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CPA

Advanced Auditing & Assurance

April 2026

Level: Advanced Level

Question 1

 Audit evaluation and reviews, Audit related assurance services, Concluding and reporting

New Energy Ltd. is a Kenyan renewable energy company listed at the Nairobi Securities Exchange. During the year ended 31 December 2025, the company acquired a solar generation subsidiary in Tanzania for Sh. 850 million. The company also entered into long-term power purchase agreements with the Government of Kenya. During the year ended 31 December 2025, the company recognised Sh.120 million in carbon credit revenue for the first time. New Energy Ltd. also implemented a new cloud-based financial reporting system across all subsidiaries.

During the audit planning stage, the audit team noted the following issues:

1 The acquisition accounting had been performed by management using internally developed valuation models.
2 Revenue from carbon credits was recognised based on management estimates of future verification approvals.
3 Migration to the new cloud-based financial system was completed two weeks before year end.
4 Internal auditors reported weaknesses in user access controls within the new system.

Required:
(a) Explain THREE audit risks arising from the acquisition of the Tanzanian subsidiary.

(b) Evaluate TWO IFRS-related financial reporting risks associated with carbon credit revenue recognition.

(c) Describe FOUR audit procedures to address risks arising from the implementation of the new cloud-based system.

(d) Discuss THREE matters that the auditor should communicate with the board of directors in accordance with International Standard on Auditing (ISA) 260 ‘Communication with Those Charged with Governance’.

✓ Answer for Question 1

(a) Audit risks arising from the acquisition of the Tanzanian subsidiary

The acquisition introduces **significant audit risk** due to complexity, judgment, and cross-border issues.

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1. Risk of incorrect purchase price allocation (PPA)

Management used internal valuation models.

Risk:

- Fair values of identifiable assets/liabilities may be misstated
- Goodwill may be overstated or understated

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2. Goodwill impairment risk

If goodwill is recognised, it must be tested annually.

Risk:

- Over-optimistic assumptions
- Delayed recognition of impairment

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3. Valuation of intangible assets

Solar subsidiary likely includes:

- licenses
- contracts
- technology

Risk:

Incorrect recognition or valuation.

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4. Foreign currency translation risk

Subsidiary operates in Tanzania.

Risk:

- Incorrect exchange rates
- Misstatement of assets, liabilities, or profits

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5. Completeness of liabilities

Undisclosed liabilities may exist.

Risk:

- Environmental obligations
- Tax exposures
- Contractual commitments

---

6. Control and consolidation risk

Integration into group financial statements.

Risk:

- Incorrect consolidation adjustments
- Inconsistent accounting policies

---

7. Related party or biased valuation risk

Management performed valuation internally.

Risk:

- Lack of objectivity
- Manipulation of acquisition values

(b) IFRS-related financial reporting risks for carbon credit revenue

Carbon credit revenue (Sh.120 million) is recognised for the first time → **high risk area**.

---

1. Premature revenue recognition

Revenue recognised based on **future verification approvals**.

Risk:

Under International Financial Reporting Standards Foundation IFRS 15, revenue should be recognised when performance obligations are satisfied.

Issue:

If verification not yet approved → revenue may be overstated.

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2. Uncertainty in measurement

Carbon credits depend on:

- verification
- certification
- market pricing

Risk:

Estimates may be unreliable or biased.

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3. Cut-off risk

Revenue may be recorded in wrong accounting period.

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4. Existence risk

Credits may not yet exist legally until verified.

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5. Classification risk

Whether carbon credits are:

- inventory
- intangible assets
- revenue items

Risk:

Incorrect accounting treatment.

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6. Disclosure risk

First-time recognition requires clear disclosures.

Risk:

Inadequate disclosure of assumptions, uncertainty, and policies.

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7. Fraud risk

Management may inflate revenue to improve performance.

(c) Audit procedures for risks from the new cloud-based system

Implementation two weeks before year-end → **high IT risk**.

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1. Test data migration controls

- Reconcile data from old system to new system
- Check completeness and accuracy of transferred balances

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2. Review IT general controls (ITGCs)

Focus on:

- access controls
- password policies
- user roles

Given internal audit flagged weaknesses → high risk.

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3. Test user access rights

- Identify unauthorized users
- Review segregation of duties (SoD)
- Remove conflicting roles

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4. Evaluate system change controls

- Review approval of system implementation
- Check testing and validation procedures

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5. Perform substantive procedures

Due to weak controls:

- Increase detailed testing
- Use external confirmations
- Recalculate balances

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6. Use audit data analytics

- Extract system data
- Identify anomalies, duplicates, unusual entries

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7. Test audit trail and logs

- Check system logs for unusual activity
- Identify override of controls

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8. Review backup and security controls

- Data protection

- Disaster recovery processes

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9. Engage IT audit specialists

Where complexity is high.

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10. Perform cut-off testing

Especially around year-end migration period.

(d) Matters to communicate to the board under ISA 260

According to International Auditing and Assurance Standards Board ISA 260, the auditor must communicate significant matters.

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1. Significant audit risks identified

- Acquisition accounting
- Carbon credit revenue
- IT system implementation

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2. Planned scope and approach

- Use of specialists
- Increased substantive testing
- Focus on high-risk areas

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3. Significant findings

- Weaknesses in internal controls (especially IT access controls)
- Errors or misstatements found

4. Significant accounting judgments

- Valuation of acquisition
- Revenue recognition assumptions

5. Difficulties encountered

- Late system implementation
- Limited documentation
- Access issues

6. Uncorrected misstatements

Any material misstatements not adjusted by management.

7. Internal control deficiencies

- Weak user access controls
- System risks

8. Auditor independence

Confirm independence and disclose relationships if any.

9. Disagreements with management

If any occurred regarding accounting treatment.

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10. Expected modifications to audit opinion

If issues remain unresolved.

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11. Going concern considerations

If risks affect sustainability.

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12. Other relevant matters

- Compliance issues
- Regulatory concerns

Conclusion

The audit of New Energy Ltd. involves **high-risk areas**: acquisition accounting, uncertain revenue recognition, and IT system changes. These require enhanced audit procedures and clear communication with the board to ensure transparency and proper governance.

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CPA

Advanced Auditing & Assurance

December 2025

Level: Advanced Level

Question 2

 Audit framework and regulations , Professional and ethical considerations, Management of audit practice , Concluding and reporting

North Grill Ltd. is a company that manufactures bicycles. In the year 2025, it acquired R&R Tires Ltd., a tyre manufacturing company as part of its strategy to integrate production and improve efficiency. However, six months after the acquisition, R&R Tires Ltd. was declared bankrupt. This unexpected collapse raised serious concerns within North Grill's management about the accuracy and reliability of R&R Tires' financial information prior to acquisition. The management of North Grill Ltd. alleged that there had been financial impropriety by the previous management of R&R Tires Ltd. They further claimed that the company's 2024 financial statements did not present a true and fair view of its financial performance and position. Additionally, the management accused R&R Tires' external auditors of professional negligence, arguing that the audit had failed to detect or report significant irregularities that existed before the acquisition.

Following these concerns, the Managing Director of North Grill Ltd. engaged an independent audit firm to conduct a forensic audit. The purpose of this audit was to determine whether the auditors of R&R Tires Ltd. were negligent in their duties and to establish if there was any deliberate financial misrepresentation by the previous management.

Required:
(a) (i) Explain THREE audit procedures that could be adopted by an auditor in undertaking the forensic audit.

(ii) Describe THREE ways in which the forensic audit of R&R Tires Ltd. could assist North Grill Ltd. in establishing legal liability and improving future acquisition due diligence processes.

(b) African Diatomite Mining Industries Limited (ADIMIL) operates in Kenya's diatomite mining sector and holds 10 mining sites across the country. The company extracts, purifies and distributes diatomite for use as a filter aid in industrial applications. ADIMIL operates under a license granted by the National Environmental Management Authority (NEMA), which regulates and monitors its environmental and mining practices. You are the audit manager at Richard Koki Ltd., the external auditors of ADIMIL, reviewing audit working papers for the year ended 30 September 2025. The draft financial statements recognise a profit before tax of Sh.18 million and total assets of Sh.175 million.

On 15 September 2025, an accident occurred at Mutaita mine, one of ADIMIL's key mining sites. Several underground tunnels collapsed causing flooding and rendering about one-third of the mine permanently inaccessible. Management intends to continue operations in the remaining sections of the mine after implementing health and safety regulations. Although no injuries were reported, the collapse caused land subsidence that damaged several nearby residential roperties. A surveyor was appointed to determine whether the houses should be demolished or repaired. Meanwhile, 20 residents have been relocated to rental accommodation, with ADIMIL covering all related expenses.

Mutaita mine was acquired several years ago and is currently recognised in the draft financial statements at a carrying value of Sh.10 million. Despite the accident, ADIMIL's management has decided not to report the incident to NEMA arguing that no casualties occurred and that production will resume in unaffected sections.

Required:
As the audit manager responsible for reviewing the audit of ADIMIL for the year ended 30 September 2025, evaluate FOUR key audit implications arising from the Mutaita mine accident.

✓ Answer for Question 2

(a) North Grill Ltd. / R&R Tires Ltd.

(i) Audit procedures that could be adopted in undertaking the forensic audit

A forensic audit is aimed at gathering evidence suitable for legal proceedings while investigating fraud, negligence, or misrepresentation.

1. Review prior year financial statements and audit files

- Examine the 2024 financial statements of R&R Tires Ltd.
- Compare disclosures, estimates, and accounting policies.
- Inspect audit working papers to determine whether auditors followed standards.

2. Reperform key audit procedures

- Recalculate provisions, depreciation, inventory valuation, receivables, and liabilities.
- Assess whether material misstatements should have been detected.

3. Detailed analytical review

- Compare margins, liquidity, gearing, debtor days, inventory turnover with prior years and industry averages.
- Identify unusual trends that may indicate manipulation.

4. Examine journal entries and adjustments

- Review late entries, round-sum adjustments, unusual manual journals, year-end postings.
- Focus on revenue inflation or expense suppression.

5. Verify existence and valuation of assets

- Inspect inventory, plant, receivables, cash balances.
- Confirm whether assets were overstated.

6. Third-party confirmations

- Obtain confirmations from banks, suppliers, customers, lawyers, lenders.
- Identify undisclosed liabilities or fictitious balances.

7. Review management communications

- Inspect emails, board minutes, internal memos, correspondence.
- Search for evidence of concealment or knowledge of distress.

8. Interview relevant parties

- Former management, finance staff, internal auditors, external auditors.
- Understand decisions made and warning signs ignored.

9. Assess going concern evidence

- Review cash flow forecasts, covenant breaches, unpaid taxes, overdue creditors existing before acquisition.

10. Use digital forensic techniques

- Recover deleted files, trace transaction patterns, identify unauthorized changes.

11. Review compliance with auditing standards

- Assess whether external auditors complied with International Auditing and Assurance Standards Board standards such as ISA 200, 240, 500, 520, 570.

12. Preserve chain of evidence

- Secure documentation properly for possible court use.

(ii) Ways the forensic audit could assist North Grill Ltd.

A. Establishing legal liability

1. Determine management fraud or misrepresentation

- Shows whether prior management intentionally misstated profits, assets, or liabilities.

2. Assess auditor negligence

- Determines whether auditors failed to exercise reasonable care and skill.

3. Quantify losses suffered

- Measures overpayment on acquisition, legal costs, operational losses.

4. Support litigation or recovery claims

- Evidence can support lawsuits against former directors, sellers, or auditors.

5. Identify breach of warranties in sale agreement

- If sellers guaranteed accuracy of accounts, claims may arise.

6. Identify individual responsibility

- Links decisions/actions to specific persons.

B. Improving future acquisition due diligence

1. Stronger pre-acquisition financial reviews

- Use independent quality-of-earnings reviews.

2. More robust legal and tax due diligence

- Identify hidden obligations.

3. Greater skepticism of target accounts

- Do not rely solely on audited statements.

4. Use earn-out clauses / deferred consideration

- Reduce risk of overpaying.

5. Require stronger warranties and indemnities

- Protection against hidden issues.

6. Industry and operational reviews

- Examine sustainability of business model.

7. Early fraud-risk assessments

- Investigate management incentives and culture.

(b) ADIMIL – Key audit implications arising from Mutaita mine accident

Main standards involved:

International Auditing and Assurance Standards Board **ISA 250, ISA 315, ISA 540, ISA 560, ISA 570** and accounting rules on provisions/impairment.

---

1. Material impairment of mine asset

Mutaita mine carrying amount = **Sh.10 million**

One-third permanently inaccessible and flooding occurred.

Audit implication:

There is a clear impairment indicator. Management must estimate recoverable amount.

Auditor action:

- Request impairment assessment.
- Review future cash flows.
- Consider expert valuation.
- If overstated and unadjusted → material misstatement.

---

2. Provision for compensation claims / legal obligations

Nearby homes damaged by land subsidence.

Audit implication:

ADIMIL may have a present obligation for:

- repairs
- demolition costs
- compensation
- legal claims

Auditor action:

- Obtain surveyor report.
- Review legal correspondence.
- Assess provision under accounting standards.
- If uncertain, contingent liability disclosure required.

---

3. Ongoing relocation/rental costs

20 residents relocated at company expense.

Audit implication:

These are liabilities and expenses of current year.

Auditor action:

- Verify accrual for unpaid rental/support costs.
- Ensure complete recognition.

---

4. Possible environmental restoration obligations

Mining collapse may trigger rehabilitation or remedial work.

Audit implication:

Additional provisions may be required.

Auditor action:

- Review site restoration estimates.

- Consult environmental experts.

---

5. Non-compliance with laws and regulations (NEMA)

Management refuses to report incident.

Audit implication:

Potential breach of environmental license conditions and regulations.

Auditor action:

Under ISA 250:

- Understand legal consequences.
- Discuss with management and those charged with governance.
- Obtain legal advice if necessary.
- Consider fines, closure risk, license suspension.
- Consider reporting obligations where permitted/required by law.

---

6. Going concern considerations

Mutaita is described as a key mining site.

Audit implication:

Loss of one-third of operations may affect production and profitability.

Auditor action:

- Review forecasts, financing, cash flows.
- Assess whether material uncertainty exists.

- Adequate disclosure required.

---

7. Need for expert evidence

Surveyor already appointed.

Audit implication:

Auditor may rely on management expert.

Auditor action:

Evaluate competence, objectivity, and adequacy of surveyor’s work.

---

8. Management bias / integrity concerns

Management intentionally choosing not to report accident.

Audit implication:

Raises doubts over honesty and reliability of representations.

Auditor action:

- Increase professional skepticism.
- Extend substantive testing.
- Reconsider reliability of management representations.

---

9. Disclosure requirements

The accident is significant and likely material relative to:

- Profit before tax = **Sh.18 million**
- Total assets = **Sh.175 million**

A Sh.10 million mine plus liabilities is significant.

Auditor action:

Ensure detailed note disclosure covering:

- accident nature
- asset damage
- claims uncertainty
- production impact
- regulatory exposure

---

10. Possible effect on audit opinion

If management refuses to impair assets/provide liabilities/disclose issues:

Possible outcomes:

- **Qualified opinion** – material misstatement.
- **Adverse opinion** – if pervasive.
- **Emphasis of Matter / Material Uncertainty** where appropriate.

Conclusion

The Mutaita accident creates **major audit risk** involving asset impairment, legal liabilities, environmental non-compliance, going concern risk, and

management integrity. This requires expanded audit work and possibly modification of the audit report if management does not make proper adjustments.

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Advanced Auditing & Assurance

August 2025

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Question 3a

Assurance and non-assurance engagements

Explain THREE differences between “assurance engagements” and “non-assurance engagements”.

✓ Answer for Question 3a

At a Glance: Core Difference

- **Assurance Engagement:** The primary goal is to **enhance the confidence** of intended users (e.g., investors, regulators) in the information provided by another party (e.g., company management). The practitioner provides an independent, professional *opinion* on the information.
- **Non-Assurance Engagement:** The primary goal is to **apply professional expertise** to help the client improve their operations, comply with laws, or prepare information. The practitioner provides advice, a service, or a product, but **no opinion** on the information.

Detailed Comparison

Feature	Assurance Engagements	Non-Assurance Engagements
Primary Objective	To provide an independent opinion or conclusion on the reliability of information (e.g., "The financial statements present a true and fair view.").	To provide professional advice, expertise, or a service without providing an opinion on the information.
Level of Assurance	Provides either: **Reasonable Assurance** (High, but not absolute; e.g., an Audit) **Limited Assurance** (Moderate; e.g., a Review) **No Assurance** (Only a summary of findings; e.g., an Agreed-Upon Procedures engagement)	No assurance is provided. The work is not designed to obtain evidence to support a conclusion.
Intended Users	Third Parties (e.g., shareholders, creditors, regulators). The report is often public.	Primarily the client themselves (management, board of directors). The output is typically for internal use.

Nature of Work	Critically evaluating evidence to support a conclusion. Procedures are designed to be objective and independent.	Applying technical skills to perform a task, such as preparing, compiling, or advising.
Output / Report	A formal, standardized assurance report that includes the practitioner's opinion (e.g., an unqualified/adverse opinion).	A deliverable such as a written report, a set of financial statements, a tax return, or advice. It does not include an opinion.
Independence	Absolute independence (in mind and appearance) is a strict, mandatory requirement.	Independence is desirable but not always mandatory. However, objectivity and integrity are always required.
Governing Standards	International Standards on Auditing (ISA), International Standards on Review Engagements (ISRE), International Standards on Assurance Engagements (ISAE), etc.	International Standards on Related Services (ISRS) for some, but often firm-specific or engagement-specific methodologies.

Examples of Each Type

Assurance Engagements

1. **Financial Statement Audit:** The most common example. Provides *reasonable assurance* that the financial statements are free from material misstatement.
2. **Review of Financial Statements:** Provides *limited assurance* that nothing has come to the practitioner's attention to suggest the financial statements are not prepared in accordance with the applicable framework.
3. **Assurance on Sustainability Reports:** Providing an opinion on a company's environmental, social, and governance (ESG) reporting.
4. **Assurance on Internal Controls:** Reporting on the effectiveness of a company's internal control over financial reporting.

Non-Assurance Engagements

1. **Compilation Engagement:** Assisting management in presenting financial information in the form of financial statements without providing any assurance on them.
2. **Tax Advisory and Compliance:** Preparing tax returns or providing advice on tax planning.
3. **Consulting Services:** Providing advice on IT system implementation, merger & acquisition strategies, or risk management frameworks.
4. **Agreed-Upon Procedures (AUP):** Performing specific procedures (e.g., testing a sample of transactions) and reporting the factual findings, **without providing an opinion or assurance**. (Note: While performed under an assurance standard like ISRS 4400, the output is a report of factual findings with no assurance.)

Key Analogy: A House Inspection

- **Assurance Engagement (An Audit):** You hire an inspector to examine a house you want to buy. They perform procedures (check foundation, wiring, plumbing) and give you a formal **opinion** on the condition of the house. You (the third party) rely on this opinion to make a buying decision.
- **Non-Assurance Engagement (A Consultation):** You hire an architect to help you *design* your dream house. They apply their expertise to create plans *for you*. They are not providing an opinion on someone else's work; they are creating the work itself for your use.

Summary

In essence, the critical difference lies in the **purpose and output**:

- **Assurance = Opinion** for third parties, requiring strict independence.
- **Non-Assurance = Service or Product** for the client, requiring professional competence.

This distinction is crucial for understanding the role of accountants and auditors and for knowing what to expect from different types of professional services.

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Advanced Auditing & Assurance

April 2025

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Question 3b

 Professional and ethical considerations, Audit evaluation and reviews, Concluding and reporting

You are the audit manager in John Bosco and Associates, a firm of Certified Public Accountants, responsible for the audit of Cider hospital for the year ended 31 March 2025. You recently visited the audit team, who are currently on site performing the field work, to review the work performed and to discuss their progress. During your visit the audit senior brought forward the following matter for your action.

During the review of medical inventories, which included medicines used in a variety of treatment at the hospital, it was noted that a number of medicines had passed their recommended use by dates. These were recorded on an inventory spreadsheet maintained by the financial controller and were easy to spot because they were highlighted in red. One of the audit team members inspected a sample of the inventories in question and confirmed that their use by date had expired. The audit team requested to look at the spreadsheet again, but they were denied access.

The following day, the finance director confronted the audit team accusing them of extending their investigation ‘beyond their scope of audit’. He also threatened to remove them from the premises if they continued to ask questions which were not relevant to the audit of the hospital’s financial statements. Since then, the audit team was unable to complete their audit of medical inventories. They also noted that the room where the inventories were previously kept had been emptied.

Required:

With reference to the above matter raised by the audit senior, describe:

(i) TWO ethical and professional issues surrounding this matter.

(ii) THREE ways that you could report the non-compliance to the management of Cider hospital.

(iii) The impact of the matter on the financial statements of Cider Hospital.

✓ Answer for Question 3b

(i) Ethical and Professional Issues

1. **Integrity and Objectivity** – The finance director's attempt to restrict access and threaten the team undermines auditor independence. The team must remain objective and not allow intimidation to impair judgment.
2. **Professional Skepticism** – Auditors must maintain skepticism. The refusal to provide evidence and disappearance of expired stock suggests deliberate concealment, possibly fraud.
3. **Confidentiality vs. Duty to Report** – Auditors must balance confidentiality with the duty to report suspected non-compliance with laws/regulations (ISA 250). Disposal of expired medicines may relate to regulatory breaches (public health laws).
4. **Threats to Independence** – Coercion by management creates **intimidation threat** under the IESBA Code of Ethics.
5. **Professional Behaviour** – The finance director's hostility signals potential governance weaknesses. Auditors must uphold professionalism even under pressure.

(ii) Ways to Report the Non-Compliance to Management

1. **Report to Those Charged with Governance (TCWG)** – Communicate directly with the hospital's board/audit committee, bypassing the finance director.
2. **Written Communication** – Issue a formal written report highlighting:
    - Nature of non-compliance (expired medicines concealed).
    - Financial reporting implications (inventory valuation misstatement).

- Possible breach of laws/regulations.

3. **Management Letter** – Include the issue as a significant matter in the management letter with recommendations (improved controls, compliance monitoring).
4. **Escalation under ISA 250** – If governance fails to address the issue and public interest is at risk (expired medicines affecting patient safety), auditors may need to report to regulators/health authorities, considering legal requirements.

(iii) Impact on Financial Statements of Cider Hospital

1. **Inventory Valuation (IAS 2)** – Expired medicines should be written down to **nil value** since they cannot be sold or used. If excluded, inventories are overstated.
2. **Profit Impact** – Overstatement of inventories inflates assets and net profit. A material adjustment may be required.
3. **Disclosure Requirements** – If material, hospital must disclose write-down of obsolete stock and accounting policy applied.
4. **Audit Report Implication** –
   - If management refuses adjustment → auditor may issue a **qualified opinion (except for)** or **adverse opinion** depending on materiality and pervasiveness.
   - If access to evidence continues to be denied → this constitutes a **limitation of scope**, possibly leading to a **disclaimer of opinion**.

Summary:

- Ethical issues = intimidation, concealment, independence threats.
- Reporting = escalate to TCWG, document in writing, possibly report to regulators.

- FS impact = inventory overstatement, profit misstatement, possible audit opinion modification.

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Advanced Auditing & Assurance

December 2024

Level: Advanced Level

Question 3c

Audit evaluation and reviews

You are the audit manager responsible for the audit of Helluland Ltd. For the year ended 31 December 2023. The final audit for the year is nearing completion and you are reviewing the audit working papers. The draft financial statements recognise total assets of Sh.500 million, revenue of Sh.120 million and profit before tax of Sh.55 million.

Helluland Ltd. owns a number of properties which have been classified as assets held for sale in the statement of financial position. The notes to the financial statements state that the properties are all due to be sold within one year. On classification as held for sale, in April 2023, the properties were revalued from carrying value of Sh.45 million to fair value less cost to sell of Sh.40 million, which is the amount recognised in the statement of financial position at the year end.

Required:

With reference to the above statement, describe THREE matters that you might consider appropriate for reclassification in respect to the audit of non-current assets held for sale.

✓ Answer for Question 3c

Matters to Consider for Reclassification of Non-Current Assets Held for Sale

1. **Criteria for Classification (IFRS 5 Compliance)**
   - Verify that the assets meet the conditions under IFRS 5 to be classified as “held for sale”:
     - The asset must be available for immediate sale in its present condition.
     - The sale must be highly probable, with management committed to a plan to sell.
     - The sale is expected to be completed within one year from classification date.
2. **Measurement Basis**
   - Ensure the properties are measured at the lower of:
     - Carrying amount before classification, and
     - Fair value less costs to sell.
   - Confirm that the Sh.45m carrying value was appropriately written down to Sh.40m (FV – costs to sell).
3. **Impairment Considerations**
   - Assess whether any impairment loss (Sh.5m here) has been properly recognised in profit or loss.
   - Confirm that no subsequent reversal has been inappropriately recorded unless permitted by IFRS 5.
4. **Disclosures in the Notes**
   - Verify that the notes adequately disclose:
     - A description of the non-current assets held for sale.

- The facts and circumstances of the sale.
- The carrying amount of major classes of assets held for sale.
- The impairment losses recognised.

5. **Subsequent Events Review**
   - Check whether the planned sale has actually progressed after year-end (contracts signed, negotiations ongoing). If not, classification as held-for-sale may no longer be appropriate.
6. **Presentation in the Financial Statements**
   - Confirm that assets held for sale are separately classified in the statement of financial position under current assets.
   - Ensure they are not depreciated while classified as held for sale.
7. **Audit Evidence**
   - Obtain supporting documentation:
     - Board minutes approving the sale.
     - Contracts with prospective buyers or estate agents.
     - Valuation reports supporting fair value.
     - Correspondence with legal advisors on sale process.

Summary:

The auditor should consider **classification criteria, valuation at FV less costs to sell, impairment recognition, proper disclosure, subsequent events, and presentation** when auditing non-current assets reclassified as held for sale.

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Advanced Auditing & Assurance

August 2024

Level: Advanced Level

Question 4a

Professional and ethical considerations

Auditor independence is part of the foundation of the auditing profession. An independent, reliable and ethically sound audit gives a company credibility and allows the public to trust in the accuracy of the results and the integrity of the accounting profession.

With reference to the Institute of Certified Public Accountants of Kenya (ICPAK) ethical guidelines, justify FIVE reasons why professional independence is considered important to the auditor.

✓ Answer for Question 4a

Importance of Auditor Independence

1. **Enhances Credibility of Financial Statements**
   - An independent auditor provides **unbiased assurance** that the financial statements present a true and fair view.
   - Stakeholders (investors, creditors, regulators) rely on this credibility for decision-making.
2. **Maintains Public Trust in the Profession**
   - Independence reinforces the **reputation and integrity** of the auditing profession.
   - The public and capital markets have confidence that audits are free from management influence or bias.
3. **Ensures Objective Audit Judgments**
   - Independence allows auditors to make **professional judgments without undue influence** from management or other parties.
   - Reduces the risk of overlooking misstatements or fraud.
4. **Complies with Legal and Professional Standards**
   - ICPAK Code of Ethics and **International Ethics Standards Board for Accountants (IESBA) Code** require auditors to remain independent both in **mind (actual independence)** and **appearance (perceived independence)**.
   - Non-compliance can lead to disciplinary action or legal liability.
5. **Supports Detection and Reporting of Fraud or Misstatements**
   - Independent auditors are more likely to **identify irregularities** and report them appropriately.

- Management or related parties cannot pressure the auditor to ignore material misstatements.

6. **Promotes Accountability and Transparency**
   - Independence ensures the audit serves the **public interest** rather than the interests of management, enhancing corporate governance.

Key ICPAK Reference:

- **ICPAK Code of Ethics (2020)**: Section on Integrity, Objectivity, and Independence emphasizes that professional accountants **must avoid situations that compromise independence or give the appearance of bias**.

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Advanced Auditing & Assurance

April 2024

Level: Advanced Level

Question 4b

Regulatory Environment

Discuss FIVE factors that might have led to increased litigation against auditors.

✓ Answer for Question 4b

Factors Leading to Increased Litigation Against Auditors

1. **Failure to Detect Fraud or Material Misstatements**
   - Auditors may be sued when financial statements are materially misstated due to fraud or errors that they failed to detect.
   - Examples: Enron, Parmalat, or local cases where investors or creditors relied on audited accounts.
2. **Increased Complexity of Business Transactions**
   - Modern business structures, derivatives, and international operations make audits more complex.
   - Complexity increases the risk of oversight, leading to disputes and potential lawsuits.
3. **Greater Public and Investor Reliance on Audited Financial Statements**
   - Stakeholders increasingly rely on audited reports for investment and lending decisions.
   - When losses occur, investors or creditors often target auditors for compensation.
4. **Expansion of Auditors' Legal Duties**
   - Courts in many jurisdictions have broadened auditors' duty of care to include third parties (investors, lenders).
   - This increases exposure to civil liability beyond just the client.
5. **Regulatory and Statutory Requirements**
   - Stricter laws and standards (Companies Act, IFRS, ISA) make auditors accountable for compliance failures.
   - Breaches, even unintentional, can trigger litigation.

6. **Inadequate Audit Documentation or Evidence**
    - Poorly documented audit work or insufficient evidence makes it difficult for auditors to defend themselves in court.
7. **Conflicts of Interest and Impaired Independence**
    - Close relationships with clients, provision of non-audit services, or biased reporting can lead to allegations of negligence or breach of professional ethics.
8. **Economic Pressures and High-Profile Corporate Failures**
    - During economic downturns, stakeholders are more likely to seek compensation for investment losses.
    - Auditors of failed or bankrupt entities are frequently sued.
9. **Technological and Cyber Risks**
    - Misstatements or fraud involving IT systems, digital transactions, or blockchain-based records can lead to audit failure claims.

Summary:

Litigation against auditors has increased due to **higher reliance on financial statements, complex business environments, expanded legal duties, regulatory pressures, and audit deficiencies**. Firms must manage these risks through rigorous quality control, professional skepticism, and documentation.

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Advanced Auditing & Assurance

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Level: Advanced Level

Question 4c

Audit related assurance services

To succeed in business in the modern world, every company must consider investing in some form of Information Technology (IT). The companies that do not have their own systems still have to protect themselves from cyber criminals whenever they use computer systems even for simple communication within and without the organisation. To ensure the security of this computerised information, companies have had to invest in controls that ensure protection and integrity of their data. IT general controls are the most common controls because they are capable of preventing data theft, stop unauthorised access, reduce operational disruption and stop data breaches.

Required:

(i). Explain how the IT general controls protect the company and its information systems from risk.

(ii) Explain the best practice for implementing IT general controls.

✓ Answer for Question 4c

(i) How IT General Controls (ITGCs) Protect the Company and its Information Systems from Risk

IT General Controls are overarching controls that apply to all systems, applications, and data across the organization. They form the foundation for reliable financial reporting and secure operations.

1. **Access Controls**
    - Ensure only authorised personnel have access to systems, data, and programs.
    - Protects against unauthorised access, data theft, fraud, or malicious manipulation.
2. **Change Management Controls**
    - Require that all changes to applications, databases, and systems are tested, documented, and authorised before implementation.
    - Prevents risks of errors, fraud, or unintended consequences from unauthorised/untested changes.
3. **Data Backup and Recovery Controls**
    - Provide routine backups and disaster recovery mechanisms.
    - Protects against data loss, system failures, and ensures business continuity.
4. **System Development and Program Controls**
    - Require secure system development life cycle (SDLC) procedures including testing, approval, and documentation.
    - Prevents introduction of faulty, insecure, or incomplete systems.
5. **IT Operations Controls**

- Includes job scheduling, monitoring, error detection, and incident management.
- Reduces operational disruption, ensures systems run smoothly, and prevents downtime.

6. **Physical and Environmental Controls**
   - Safeguard servers, networks, and data centres against theft, fire, power failures, or environmental hazards.
   - Maintains integrity and confidentiality of critical information.

Overall effect: ITGCs enhance the **integrity, confidentiality, and availability** of data, ensuring reliable reporting, operational continuity, and protection from cyber risks.

(ii) Best Practices for Implementing IT General Controls

1. **Risk Assessment and Prioritisation**
   - Identify IT-related risks (cybercrime, fraud, downtime) and design controls that align with business objectives.
2. **Segregation of Duties**
   - Ensure no single individual has control over authorising, recording, and maintaining IT systems.
   - Reduces risk of fraud and errors.
3. **Documented Policies and Procedures**
   - Clear IT governance framework, policies for access, change management, backups, and security.
   - Ensures accountability and consistency.
4. **Regular Monitoring and Review**
   - Conduct continuous monitoring, log reviews, penetration testing, and vulnerability assessments.
   - Helps in early detection of threats or control failures.

5. **User Training and Awareness**
    - Regular training on password policies, phishing, malware, and proper IT usage.
    - Reduces human error and social engineering risks.
6. **Independent Audit and Testing**
    - Regular internal and external IT audits to test effectiveness of controls.
    - Provides assurance of compliance and reliability.
7. **Incident Response and Recovery Plans**
    - Establish structured plans for responding to cyberattacks, breaches, or system failures.
    - Minimises operational disruption and financial loss.
8. **Continuous Improvement**
    - Update controls as technology evolves (e.g., cloud computing, AI threats).
    - Ensures controls remain relevant and effective.

Summary:

- **ITGCs protect** against unauthorised access, fraud, data loss, and operational disruptions.
- **Best practice implementation** invo

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Question 5a

Audit related assurance services

Exlink Commercial Bank is a mid-size bank with a large pool of customers seeking credit. The bank's credit activities mainly comprise the following:

1. Origination and disbursement.
2. Monitoring.
3. Collection.

Required:
As the lead auditor of the bank, prepare a checklist of the key internal controls that you would expect under each of the three functions above.

✓ Answer for Question 5a

Internal Controls Checklist for Exlink Commercial Bank

As lead auditor, the following **key internal controls** would be expected in the three main credit functions:

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1. Origination and Disbursement

Controls to ensure only **genuine and creditworthy customers** are granted loans:

- **Credit policy compliance** – Existence of documented lending policies approved by the board.
- **Segregation of duties** – Credit appraisal, approval, and disbursement handled by different officers.
- **Creditworthiness assessment** – Verification of financial statements, credit references, collateral, and repayment capacity.
- **Authorization procedures** – Loan approvals based on delegated limits (branch vs. head office).
- **KYC/AML checks** – Compliance with Know Your Customer and anti–money laundering regulations.
- **System controls** – Automated loan processing systems to prevent bypassing approval steps.
- **Documentation** – Properly executed loan agreements, security documentation, and collateral registration before disbursement.
- **Dual control on disbursements** – Disbursement authorised by at least two officials.

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2. Monitoring

Controls to ensure **loans remain performing and risks are detected early**:

- **Regular loan review** – Periodic review of loan accounts and repayment patterns.
- **Automated monitoring reports** – Exception reports for overdue loans, excesses, and irregularities.
- **Covenant compliance monitoring** – Continuous checks to ensure borrowers meet agreed financial ratios or restrictions.
- **Collateral revaluation** – Regular valuation of securities to ensure adequacy of coverage.
- **Credit grading system** – Internal credit ratings updated regularly to identify problem accounts.
- **Early warning system** – Identification of signs of financial distress (missed payments, overdraft reliance, declining deposits).
- **Independent credit risk unit** – Separate team from loan officers to review portfolio quality.

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3. Collection

Controls to ensure **timely recovery of loans and minimisation of credit losses**:

- **Ageing analysis** – System-generated reports to track overdue accounts.
- **Follow-up procedures** – Structured reminders, demand notices, and escalation protocols for overdue loans.
- **Segregation of duties** – Staff involved in loan recovery are independent of loan origination staff.
- **Restructuring policies** – Clear policies for loan restructuring, refinancing, or write-offs approved by senior management.

- **Legal recovery procedures** – Timely initiation of legal action or engagement of debt collection agencies.
- **Provisioning and write-offs** – Compliance with regulatory requirements for provisioning of non-performing loans (NPLs).
- **Performance review** – Monitoring recovery officers' effectiveness and independence.
- **Reporting** – Regular reporting of NPL ratios, recoveries, and write-offs to management and the board.

Summary:

- **Origination & Disbursement** → Policies, approvals, KYC, segregation, documentation.
- **Monitoring** → Loan reviews, exception reports, collateral checks, covenant compliance.
- **Collection** → Ageing analysis, recovery follow-ups, provisioning, legal action.

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Question 5

 Assurance and non-assurance engagements , Management of audit practice , Audit evaluation and reviews, Concluding and reporting

Your firm is the current auditor of Safi Limited, a renowned wholesale business. You have been asked to carry out audit checks on the cut off and verifying inventory quantities at the year end.

The company maintains the details of the inventory quantities on its computer. These inventory quantities are updated from the goods received notes and the sales invoices. The company carries out the inventory count each month when all the fast moving and high value inventory is counted, and a third of the remaining inventory is counted in rotation so that all the items are counted at least four times a year. You attended the inventory count on the second Sunday of October 2022 and a further inventory count on the first Sunday of November 2022.

The company's year-end was 31 October 2022 and the inventory quantities as at that date as shown by the computer had been used in the valuation of the inventory. No inventory was counted at the year end.

Required:

(a). Describe the principal matters that you should have checked and the matters you should have recorded when you attended the company's inventory count on the second Sunday of October 2022.

(b). Explain the checks you will perform in confirming the sales and purchases cut offs have been correctly carried out at the year end.

(c). Discuss the work you will carry out to check that the book inventory records have been correctly updated from the inventory count.

(d). Summarise the work you will carry out to satisfy yourself that the inventory quantities used in the relation of the inventory at the year end is correct.

✓ Answer for Question 5

(a) Principal matters to check & record during the October inventory count

Topic: Audit Evaluation and Reviews

When attending the inventory count (before year-end), the auditor should:

1. **Observe count procedures**
    - Ensure staff are following documented counting instructions.
    - Check segregation of counting teams (counters, recorders, supervisors).
2. **Inspect condition of inventory**
    - Identify obsolete, slow-moving, or damaged items for potential write-down.
3. **Perform test counts**
    - Select samples and count independently to compare with client's count sheets.
4. **Check completeness of count sheets**
    - Ensure all inventory locations (warehouses, stores) are included.
5. **Verify cut-off during count**
    - Confirm that movement of goods during the count is controlled (e.g., separate areas for receipts/dispatch).
6. **Record details**
    - Date and location of count attended.
    - Procedures observed and anomalies noted.

- Test counts performed, with quantities, item codes, and comparison with client records.
- Persons responsible for the count.

(b) Checks to confirm sales and purchases cut-offs at year end

Topic: Assurance and Non-Assurance Engagements

1. **Sales cut-off**
   - Examine sales invoices and dispatch notes around 31 October.
   - Ensure only goods dispatched before year-end are recorded as sales.
   - Trace post year-end dispatches back to sales ledger to confirm correct timing.
2. **Purchases cut-off**
   - Review GRNs (goods received notes) and purchase invoices around year-end.
   - Verify goods received before 31 October are included in inventory and payables, even if invoices are received later.
   - Ensure goods received after year-end are excluded.
3. **Matching principle**
   - Confirm purchases and related liabilities are recognised in the correct accounting period.

(c) Work to check book inventory records updated from counts

Topic: Management of Audit Practice

1. **Reconcile test counts**
    - Compare auditor’s test counts with system records to check accuracy of updates.
2. **Review reconciliation process**
    - Confirm differences between physical counts and system balances were investigated and resolved.
3. **Inspect adjustments**
    - Check adjustments posted from counts to the inventory records (additions, reductions, corrections).
4. **Control testing**
    - Test a sample of items to ensure count sheets are authorised and properly entered into the computer system.
5. **Subsequent counts**
    - Verify consistency of balances from October count to November count, ensuring no unexplained variances.

(d) Work to satisfy correctness of year-end inventory quantities

Topic: Concluding and Reporting

1. **Roll-forward procedures**
    - Use October physical counts and reconcile movements (purchases, sales, production, adjustments) between count date and 31 October.
2. **Roll-back procedures**
    - Use November count and adjust backward to 31 October, confirming the system balances reconcile.
3. **Analytical review**

- Compare inventory quantities and values with prior periods and budgets to identify unusual trends.

4. **Cut-off testing**
   - Ensure sales/purchases cut-off tests (part b) are consistent with inventory balances.
5. **System reliability**
   - Test controls over updating inventory records from GRNs and sales invoices (to confirm quantities in computer system are reliable).
6. **Management representation**
   - Obtain written representations confirming inventory quantities at 31 October are complete and accurate.
7. **Disclosure check**
   - Ensure inventory disclosure complies with IAS 2 (including basis of valuation and any write-downs).