



INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

Credibility

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Professionalism

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AccountAbility

Auditor's Report



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Kabiru

EXTERNAL AUDITORS, REGULATORS, AND OTHER EXTERNAL BODIES

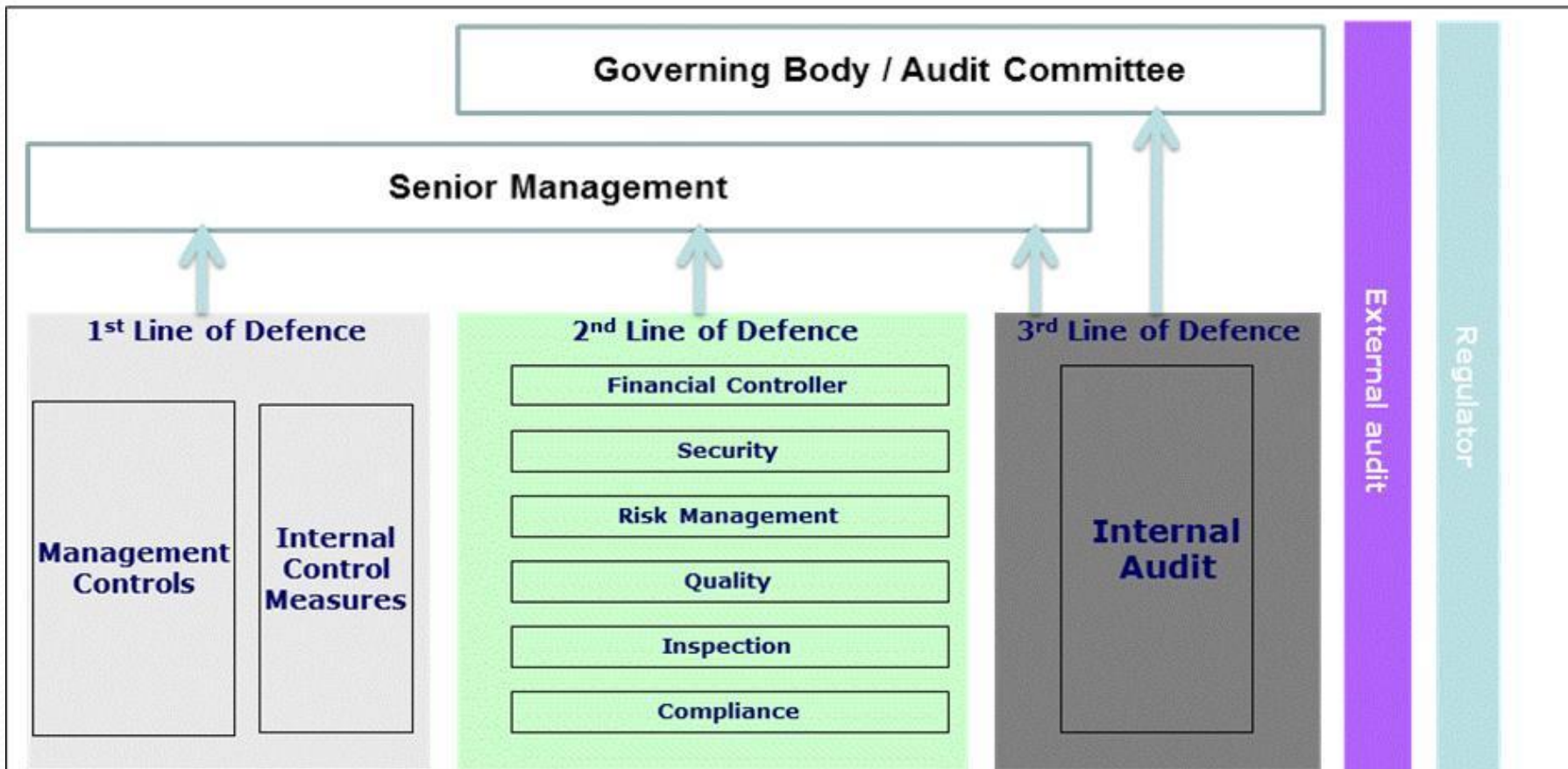


External auditors, regulators, and other external bodies reside outside the organization's structure, but they can have an important role in the organization's overall governance and control structure. They can have a profound impact on the Organizations' performance. This is particularly the case in regulated industries, such as SACCOs.

When coordinated effectively, external auditors, regulators, and other groups outside the organization can be considered as additional lines of defense, providing assurance to the organization's stakeholders including shareholders, the governing body and senior management.

Three Lines of Defense Model

The Three Lines of Defence



Adapted from ECIIA/FERMA *Guidance on the 8th EU Company Law Directive, article 41*

Common SACCO Issues



- Governance
- Fraud and Corruption
- Talent & Leadership
- Capital Adequacy Requirements
- Minimum Liquid Assets
- Prohibited Business
- Asset Review Systems
- Limitations on Award of Loans
- Investments (no investment in land except for purpose of deposit taking)
- Improving Member Attendance
- Regulatory Compliance

Good Governance Requires



- Defined Roles for Board and Management
- Compliance with Rules and Regulations
- Active Risk Assessment and Communication
- Effective Audits
- Management Integrity and Attestation
- Performance Evaluation Process
- Promoting Financial Transparency
- Financial Training

Kenya Sacco's Requirements



- **Financial year:** shall be 12 months ending 31, December in each year.
- **Form of accounts:** Sacco societies shall keep proper books of accounts denominated in Kenyan shillings that show a true and fair state of affairs and comply with IFRS.
- **The board of directors;** shall cause accounts of the Sacco society to be audited within three months after the close of each financial year.
- **Submission of accounts to the authority:** A Sacco society shall submit an audited balance sheet, profit and loss account and a copy of the auditor's report not later than three months after end of the financial year.
- **Disclosure requirements:** Sacco societies must disclose (a) members holding more than 20% of the share capital and deposits, (b) advances or credit facilities exceeding limits on core capital set by SASRA, (c) any insider lending.

Kenya Sacco's Requirement_Cont.



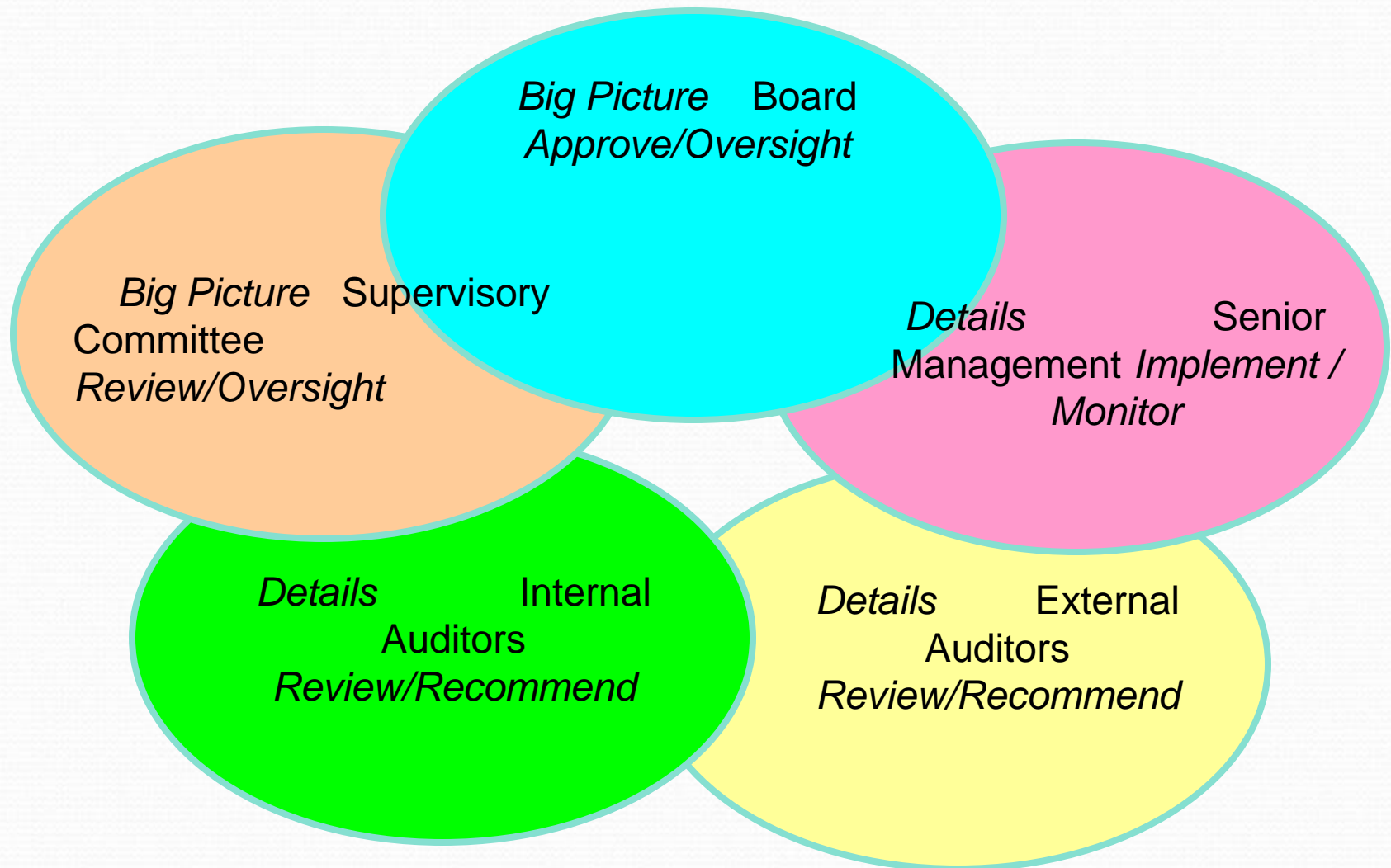
- **Appointment of Internal Auditor:** Every Sacco society shall appoint an internal auditor who shall report to the board of directors.
- **Appointment of External Auditor:** Every Sacco society shall appoint a qualified external auditor who should not be removed from office without SASRA's consent.
- **Capital Adequacy Requirements;** ensure that each SACCO Society maintains a level of capital adequate to protect or cushion member deposits and creditors against losses resulting from business risks that the SACCO, faces.
 - These risks include credit, investment, legislative, liquidity, interest rate and competitive risks.

What Auditors Do



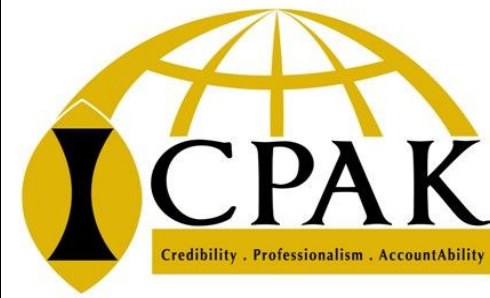
- The independent auditor is engaged to render an opinion on whether a company's financial statements are presented fairly, in all material respects, in accordance with financial reporting framework.
- An audit conducted in accordance with GAAP and relevant ethical requirements enables the auditor to form that opinion.
- To form the opinion, the auditor gathers appropriate and sufficient evidence and observes, tests, compares and confirms until gaining reasonable assurance.
- The auditor then forms an opinion of whether the financial statements are free of material misstatement, whether due to fraud or error.
- The audit provides users such as lenders and investors with an enhanced degree of confidence in the financial statements.

Governance Model



Governance Guidelines

External Auditor



Attributes (what you are)

- Independent and objective
- Free from conflicts of interest
- Report any impairment to independence
- Mandatory rotations
- Periodic bid process

➤Qualifications and background to Audit SACCOs,
Specialized skills (I.T., Compliance, ...)

Governance Guidelines

External Auditor



Performance (what you do)

- Annual audit of financial statements including consolidated statements
- Generally Accepted Accounting Principles
- Reasonable assurance
- Limited scope; not a fraud audit
- Disclosures of GAAP
- Transparency

PART IX: Financial Performance Reporting



Section 52:	Financial Returns
Section 53:	Internal Auditor
Section 54:	Appointment of External Auditor
Section 55:	Submission of Audited Accounts
Section 56:	Responsibilities of External Auditor to SASRA
Section 57:	Establishment of Audit Committee
Section 58:	Sanctions (kshs 100,000 /12 Months)

Governance Guidelines

External Auditor









Performance (What you do)

- Report any disagreements with management
- Report accounting adjustments (actual / proposed)
- Management representation letters - disclaimers
- Report any irregularities or frauds discovered
- Management letter
 - Material weakness in controls
 - Observations
 - Improvements
 - Recommendations

Audit Procedures



-  Inquiring of management and others to gain an understanding of the organization itself, its operations, financial reporting, and known fraud or error
-  Evaluating and understanding the internal control system
-  Performing analytical procedures on expected or unexpected variances in account balances or classes of transactions
-  Testing documentation supporting account balances or classes of transactions
-  Observing the physical inventory count where necessary
-  Confirming accounts receivable and other accounts with a third party

Control Process



A process, or device designed to provide reasonable assurance regarding the achievement of :

- Business Plans and Objectives
- Effectiveness and efficiency in operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

Best Practice- Beyond Audit / Oversight



- External audits should not be relied upon as an organization's primary fraud detection method.
- Studies indicate only 3% of the frauds are detected.
- While external audits serve an important purpose and can have a strong preventive effect on potential fraud, their usefulness as a means of uncovering fraud is limited.

Effectiveness



As the Supervisory Committee is a volunteer group with limited time, resources and skills, it is dependent on them to –

- Establish an Effective Audit Effort
- Develop Comprehensive Audit Plans and Procedures
- Ensure Independence
- Employ Qualified Audit Professionals
- Monitor Corrective Measures

BEST PRACTICE Recommendations



- Get expertise on the Board and Committees
- Renew ethics, fraud and conflict of interest policies regularly
- Establish whistle blower provisions,
- Establish charters for all committees,
- Establish a governance policy (qualifications, responsibilities, access, continuing education)

Audit Process Steps/Approach



Although every audit is unique, the audit process is similar for most engagements and generally consists of 4 stages:

- ☐ Planning (Goals and Objective/Scope/Schedules /Resourcing /Reporting)
- ☐ Field work/Execution (Audit Risk Mgt, Sampling & Testing)
- ☐ Reporting
- ☐ Follow-up

Audit Process Steps/Approach



Planning

- Understand auditee department functions
- Determine audit scope and approach
- Conduct pre-audit meetings

Fieldwork/ Testing

- Conduct interviews
- Evaluate records
- Assess & observe procedures
- Document test results
- Conduct closing meeting

Reporting

- Prepare and submit draft audit report
- Obtain and discuss auditee comments
- Submit final report

Follow-up

- Perform follow-ups on high risk audit findings and/or re-occurring audit findings
- Communicate results

Phase 3: Reporting



- ❑ This refers to the communication between the Auditor and the Client on the results of the audit engagement (It is the **product of audit engagement**).
- ❑ It is the most **visible output** that provides **feedback** to the client and other stakeholders on the **result of engagement**.
- ❑ It is an opportunity **for audit** showing how it can **add value** to the organization.
- ❑ It provide the management with the opinion on the **adequacy of internal controls systems**.
- ❑ It provides stakeholders an assurance that the financial statements provide a **true and fair view**.

Quality of an Audit Report



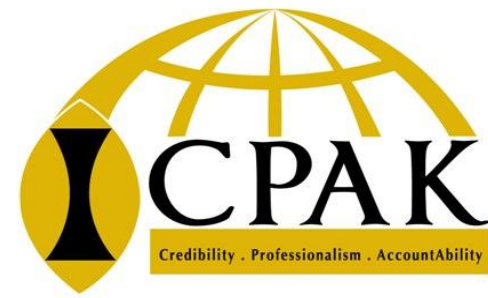
- ❑ **Accurate** - Free from errors and distortions (purpose clearly communicated).
- ❑ **Objective** - Fair, impartial and unbiased.
- ❑ **Clear** - Easy to understand and logical.
- ❑ **Concise** - Straight to the point without unnecessary details.
- ❑ **Constructive** - Help the client to improve its performance (**practical solution**).
- ❑ **Complete** - Should include all the **relevant facts**.
- ❑ **Timely** - Well **timed** to enable **timely decision** on proposed recommendations.

Format of an Audit Report



- **Approach or Methodology :** describe the criteria followed; standards used; work done in testing; documents used (reviewed) etc.
- **Findings and Recommendations:** For each finding, describe the condition; criteria; cause and effect/impact. Recommendations should address the cause to improve operations, and is shown in a separate sub-paragraph.
- **Conclusion/Summary:**
 - This show the auditors' evaluation of the effect of the findings on the activity audited (The overall implications).
 - Should focus on audit objectives and any qualifications.
 - Can also focus on **clients accomplishment** in relation to previous findings, compliance and achievements of operations (Here the auditor can show the **noted strengths**).
- **Compliance Plan:** Agreement between auditor and client on the implementation of the auditor's recommendations as part of management responses. It shows area of improvement, responsible person, action to be taken and time frame, name and signature of both parties (client & auditor).
- **Acknowledgement:** General statement to show the appreciation for cooperation/assistance extended by client to the audit team during time of audit (**Note:** it should not mention specific individuals).

Audit Report Defined



- An audit report is an appraisal of an entity's complete financial status.
- Prepared by an independent accounting professional, this document covers a company's assets and liabilities, and presents the auditor's educated assessment of the firm's financial position and future.
- Audit reports are required by law if a company is publicly traded or in an industry regulated (SASRA).
- Companies seeking funding, as well as those looking to improve internal controls, also find this information valuable.

Auditor's Report



- The auditor's report is the key deliverable communicating the results of the audit process.
- Investors and other financial statement users have asked for a more informative auditor's report—in particular for auditors to provide more relevant information to users.
- Research, public consultations, and stakeholder outreach, including global roundtables, indicate that enhanced auditor reporting is critical to influencing the perceived value of the financial statement audit

Principles Underlying Audit Reporting



The principles require auditors to either:

- Express an unqualified opinion on the entire set of financial statements and related footnotes, or
- State the reasons that such an opinion cannot be expressed

- If there is a material deviation from generally accepted accounting principles (GAAP):

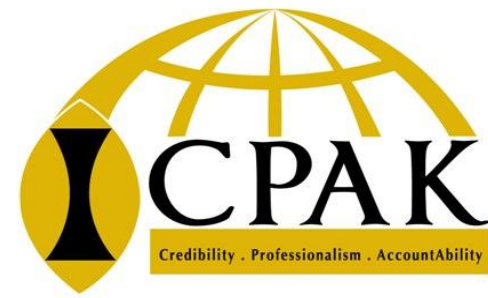
- Auditor should explicitly state the nature of the deviation and the dollar effects so that a user can appropriately modify the financial statements

Audit Opinion



- Section: 55 ((2c) audit opinion)
- An audit opinion is expressed on audited statements. It is required that an auditor state in the opinion that generally accepted accounting principles have been followed and that they have been applied on a basis consistent with that used the preceding year.

Formant of Audit Opinion



Title

- Includes the word 'independent'

Addressee

- Board of directors or shareholders of the organization for public companies
- Varies depending on the circumstances of the engagement

Audit report date

- No earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the opinion

Signature of audit firm

City/state from which the auditor's report has been issued

Standard Unqualified Audit Opinion



- There should be no material violations of GAAP
- Disclosures should be adequate
- Auditor should be able to perform all of the necessary procedures
- There should be no change in accounting principles that had a material effect on the financial statements
- The auditor should not have significant doubt about the client remaining a going concern
- The auditor should be independent

Standard Unqualified Audit Opinion



- Introductory paragraph - What was audited
- Management's responsibility paragraph - Responsibilities of client management
- Scope paragraph - Responsibilities of the auditor and the nature of the audit process
- Opinion paragraph - Auditor's opinion on the fairness of the financial statements
- For some engagements, financial statements might be audited in accordance with multiple auditing standards

Unqualified Audit Reports with Explanatory Language



Used to explain:

- Justified departure from GAAP
- Inconsistent application of GAAP
- Substantial doubt about client being a going concern
- Emphasis of some matter, such as unusually important subsequent events, risks, or uncertainties associated with contingencies or significant estimates
- Reference to other auditors



Explanatory Language - Substantial Doubt About the Client Being a Going Concern

Explanatory paragraph should be clearly worded to indicate:

- Auditor's substantial doubt about client's continuing as a going concern
- Reference to management's footnote(s) explaining the problems and plans to overcome the problem

Auditor may not feel comfortable expressing any opinion for some going-concern situations in which client is experiencing severe financial distress

- Would issue a disclaimer

Explanatory Language - Emphasis of a Matter



- Significant transactions with related entities
- Important subsequent events, such as a board-of-director decision to divest a major segment of the business
- Important risks or uncertainties associated with contingencies or significant estimates

Qualified Audit Opinions-Situations



- A material unjustified departure from GAAP that is not pervasive
- Inadequate disclosure that is not pervasive
- A scope limitation such that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive

Qualified Audit Opinions



- This means that the auditor has taken exception to certain current-period accounting applications or is unable to establish the potential outcome of a material uncertainty.
- In situations when a company's financial records have **not** been maintained in accordance with GAAP but no misrepresentations are identified, an auditor will issue a qualified opinion.
- The writing of a qualified opinion is extremely similar to that of an unqualified opinion.
- A qualified opinion, however, will include an additional paragraph that highlights the reason why the audit report is not unqualified.

Qualified Report - Scope Limitation



Restrictions on scope of audit, whether imposed by client or by circumstances beyond the auditor's or client's control, may require auditor to qualify an opinion

- In some situations circumstances may be such that a disclaimer would be more appropriate

Circumstances that may limit the audit scope

- Timing of the fieldwork
- Inability to gather sufficient appropriate evidence
- Inadequacy in the accounting records

Qualified opinion- Disclaimer



An auditor issues a disclaimer of opinion report when:

- Scope limitation exists
- Substantial doubt exists about the client being a going concern
- There is lack of independence

Disclaimer - Scope Limitation



Scope limitations caused by circumstances are such that it is not possible to form an opinion

- Introductory paragraph's wording modified for a scope limitation
- Scope paragraph is omitted
- Additional paragraph is inserted to describe the scope limitation(s)
- Last paragraph states that no opinion can be expressed

Disclaimer - Substantial Doubt About the Client Being a Going Concern



- Auditor may issue a disclaimer of opinion if there is a substantial doubt about the client continuing as a going concern
- In such cases, auditor would believe that an additional paragraph to an unqualified opinion is not appropriate

Disclaimer - Auditor Lacking Independence



When auditors lack independence with respect to a client:

- They cannot perform an audit in accordance with professional auditing standards
- They are precluded from expressing an opinion on the financial statements

In such cases, a one-paragraph disclaimer should be issued stating the lack of independence

- Auditor omits the reasons for lack of independence

Qualified opinion



Disclaimer opinion — This is a special type of audit report that should be issued when the auditor permits his or her name to be associated with financial statements that were not examined in accordance with generally accepted auditing standards.

On some occasions, an auditor is unable to complete an accurate audit report. This may occur for a variety of reasons, such as an absence of appropriate financial records. When this happens, the auditor issues a disclaimer of opinion, stating that an opinion of the firm's financial status could not be determined.

Qualified opinion



Adverse opinion — This is a type of audit opinion which states that the financial statements do not fairly present the financial position, results of operations, and changes in financial position, in conformity with generally accepted accounting principles.

Adverse report is appropriate when financial statements contain:

- Pervasive and material unjustified departure from GAAP
- Lack of important disclosures that is pervasive
- When a significant number of items in the financial statements violate GAAP

Adverse Report - Lack of Important Disclosures That Is Pervasive



Auditor can issue an adverse opinion if:

- Client's financial statements have omitted disclosures, such that
- Financial statements taken as a whole are not presented fairly in conformity with GAAP

Illustration of The Auditor's Report



ISA 700 Revised

Illustration of the Auditor's Report

END



QUESTIONS & COMMENTS

