



# Inaugural Entrepreneurship Workshop – Nairobi

Presentation by:  
CPA Charles Mukunu

Friday, 15<sup>th</sup> November 2019

# Audit Engagement, Execution and completion



Pre-engagement – Consider risk of acceptance (new engagement) and retention/continuance (existing engagement)

Planning – identify risk and formulate a response

Execution – obtain evidence from work performed (risk response – gathering evidence)

Completion – evaluate the sufficiency of the results of all testing and consider specific items

# Pre-engagement



An auditor will consider the following under pre-engagement;

- Client acceptance and continuance
- Nature of client
- Independence and Ethical consideration
- Engagement letter

# Client acceptance and continuance - ISA 300 A5-A7



Consider the following;

- Management integrity – speak to client about changes in the entity, research media report, enquire from partner's view of risk related to continuing with the client
- Consider the requirements of Section 290 of the IESBA Code of Ethics in determining that the services are not considered to be prohibited services
- Financial reporting framework is acceptable
- Client is in a position to pay audit fees
- Reason for change of auditor in case of a new engagement
- Process of appointment was duly followed

Client continuance procedures should be done annually due to change of management, business growth and risks

# Nature of the client



It's important to understand the nature of the client for the following reasons;

- Reputational risk
- Planning purpose – risks identification, firm capacity
- Understanding of industry and business risk
- Understanding if there are any regulatory reporting requirements

# Independence and ethical considerations- ISA 220



An auditor will consider the following

- Confidentiality;
- Integrity;
- Independence;
- Objectivity;
- Professional competence and due of care;
- Professional behavior; and
- Code of conduct

Independence of the whole engagement team – each member should sign an independence declaration form.

# Letter of engagement (LOE)

## ISA 210



Key matters to be included in the letter of engagement (LOE)

- The objective and scope of the audit;
- The identification of an applicable financial reporting framework;
- The responsibilities of management/board of directors;
- The responsibility of the auditor;
- Reference to the expected form and content of any report to be issued;
- Agreed fees for the assignment

LOE should be reviewed annually and consider whether:

- (a) circumstances require the terms of the engagement to be revised; or
- (b) the client needs to be reminded of the existing terms of the engagement.

# New client considerations



Key issue to consider;

- Ask the prospect client for permission to contact the outgoing auditor and reject acceptance if client refuses (might be an integrity issue);
- Seek for professional clearance from outgoing auditor;
- Ensure legal requirements/process in relation to the removal of previous auditor and appointment of incoming auditor have been met;
- Firm should that this is a desirable client (e.g. right industry);

DON'T accept appointment where its known that a limitation will be placed on the scope of the audit.

# Planning



Risk assessment and response to assessed risks (ISA 300-499)

- Client risk profile – consider the following;
  - Understanding the client
  - Preliminary Analytical review
  - Control environment
  - Fraud Risk Factor
- Audit plan
  - Risk assessment procedures
  - Materiality in planning and performing the audit
  - Audit Strategy

Audit Risk (AR)= Inherent Risk (IR)X Control Risk (CR) X Detection Risk (DR)

# Planning (cont'd)



Audit risk – risk that an auditor may incorrectly issue an unqualified report due to the auditor's failure to detect material misstatements either due to error or fraud.

Detection risk – risk that an auditor will not detect a misstatement that exist in an assertion that could be material either individually or when aggregated with other misstatements.

- ✓ There is an inverse r/ship between IR and CR compared to DR. The higher the IR & CR the lower the DR is needs to be to maintain the overall low risk. Low DR means more audit work to be done.
- ✓ IR and CR (risk of material misstatement) are identified through understanding the business.

# Planning (cont'd)



## Understanding the client (risk identification)

Factors to consider include;

- ✓ Industry, regulatory and other external factors – (IRs)
- ✓ Nature of entity – ownership and financing structure, related parties, management oversight, accountability and operating style.
- ✓ Accounting policies & estimates – risk of errors in preparation of FS, inappropriate use of accounting policies, New standards
- ✓ Objectives and strategies – risk related to stage of business's development and obligations, aggressive strategies
- ✓ Internal controls relevant to the audit – help auditor in identifying types of potential misstatements and factors that affect the risk of material misstatement.

# Planning (cont'd)



## Preliminary Analytical review

Comparison of recorded values with expectations developed by auditor to identify risks

# Planning (cont'd)



## Control environment

ISA 315 states that;

An auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit (this is an auditor's professional judgement)

# Planning (cont'd)



## Control environment (cnt'd)

DOCUMENT the system

IDENTIFY the “what could go wrong” in the system (controls are implemented to prevent, detect or correct misstatements)

IDENTIFY controls in the system

ASSESS if the controls will prevent, detect and correct material misstatements (DESIGN)

Test IMPLEMENTATION (walk through tests)

If Design and Implementation (D&I) of control is appropriate, consider testing controls otherwise go detailed substantive approach (do not place any reliance on internal controls).

# Planning (cont'd)



## Control environment (cont'd)

*Test of controls is performed to ensure that they are maintained and operate effectively for the audit period*

*Control testing evidence is obtained through;*

- 1. enquiry,*
- 2. Inspection*
- 3. Observation*
- 4. Re-performance*

*Pervasive/entity level risk* – risks that affects the FSs as a whole then filters in the individual account and transactions

*Assertion level risk* – affects a specific account balance or transactions

# Audit Plan



Audit plan is how the audit will be done i.e.

- The nature, timing and extent of planned procedures
- Risk assessment procedures
- Further audit procedures

## Risk assessment

Process of identifying and assessing the risks of material misstatements, whether due to fraud or error, at the financial statement and assertion levels.

Significant risk – an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

# Audit Plan



## Risk assessment (continued)

In assessing if a risk is significant, you need to take account likelihood and magnitude (both must be high)

Matters to consider in determining if risk is significant;

- Whether the risk is related to recent significant economic, accounting or other devt and therefore requires special attention;
- The complexity of transactions
- Whether the risk involves significant transactions with related parties
- The degree of subjectivity in measurement of the financial information related to the risk (Use of Key judgments and assumptions)

# Audit Plan



## Risk assessment (continued)

Compulsory significant risks on every audit engagement;

- Revenue recognition (ISA 240.p27 & 47) unless justified why it is NOT;
- Management override of controls – Year end and non- routine journals (ISA 240.p31 & 32)
- Related parties transactions NOT at arm's length (ISA 550.p18)
- Fraud risks (ISA240.p26)

Other possible significant risks;

- Complex judgments and estimates (ISA 240.p32)
- Significant transactions outside normal course of business
- Completeness of related parties

# Audit Plan



## Risk assessment (continued)

How to identify significant risks

- General;
  - ✓ Client acceptance or continuance procedures
  - ✓ Other engagements performed for the entity
  - ✓ Previous audit engagement e.g. source of past misstatements, brought forward points, changes in ICs, deficiency in ICs
- Analytical procedures – comparing expectations to actual recorded amounts.
- Observation and inspection e.g. read business plans, budgets, minutes of board/audit committee, reports from regulators, internet/magazine/newspaper articles, significant contracts

# Audit Plan



## Risk assessment (continued)

- Enquiry – discussion held with various staff at the client (management staff and TCWG).

Document the following in the file;

- ✓ With whom you had the discussion
- ✓ Their position
- ✓ Date of discussion

# Audit Plan



## Materiality when planning and performing and audit (ISA 320)

**Materiality** defines the threshold or cut-off point after which financial information becomes relevant to the decision making needs of the users (influence the economic decision of the user).

**Planning materiality** – amount(s) set by an auditor at less than materiality for the financial statements as a whole to reduce to an appropriate low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

**Clearly trivial** – amount below which adjustments will not be required

# Audit Plan



## Materiality when planning and performing and audit (ISA 320)

N/B – different audit firms use different ranges for planning materiality

Materiality can either be Quantitative (material because of amount) or Qualitative (material because of nature)

There is an INVERSE r/ship between materiality and the level of audit risk

Materiality should be considered at planning, during audit and completion stage

# Audit Plan



## Calculating materiality

Parameters to be used are;

- ✓ Revenue, Net profit before tax, Shareholders equity, Total assets or Total expenses

The parameter to use depends on:-

- ✓ Relevance (does the entity use the balance for decision making)
- ✓ Stability (can it be used next year)
- ✓ Predictability (any large fluctuations expected)

All errors/misstatement below PM but above Trivial should be transferred to schedule of unadjusted errors (SUE). If the total unadjusted errors/misstatements are material, all the amounts should be adjusted.

# Audit Strategy



Audit strategy is about *when and who* will do the audit

Factors to consider are;

1. Engagement characters -
  - ✓ Identify financial reporting framework,
  - ✓ Identify industry specific requirements
  - ✓ Need for a specialist (reliance on the work of expert)
  - ✓ Need for evidence from service organization
  - ✓ Previous audit findings and effect of IT on the audit
2. Reporting objectives – various deadlines and various meetings to held
3. Nature, timing and extent or resources required – audit team, allocation of sections and budgeting

# Fraud consideration (ISA 240)



Fraud- an intentional act by one or more individuals among management, TCWG, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. There are two type of fraud;

1. Misstatement resulting from fraudulent financial reporting; and
2. Misstatements resulting from misappropriation of assets

Revenue recognition – ISA 240.p6 states that there is the presumption that there are risks of fraud on revenue recongnition

# Fraud consideration (ISA 240) cont'd



- ✓ Who is responsible in managing fraud risk? – management
- ✓ When is risk fraud considered? – throughout the audit process by;
  - ❖ Exercise professional skepticism
  - ❖ Having team discussion
  - ❖ Must be part of significant risks identified
  - ❖ Obtain letter of representation from TCWG
- ✓ Management override of controls through journal entries, accounting, estimates and significant judgments

# Execution



Audit execution involves;

- ✓ Follow audit programs and procedures identified at planning to address the risks identified either significant risks or risk of material misstatements (assertion level risks)
- ✓ Test of controls where reliance will be placed on ICs
- ✓ Substantive tests – tests in detail or other substantive analytical reviews
- ✓ Evaluate sufficiency of audit evidence obtained.

# Execution cont'd



General principle of directional testing when testing transactions and account balances is;

- ✓ All credit balances will be tested for understatement
- ✓ All debit balances will be tested for overstatement

However, inventories will be tested for both overstatement and understatement.

N/B

IT audit/assurance should be done for all complex IT environment.

For all debit balances (assets and expenses), samples will be selected from the general ledger.

# Execution cont'd



- For all credit balances (liabilities and income), samples will be selected from the source documents.

The number of samples to be tested will be dependent on the following factor;

1. Size of the population to be tested
2. Materiality chosen i.e. overall materiality or assertion level materiality
3. Level of risk identified i.e. high, medium or low

# Execution cont'd



## Audit evidence (ISA 500)

The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.” - ISA 330

Evidence is everything that can make a person believe that a fact, proposition, or assertion is true or false.

**Reasonable assurance** is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. – ISA 200

# Execution cont'd



## Sources of evidence

Internally generated – physical verification (inventories, assets)

Externally generated – confirmation of balances

Self generated – test of controls, substantive procedures

Audit evidence should be sufficient and appropriate.

**Sufficiency** is the measure of the **quantity** of audit evidence

**Appropriateness** is the measure of **quality** of audit evidence, its **reliability**, & its **relevance** in providing support for, or detecting, misstatements in transactions, balances, disclosures and related assertions

# Execution cont'd



Auditor's judgment as to what constitutes sufficient audit evidence is influenced by;

- Materiality
- Understanding of the entity and its environment, including internal controls
- Reliance on effective controls
- The effectiveness of management's response and controls to address the risks
- Reliability of information
- Audit findings: if other audit evidence found not to be reliable as expected – further evidence will be required.

# Execution cont'd



Reliability of audit evidence – influenced by its nature & source

- **External v Internal:** Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- **Direct v Indirect:** Audit evidence obtained directly by the auditor (e.g., observation, re-performance) is more reliable than audit evidence obtained indirectly or passed on by client.
- **Written v Oral:** Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium.
- Audit evidence provided by **original documents** is more reliable than audit evidence provided by photocopies or facsimiles.
- The effectiveness of the client's **internal control** structure has a significant impact on reliability of evidence.

# Execution cont'd



## Audit procedures for Gathering audit evidence

- **Inspection of records and documents:** evidence obtained from external documents is more reliable than internal documents.
- **Confirmations:** cash and bank, trade receivables, trade payables etc.
- **Inquiry:** consider the knowledge, objectivity, experience, responsibility, and qualifications of the person to be questioned
- **Recalculation:** checking the mathematical accuracy of documents or records
- **Re-performance:** The auditor's independent execution of procedures or controls that were originally performed as part of the internal control system

# Execution cont'd



## Audit procedures for Gathering audit evidence

- **Observation:** the process of watching a process or procedure being performed by others.
- **Scanning:** review of accounting data to identify significant or unusual items

# Execution cont'd



## Summary

- All risks identified at planning stage to be addressed by having adequate documentation in the audit file
- The following should always be considered;
  - ❖ Obtaining a lawyer's confirmation
  - ❖ Going concern assessment review
  - ❖ Obtaining bank confirmations
  - ❖ Review of laws and regulations – potential adjustments and or disclosures (contingent liabilities) in the FS. Could also have an impact on going concern assessment.
  - ❖ Review of journal entries – risk of management override
  - ❖ Test of related parties transactions and balances
  - ❖ Audit of tax figures – current tax and deferred tax
  - ❖ Adequate documentation in case of reliance on the work of experts or internal audit function

# Execution cont'd



## Summary

- All risks identified at planning stage to be addressed by having adequate documentation in the audit file
- The following should always be considered;
  - ❖ Obtaining a lawyer's confirmation
  - ❖ Going concern assessment review
  - ❖ Obtaining bank confirmations
  - ❖ Review of laws and regulations – potential adjustments and or disclosures (contingent liabilities) in the FS. Could also have an impact on going concern assessment.
  - ❖ Review of journal entries – risk of management override
  - ❖ Test of related parties transactions and balances
  - ❖ Audit of tax figures – current tax and deferred tax
  - ❖ Adequate documentation in case of reliance on the work of experts or internal audit function

# Completion



Auditor should ensure the following procedures are adequately completed and documented at completion stage;

- Have all significant risks and risks of material misstatements been addressed
- Subsequent (post balance sheet) events review updated upto the date of signing the audit report
- Going concern assessment and where necessary, obtain letter of support
- Bank, legal and related parties confirmations
- Overall analytical and annual financial statements review
- Letter of representation together with schedule of unadjusted errors signed by TCWG – should be dated on or before the date of audit report.

# Completion cont'd



- Management letter with comments from client
- Final materiality calculation
- Final financial statements agreed to audit working papers
- Ensure the final financial statements are in compliance with the reporting framework and other regulatory requirements e.g. Companies Act
- Ensure the audit report issued is appropriate and is supported the working done as per the Audit Working Papers

# Audit Engagement, Execution and completion



Q&A

# New and Upcoming Standards



New standards, amendments and interpretations are;

## **International Financial Reporting Standard 16 (IFRS 16): Leases**

- IFRS 16 'Leases' (issued in January 2017) effective for annual periods beginning on or after 1 January 2019, replaces IAS 17 'Leases'. It establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions.
- An entity recognises lease liabilities relating to leases under which the entity is the lessee that had previously been classified as operating leases (except for leases less than 12 months).

# New and Upcoming Standards



## International Financial Reporting Standard 16 (IFRS 16): Leases (continued)

- Liabilities have been measured as at 1.01.2019 at the present value of the remaining lease payments discounted using the entity's incremental borrowing rate as at 1 January 2019.
- Corresponding right-of-use assets recognised, measured as if the entity's new accounting policy had been applied since the commencement of each lease but discounted using incremental borrowing rate as at 1 January 2019
- The difference between the lease liabilities and right-of-use assets at 1 January 2019 has been recognised as an adjustment to retained earnings at that date.

# New and Upcoming Standards



## International Financial Reporting Standard 17 (IFRS 17): 'Insurance Contracts'

- IFRS 17 'Insurance Contracts' (issued May 2017) effective for annual periods beginning on or after 1 January 2022 establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts.

# New and Upcoming Standards



## Amendments to IAS 12 'Income Taxes'

- Effective for annual periods beginning on or after 1 January 2019 clarifying on the recognition of income tax consequences of dividends.
- In the circumstances where the payment of dividends impacts the tax rate or results in taxable amounts or refunds, the income tax consequences of dividends are considered to be more directly linked to past transactions or events and so are recognised in profit or loss unless the past transactions or events were recognised outside of profit or loss. (p52B)

# New and Upcoming Standards



## Amendments to IAS 19 'Employee Benefits'

- Effective for annual periods beginning on or after 1 January 2019 clarifying the effects of a retirement benefit plan amendment, curtailment or settlement.

## Amendments to IAS 23 'Borrowing Costs'

- Effective for annual periods beginning on or after 1 January 2019 clarifying that specific borrowings remaining unpaid at the time the related asset is ready for its intended use or sale will comprise general borrowings.

## Amendments to IAS 28 'Investments in Associates and Joint Ventures'

- Effective for annual periods beginning on or after 1 January 2019 clarifying that IFRS 9 is only applicable to investments to which the equity method is not applied.

# New and Upcoming Standards



## Amendments to IFRS 3 'Business Combinations' and IFRS 11 'Joint Arrangements'

- Effective for annual periods beginning on or after 1 January 2019 in relation to remeasurement of previously held interests on a joint operation on obtaining control.

## Amendments to IFRS 9 'Financial Instruments'

- Effective for annual periods beginning on or after 1 January 2019 clarifying that the existence of prepayment features with negative compensation will not in itself cause the instrument to fail the amortised cost classification.

## Amendments to IFRS 11 'Joint Arrangements'

- Effective for annual periods beginning on or after 1 January 2019 clarifying that when an entity obtains joint control of a business that is a joint operation, it does not remeasure its previously held interests.