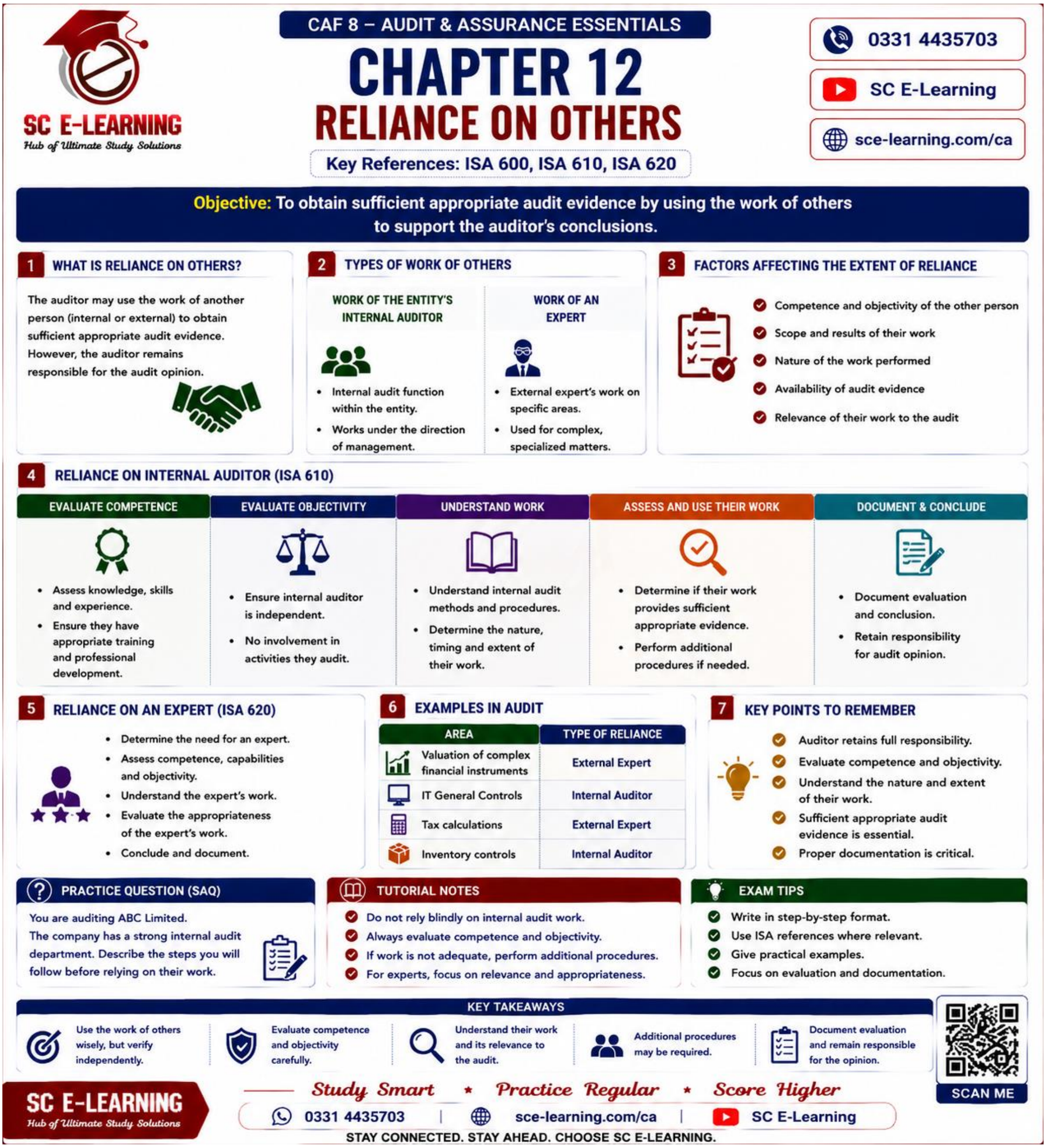
- Use headings and sub-headings in answers.
- Write procedures in logical order.
- Support with ISA and IFRS references.
- Give practical examples.

COMMON MISTAKES TO AVOID

- Ignoring indirect relationships.
- Not testing terms of transactions.
- Missing key management personnel.
- Incomplete disclosure review.

KEY TAKEAWAYS

- Identify all related parties and transactions.
- Verify terms, balances and authorization.
- Ensure proper accounting and complete disclosures.
- Related party risk requires professional skepticism.
- Strong documentation supports audit conclusion.


CAF 8 – AUDIT & ASSURANCE ESSENTIALS
CHAPTER 12
RELIANCE ON OTHERS
Key References: ISA 600, ISA 610, ISA 620
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Objective: To obtain sufficient appropriate audit evidence by using the work of others to support the auditor's conclusions.
1 WHAT IS RELIANCE ON OTHERS?
The auditor may use the work of another person (internal or external) to obtain sufficient appropriate audit evidence. However, the auditor remains responsible for the audit opinion.
2 TYPES OF WORK OF OTHERS
WORK OF THE ENTITY'S INTERNAL AUDITOR
Internal audit function within the entity.
Works under the direction of management.
WORK OF AN EXPERT
External expert's work on specific areas.
Used for complex, specialized matters.
3 FACTORS AFFECTING THE EXTENT OF RELIANCE
Competence and objectivity of the other person
Scope and results of their work
Nature of the work performed
Availability of audit evidence
Relevance of their work to the audit
4 RELIANCE ON INTERNAL AUDITOR (ISA 610)
EVALUATE COMPETENCE
Assess knowledge, skills and experience.
Ensure they have appropriate training and professional development.
EVALUATE OBJECTIVITY
Ensure internal auditor is independent.
No involvement in activities they audit.
UNDERSTAND WORK
Understand internal audit methods and procedures.
Determine the nature, timing and extent of their work.
ASSESS AND USE THEIR WORK
Determine if their work provides sufficient appropriate evidence.
Perform additional procedures if needed.
DOCUMENT & CONCLUDE
Document evaluation and conclusion.
Retain responsibility for audit opinion.
5 RELIANCE ON AN EXPERT (ISA 620)
Determine the need for an expert.
Assess competence, capabilities and objectivity.
Understand the expert's work.
Evaluate the appropriateness of the expert's work.
Conclude and document.
6 EXAMPLES IN AUDIT
AREA | TYPE OF RELIANCE
Valuation of complex financial instruments | External Expert
IT General Controls | Internal Auditor
Tax calculations | External Expert
Inventory controls | Internal Auditor
7 KEY POINTS TO REMEMBER
Auditor retains full responsibility.
Evaluate competence and objectivity.
Understand the nature and extent of their work.
Sufficient appropriate audit evidence is essential.
Proper documentation is critical.
PRACTICE QUESTION (SAQ)
You are auditing ABC Limited. The company has a strong internal audit department. Describe the steps you will follow before relying on their work.
TUTORIAL NOTES
Do not rely blindly on internal audit work.
Always evaluate competence and objectivity.
If work is not adequate, perform additional procedures.
For experts, focus on relevance and appropriateness.
EXAM TIPS
Write in step-by-step format.
Use ISA references where relevant.
Give practical examples.
Focus on evaluation and documentation.
KEY TAKEAWAYS
Use the work of others wisely, but verify independently.
Evaluate competence and objectivity carefully.
Understand their work and its relevance to the audit.
Additional procedures may be required.
Document evaluation and remain responsible for the opinion.
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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 9
SUBSTANTIVE PROCEDURES: CURRENT ASSETS

Key References: ISA 500, ISA 501, ISA 505, ISA 510, ISA 530

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Objective: To obtain sufficient appropriate audit evidence about existence, rights & obligations, completeness, valuation and disclosure of current assets.

1 CURRENT ASSETS INCLUDE:

- Inventory
- Trade Receivables
- Prepayments
- Bank Balances
- Cash in Hand

2 KEY RISKS OF MATERIAL MISSTATEMENT

- Inventory overvalued (cost > NRV)
- Fake or obsolete inventory
- Receivables may be overstated or uncollectible
- Prepayments may not relate to future periods
- Bank & cash may be misstated or not properly recorded

3 AUDITOR'S OBJECTIVE

To design and perform substantive procedures that provide direct evidence to confirm:

- Existence
- Rights & Obligations
- Completeness
- Valuation / Accuracy
- Presentation & Disclosure

4 KEY SUBSTANTIVE PROCEDURES (BY AREA)

INVENTORY
- Attend physical inventory count (ISA 501).
- Test count quantity and condition.
- Test costing & valuation (FIFO / W.A / Specific ID).
- Inquire about obsolete, slow-moving items.
- Compare NRV with carrying amount.
- Review subsequent sales & price trends.

TRADE RECEIVABLES
- Send confirmation requests (positive confirmation preferred).
- Perform alternative procedures for non-confirmed items.
- Review aging analysis and follow-up.
- Check subsequent receipts.
- Evaluate ECL / Bad debt provision.

PREPAYMENTS
- Inspect supporting documents (invoices, contracts).
- Verify period of benefit and amortization.
- Perform cut-off test.
- Confirm with vendors if material.

BANK BALANCES
- Obtain bank confirmations. (ISA 505)
- Reconcile bank statement with cash book.
- Check for unrecorded transactions.
- Review subsequent cash movements.

CASH IN HAND
- Surprise cash count (if possible).
- Reconcile with cash book.
- Test supporting vouchers.
- Review internal controls over receipts & disbursements.

5 ISA 501 – AUDIT EVIDENCE: SPECIFIC CONSIDERATIONS FOR INVENTORY

- Observe the entity's inventory count.
- Perform test counts.
- Review count records.
- Perform cut-off procedures.
- Evaluate management's instructions regarding inventory.

6 VALUATION – LOWER OF COST & NRV

- Cost includes all costs of purchase, conversion & other costs.
- NRV = Estimated selling price less costs to complete & sell.
- Write down inventory to NRV if NRV < Cost.
- Disclosure required if material.

7 PRESENTATION & DISCLOSURE CHECKS

- Check classification in statement of financial position.
- Ensure relevant notes are disclosed.
- Verify cupsistency with accounting standards.

PRACTICE QUESTION (SAQ)

You are auditing inventory.
The company's sales have declined and inventory levels are high.
List the substantive procedures you would perform to ensure inventory is stated at the lower of cost and net realisable value.

TUTORIAL NOTES

- Do not rely only on management representation.
- Link every procedure to assertion being tested.
- NRV assessment requires professional judgment.
- Document all audit evidence clearly.
- Use analytics to identify unusual fluctuations.

EXAM TIPS

- Write in exam language and use headings.
- Explain 'why' behind each procedure.
- Use ISA references where relevant.
- Diagrams and tables earn extra marks.
- Manage time and attempt all parts.

KEY TAKEAWAYS

- Substantive procedures provide direct evidence about assertions.
- Focus on existence, valuation and completeness.
- Inventory needs special attention due to risk of overstatement.
- Confirm, verify and reconcile wherever possible.
- Good documentation = Strong audit evidence trail.

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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 8
SUBSTANTIVE PROCEDURES: NON-CURRENT ASSETS

Key References: ISA 500, ISA 501, ISA 540, ISA 560

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Objective: To obtain sufficient appropriate audit evidence about existence, rights & obligations, completeness, valuation and disclosure of non-current assets.

1 WHAT ARE NON-CURRENT ASSETS?

Assets that are held for use in the business for more than one year.

Examples:

- Property, Plant & Equipment
- Investment Property
- Intangible Assets
- Long-term Investments
- Deferred Tax Assets

2 RISKS OF MATERIAL MISSTATEMENT

- Assets may not exist or may not be owned by the entity.
- Assets may be incorrectly stated at valuation.
- Assets may be impaired but not recognized.
- Disposals may not be recorded.
- Incorrect depreciation / amortization.
- Incomplete or inaccurate disclosures.

3 AUDITOR'S RESPONSE – SUBSTANTIVE PROCEDURES

The auditor performs tests of details to obtain direct evidence about material assertions.

4 KEY SUBSTANTIVE PROCEDURES (EXAMPLES)

ASSERTION	KEY PROCEDURES AN AUDITOR MAY PERFORM	EXAMPLES / FOCUS AREAS
Existence	• Physically inspect assets. • Observe assets in use. • Confirm with third parties (where applicable).	• Visit to site, count and tag verification. • Confirm titles / ownership documents.
Rights & Obligations	• Examine title deeds / ownership documents. • Check for liens, pledges, mortgages.	• Legal ownership of land, vehicles, machinery. • Loan agreements on assets.
Completeness	• Reconcile additions & disposals with records. • Review board minutes for approvals. • Search for unrecorded assets.	• Compare fixed asset register with general ledger. • Check capital work-in-progress.
Valuation & Accuracy	• Recalculate depreciation / amortization. • Review useful lives and residual values. • Test for impairment indicators.	• Use correct depreciation method. • Perform impairment test (ISA 36 principles).
Presentation & Disclosure	• Check classification in financial statements. • Verify disclosures in notes to accounts.	• Ensure all required disclosures are complete. • Consistency with accounting standards.

5 FOCUS ON IMPAIRMENT (ISA 540)

- Indicate impairment when recoverable amount is less than carrying amount.
- Sources of indicators:
  - ✓ Obsolescence or physical damage
  - ✓ Poor financial performance
  - ✓ Significant decline in market value
  - ✓ Changes in legal or economic environment
- Auditor evaluates management's assessment and testing.

6 DISPOSAL OF NON-CURRENT ASSETS

- Vouch disposal documents (sale, scrap).
- Check approvals for disposal.
- Verify removal from fixed asset register.
- Ensure gain / loss is properly recorded.
- Proceeds are deposited in bank.

PRACTICE QUESTION (SAQ)

You are auditing a manufacturing company. The company has purchased a machine during the year. Outline the substantive procedures you would perform to obtain evidence about existence, rights & obligations, and valuation of this machine.

TUTORIAL NOTES

- Always link procedures to relevant assertions.
- Physical verification is key for existence.
- Focus on impairment indicators and useful life review.
- Document all findings and conclusions.
- Do not rely only on management representations.

EXAM TIPS

- Write step-by-step with headings.
- Use ISA references where relevant.
- Give practical examples in answers.
- For impairment, mention indicators and recoverable amount concept.
- Draw neat formats / tables for better marks.

COMMON MISTAKES TO AVOID

- Ignoring impairment testing.
- Not checking title / ownership documents.
- Wrong depreciation calculations.
- Missing disclosures in notes.
- Not reconciling additions & disposals.

KEY TAKEAWAYS

- Focus on assertions existence, rights, valuation & disclosure.
- Perform physical verification where possible.
- Be alert to impairment indicators and test recoverable amount.
- Ensure disposals are properly recorded and removed from books.
- Document everything – it's your audit evidence trail.

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CHAPTER 10
SUBSTANTIVE PROCEDURES: OTHER AREAS

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Key References: ISA 500, ISA 501, ISA 505, ISA 540, ISA 550, ISA 560

Objective: To obtain sufficient appropriate audit evidence about existence, rights & obligations, valuation and disclosure for liabilities, equity and key income statement items.

1 AREAS COVERED IN THIS CHAPTER

TRADE PAYABLES
- Verify existence, accuracy and cut-off.
- Confirm with suppliers.
- Check subsequent payments.
- Review for unrecorded liabilities.

ACCRUALS, PROVISIONS & CONTINGENCIES
- Assess obligation (present) and outflow (probable).
- Review calculations and assumptions.
- Check completeness and disclosures.
- Consider subsequent events.

NON-CURRENT LIABILITIES
- Verify existence and terms.
- Check interest calculations and repayments.
- Review compliance with covenants.
- Ensure proper classification and disclosures.

EQUITY
- Verify share capital, reserves and dividends.
- Check authorizations and legal compliance.
- Reconcile movements in equity.

KEY INCOME STATEMENT ITEMS
- Test revenue, COGS, expenses and other income.
- Verify accuracy, cut-off and occurrence.
- Review unusual items and trends.

2 KEY SUBSTANTIVE PROCEDURES (DETAILS)

AREA	KEY PROCEDURES	AUDIT EVIDENCE	FOCUS POINTS
Trade Payables	• Confirm balances with suppliers. • Vouch subsequent payments. • Check cut-off around year end. • Review for unrecorded liabilities.	• Supplier confirmations • Invoices, GRNs, payment proofs • Bank statements • Accrual listings	• Completeness of liabilities • Accuracy of amounts • Proper period recognition
Accruals, Provisions & Contingencies	• Identify all possible obligations. • Evaluate management's estimates. • Verify calculations and assumptions. • Ensure adequate disclosures.	• Management calculations • Board minutes • Legal letters • Correspondence	• Present obligation exists • Probable outflow of resources • Reliable estimation
Non-Current Liabilities	• Confirm loan agreements and terms. • Realculate interest and repayments. • Check compliance with covenants. • Verify classification and disclosures.	• Loan agreements • Amortization schedules • Bank confirmations • Financial covenant reports	• Existence of liability • Accuracy of balances • Compliance with terms
Equity	• Check share capital and reserves. • Verify dividends authorized and paid. • Reconcile movements in equity. • Ensure compliance with company law.	• Share register • Board/AGM minutes • Resolutions • Dividend vouchers	• Legal compliance • Proper authorization • Correct presentation
Key Income Statement Items	• Test revenue recognition (occurrence & cut-off). • Verify COGS and expense accuracy. • Review unusual or non-recurring items. • Compare trends and budgets.	• Sales invoices, contracts • Expense invoices, payroll • Bank statements • Budget vs actual reports	• Occurrence & accuracy • Cut-off & completeness • Proper classification

Remember: Link every procedure to an assertion – Existence, Completeness, Rights & Obligations, Valuation/Accuracy, Presentation & Disclosure.

PRACTICE QUESTION (SAQ)

You are auditing a company that has recognized a provision for warranty claims.

List the substantive procedures you would perform to evaluate the provision and its disclosure in the financial statements.

TUTORIAL NOTES
- Focus on identifying obligation and probability.
- Do not rely only on management representation.
- Always review subsequent events.
- Ensure disclosures are complete and clear.
- Link each procedure with relevant assertion.

EXAM TIPS
- Use headings and bullets in answers.
- Write ISA references where relevant.
- Give practical examples.
- Highlight key audit evidence.
- Manage time and attempt all parts.

KEY TAKEAWAYS
- Assess liabilities, equity and income statement items carefully.
- Obtain direct and indirect audit evidence.
- Focus on assertions and risks of material misstatement.
- Ensure proper disclosures and legal compliance.
- Well-designed procedures lead to reliable audit conclusions.

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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 6
TESTS OF CONTROLS

ISA 330 – The Auditor's Responses to Assessed Risks

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Tests of controls help the auditor evaluate the design and operating effectiveness of controls in preventing or detecting material misstatements.

1 OBJECTIVES OF TESTS OF CONTROLS

- To obtain evidence about the **design** of controls.
- To obtain evidence about the **operating effectiveness** of controls.
- To help determine the **nature, timing and extent** of substantive procedures.

2 TYPES OF CONTROL TESTS

TESTS OF DESIGN

Determine whether a control, if operated, would prevent or detect and correct material misstatements.

TESTS OF OPERATING EFFECTIVENESS

Determine whether a control is actually operating as designed over a period of time.

3 TRANSACTION CYCLES COVERED

- Sales and Receivables
- Purchases and Payables
- Payroll and Human Resources
- Inventory and Warehousing
- Cash and Bank
- Non-current Assets

4 EXAMPLES OF CONTROL TESTS BY CYCLE

SALES AND RECEIVABLES

- Test credit approval of new customers.
- Verify sales orders are **authorized.**
- Check dispatch of goods is against authorized orders.
- Verify invoices are prepared, pre-numbered and match dispatch documents.
- Test recording of sales in sales journal.
- Test follow-up of overdue receivables.

PURCHASES AND PAYABLES

- Test purchase requisition authorization.
- Verify vendor master file maintenance.
- Check purchase order is authorized and pre-numbered.
- Verify goods received note (GRN) is matched with PO.
- Test three-way match (PO, GRN, Invoice) before payment.
- Test approval of payments.

PAYROLL AND HUMAN RESOURCES

- Test authorization of new employee.
- Verify **changes in salary** are approved.
- Check **attendance** records are maintained and reviewed.
- Test **payroll** preparation by authorized person.
- Verify payroll is reviewed and approved before payment.
- Test reconciliation of payroll bank payments.

INVENTORY AND WAREHOUSING

- Test authorization of inventory receipts.
- Verify goods are inspected before being recorded.
- Check stores issue is against authorized requisition.
- Test periodic physical count and recording.
- Test review of inventory reports by management.

CASH AND BANK

- Test authorization for cash receipts.
- Verify deposit of cash to bank on timely basis.
- Test bank **reconciliations** are prepared and reviewed.
- Test authorization for disbursements.
- Verify canceled checks and payment vouchers.

NON-CURRENT ASSETS

- Test authorization for purchase of assets.
- Verify additions recorded in fixed asset register.
- Test periodic physical verification of assets.
- Test review of depreciation calculations.
- Test disposal of assets is authorized and properly recorded.

5 CAATS AND DATA ANALYTICS IN TESTING CONTROLS

- Use of audit software (e.g., ACL, IDEA) to test 100% data.
- Helps in identifying unusual trends, exceptions and outliers.
- More effective and efficient in large volume transactions.
- Supports continuous auditing and real-time monitoring.

6 KEY POINTS TO REMEMBER

- Tests of controls are not an end in themselves.
- If controls are effective, auditor performs less substantive testing.
- If controls are weak or not operating, auditor increases substantive work.
- Always document the nature, timing, extent and results of tests.

PRACTICE QUESTION (SAQ)

You are auditing a trading company. The client uses a pre-numbered purchase order system and requires three-way match (PO, GRN and invoice) before payment.

Required: Explain the control and the tests you would perform to assess its design and operating effectiveness.

TUTORIAL NOTES

- Understand the flow of each transaction cycle.
- Identify key controls and their objectives.
- Perform tests of design first, then tests of operating effectiveness.
- Document exceptions and evaluate their impact.
- Link the results with audit risk and substantive procedures.

EXAM TIPS

- Write in points with clear headings.
- Use examples from each cycle.
- Mention ISA reference where relevant.
- Focus on control objective and how you tested it.
- Practice past paper scenarios.

KEY TAKEAWAYS

- Strong controls reduce audit risk and substantive testing.
- Test both design and operating effectiveness of controls.
- Focus on significant controls related to financial reporting.
- Use CAATs for better coverage and accurate results.
- Document everything – it's your audit evidence/audit trail.

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CAF 8 – AUDIT & ASSURANCE ESSENTIALS

CHAPTER 6
TESTS OF CONTROLS

Key Reference: ISA 330, ISA 315 (Revised)

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Purpose: To evaluate the design and operating effectiveness of internal controls in different systems and rely on them to reduce audit risk.

1 WHAT ARE TESTS OF CONTROLS?

- Tests of controls are audit procedures performed to evaluate the **design** and **operating effectiveness** of internal controls.
- They help the auditor decide how much to rely on controls and how much substantive testing is needed.

2 OBJECTIVES

- Verify that controls are properly designed.
- Check that controls are actually operating.
- Identify control weaknesses or deficiencies.
- Decide the extent of substantive procedures.

3 KEY POINTS TO REMEMBER

- Understanding a control ≠ Testing a control.
- Tests are performed on a sample basis.
- Tests of controls do not detect fraud.
- If control is weak/ineffective → More substantive testing.
- If control is strong/effective → Reduced substantive testing.

4 MAIN SYSTEMS & KEY CONTROLS (COMMON CONTROLS TESTED)

SALES SYSTEM
- Customer master file approval.
- Credit approval before sale.
- Sequentially numbered invoices.
- Goods dispatch note (GDN) matched with invoice.
- Recording in sales register.

PURCHASES SYSTEM
- Approved vendor list.
- PR (Purchase Requisition) before purchase.
- GRN (Goods Received Note) matched with invoice.
- Three-way match: PR–GRN–Invoice.
- Proper authorization for payments.

PAYROLL SYSTEM
- Hiring authorization.
- Attendance records verified.
- Salary changes approved.
- Calculation accuracy checked.
- Payments authorized by responsible person.

CASH & BANK SYSTEM
- Cash receipts immediate deposit.
- Payments by cheque/online.
- Bank reconciliations prepared regularly.
- Dual authorization for payments.
- Physical cash verification.

INVENTORY SYSTEM
- Physical stock count periodically.
- Stores access restricted.
- Issue of goods authorized.
- Stock records updated properly.
- Slow moving/obsolete stock reviewed.

IT CONTROLS (CAATs)
- User access rights controlled.
- Change management process.
- Backup and disaster recovery.
- System logs maintained.
- Data validation controls.

5 COMMON CONTROL DEFICIENCIES

- Lack of proper authorization.
- Poor documentation.
- Inadequate segregation of duties.
- Lack of monitoring and review.
- Overriding of controls by management.

Remember
Test of controls = Check Design + Check Operation (Design + Operation = Effectiveness)

6 PRACTICE QUESTION (SAQ)

Scenario: You are auditing the payroll system of ABC Ltd. State the key controls you will test to ensure the accuracy and proper authorization of salary payments.

Key Points to Include in Answer:
- Hiring authorization verified
- Attendance records checked
- Salary rates authorized
- Calculations verified
- Changes in salaries authorized
- Payments approved by responsible person
- Reconciliation with bank

SAQ

7 QUICK EXAM TIPS

- Always relate control to the objective.
- Write specific controls, not generic ones.
- Use system-wise headings in answers.
- Link control with relevant assertion if possible.
- Keep answers neat with bullet points.

KEY TAKEAWAY

Strong internal control = Lower Risk
Weak internal control = Higher Risk

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