



CPA Ireland Skillnet

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The CPA Ireland Skillnet provides excellent value CPE (continual Professional Education) in accountancy, law, tax and strategic personal development to accountants working both in practice and in industry. However our attendees are not limited to the accountancy field as we welcome all interested parties to our events.



The CPA Ireland Skillnet is funded by member companies and the Training Networks Programme, an initiative of Skillnets Ltd. funded from the Department of Education and Skills.

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Trainee Accountant
Workshop Series

March 2016

Current Issues in Auditing

Solutions to June 2015 Exam

Introduction

Introduction

- The purpose of this session is to
1. To examine current issues in auditing in the context of the P2 Examination and
 2. To consider some approaches to tackling P2 exam questions bearing in mind that this is an open-book examination
 3. Part 8 of the syllabus states that the following is examinable
"The current issues and developments relating to auditing, including audit expectations and developments in the regulation of audits".
 4. To examine other improvements candidates could make in their approach to the paper.

Current Issues

Overview

- Changes to the audit environment
- Dynamic environment
 - E-commerce
 - Auditing and accounting standards
 - Internationalisation/globalisation
 - Public sector expansion, VFM issues



Changes in the audit boundary

Scope of Audit

- Corporate governance
- Risk assessment
- Social audit
- Performance audit
- Environmental audit
- Regulatory impact assessments (RIA)



Social accounting and auditing

Assurance and other reports

- Reporting of non-financial information
 - More accountability/pressure from society as a whole vs public relations exercise (Corporate Social Responsibility)
 - Corporate Social Responsibility reporting has increased massively in the last 10 years
 - Consistency can be a problem due to lack of standards – only report what you want to hear

Enhancing Auditor Independence

Proposals to improve (or enforce) auditor independence include:

- Compulsory rotation of audit firms
- Ban on provision of non-audit services
- Audit of all 'public interest' companies (e.g. FTSE 100, Banks?) by state auditors
- Government to appoint auditors of 'public interest' companies
- Tightening of limits in ACCA code, e.g. 15% rule becomes 5% rule, rule to apply to individual countries and/or in US states, 2-year limit for engagement partners, etc.

Consequences of internationalisation

- Global businesses operate in widely different legal and ethical systems.
- Audit firms have to have the resources and expertise to operate in a diverse geographical market and have to know how to audit highly regulated modern businesses.
- Only the larger audit firms can acquire the global expertise to handle such audits so concentration of the audit market into a few very large firms



Consequences of internationalisation

- Affiliation is used by the larger accounting firms to develop an internationally recognised brand name,
- Cooperation is used by the mid tier firms who join international cooperatives of firms who send each other business, but retain their own trading name in their home countries.



Big 4

Advantages

- Wide ranging expertise
- Global facilities
- Can invest in expensive systems and necessary IT to meet needs of international clients

Disadvantages

- Lack of competition and choice, particularly for large companies
- Provisions of SOX (if applicable) further restrict choice
- If "Big 4" became the "Big 3"???

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Fraud and the auditor – future proposals

▪Possibilities for combating fraud

- Could make auditors report on adequacy of internal controls to prevent and detect frauds to audit committee or board
- Increase use of forensic audits
- Increase requirement to report suspected frauds

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Current issues in recent examinations

Issues that are always "current"

Some issues in auditing appear to be always "current". Others follow various fashions and trends in society.

Among those that are always current are:

- Audit Independence (Q4 (a) April 2014; 9 marks, Q4 (a) August 2012, 15 marks)
- Audit Rotation (Q1 (a) April 2014; 10 marks)
- Audit of Smaller Entities/ Audit Exemption (Q2 (a) & (b) August 2013; 15 marks).

Current issues in recent examinations

Issues that are always “current”

- Fraud (Q4(a) April 2013; 7 marks, Q1 (d) August 2015; 8 marks)
- Going Concern (Q4 August 2011; entire 25 mark question)
- Professional scepticism, earnings management, audit failure (Q4 August 2010; entire 25 mark question).
- Audit fee levels



Current Emerging issues

Current emerging issues

Among more recent topics that have emerged are:-

- Social and Environmental Reporting/Assurance Reports / Reports on Prospective Financial Information (Q2 April 2015; question Q3 August 2015, both full 25 mark questions)
- Joint Audits (Q1(e) August 2011 (5 marks)



Current Emerging issues

Current emerging issues

Among more recent topics that have emerged are:-

- Developments in Audit Reporting –new standards effective for periods ending on or after 15 December 2016 (not directly relevant for exams in 2016).
- Professional self-regulation.



Preparing for questions
on “current issues”

These questions are more difficult to prepare for because:-

- You cannot possibly anticipate all different “angles” on a questions that might be asked.
- You may need to be able to apply your answer to a particular scenario.
- You may be asked your opinion on a particular issue e.g. “Is the guidance available in a particular ISA adequate?” or “Does a particular auditing practice serve the profession/the public well?”

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Tackling questions
on current issues

When tackling such questions in the examination remember

- There are no right or wrong answers (If there were, the profession wouldn’t have spent the last 30 years debating them!)
- The questions remain but the context continuously changes e.g. consider the importance of “going concern” to an auditor in 2006, 2011, and 2016. The explains why you can’t rely on last year’s suggested solutions!

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Tackling questions
on current issues

When tackling such questions in the examination remember

- Your opinion matters and your opinion can’t be wrong! Neither does it have to correspond with mine!
- At this level you should always think about the reason why things are as they are and possible alternatives.

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Types of question

Types of questions on current issues

There are at least three types of questions you can be asked on current issues.

- 1. Straight question with no related scenario.
- 2. Question with a scenario built around it (for example Q2 April 2015; question Q3 August 2015)
- 3. Question related to Case Study (Q1 April 2014)

Let us now look at an example of each scenario.



Q4 (a) August 2012

Example Question 4(a) August 2012

The managing partner in your firm of registered auditors has been invited to a discussion on auditor independence at a forthcoming business conference. He has asked you, a recently qualified Certified Public Accountant, to assist with his preparation for this event.



Q4 (a) August 2012

Example Question 4(a) August 2012

REQUIREMENT:

Prepare a briefing note critically examining the assertion that auditors can never be independent in a meaningful way, because ultimately it is their clients who pay the fee. (15 marks)



Approach to
Q4 August 2012

Approach
to solution

You are asked for a briefing note so begin
To: Mr. Accountant, Managing Partner
From: CP Newqual
Briefing Notes
In relation to your forthcoming attendance at the discussion on auditor independence these notes examine the implications of auditors being dependent on their clients to pay fees.
I hope you find the above helpful.

CP Newqual



Approach to
Q4 August 2012

Approach
to solution

You could make (and expand on) the following points.

- Issue certainly does constitute some degree of conflict of interest.
- Such conflicts are, however, commonplace across the professions and auditors have a duty to act in their clients' best interests.
- There is some (but limited) legal protection for auditors against clients putting undue pressure on them.
- Auditing Standards attempt to set minimum parameters for the amount of work required.

Approach to
Q4 August 2012

Approach
to solution

- IESBA's Code of Ethics (and similar codes) are designed to reduce the pressure on auditors from their clients. The Code is reinforced by periodic audit practice Quality Reviews from the RSBs such as CPA Ireland.
- ☐ The first ethical principal is that auditors should, at all times, act with integrity towards their clients and third parties.
- ☐ Auditors should not accept or continue with a client if revenue from the client would constitute 15% or greater of "gross recurring fee income" for two or more years.
- ☐ Auditors should cease working for client with overdue fees or fees in arrears even if these fees are not directly related to audit work.

Approach to
Q4 August 2012

You could also consider the question of alternatives
If we consider that auditors provide a service to society that is useful it has – somehow – to be paid for.
☐ Government auditing of companies might be seen as too adversarial akin to a Revenue Audit.
☐ A government agency paying the fee might work but would, possibly, be very bureaucratic with, possibly, scope for corruption.
Finally, you should come to a conclusion which can only be your own.

Approach to
Q4 August 2012

Marking Scheme

An approximate marking scheme would be as follows:

Layout, presentation, and conclusion	4 marks
Recognition that an issue exists	1 mark
<u>How the profession mitigates the issue</u>	
Auditing Standards	
Practice Review	
Ethical Guidelines	6 marks
<u>Specific guidelines</u>	
The “15% rule”, overdue fees etc.	4 marks
Alternatives ways of organising the service	3 marks
Other valid points	<u>3 marks</u>
Total	<u>21 marks</u>
Maximum	15 Marks

Question 2
August 2015

Big Manufacturing

(a) There is some scepticism in the professional and business community and amongst outside commentators as to environmental and social reporting. Discuss the extent to which the auditing of such reports could help to allay the sceptics’ concerns in this regard. Use the scenario presented above to illustrate your argument.

(10 marks)

Question 2
August 2015

Big Manufacturing

The marking scheme provides a good guide of the issues we should be picking up on here:
Discussion of absence of legally enforceable standards- possibly contrasted with "regular" financial reporting. (3 marks)
Reasons why company's commission environmental and social reports (2marks)
Companies may choose to emphasize what they are "good at" (2 marks)
Lack of common standards of measure in social and environmental reports (2 marks)
Placing discussion in context of case study (2 marks)
Other relevant points (maximum) (3 marks)
Maximum for part (a) (10 marks)

Question 2
August 2015

Big Manufacturing
Part (b)

(b) Assess critically the particular difficulties you would experience in auditing Big Manufacturing plc's claim that:
(i) The new car is efficient and that its use will not adversely affect the environment compared with existing forms of transport;
(ii) The new cars will operate to an acceptable standard of safety;
(iii) It will be capable of recycling all scrap cars.
(15 marks)

Question 2
August 2015

Big Manufacturing
Part (b)

(b)
(i) Some details verifiable such as fuel efficiency 1
Overall impact much more difficult 2
Location and volume of sales important 1
"Second-Order" impacts more difficult still 1
Other relevant points 2
(ii) Defining "acceptable" 1
Discussion of features these cars have (and lack) 2
Need for an expert 1
Examination of statistics, if any available 1
Other relevant points 2

Question 2
August 2015

Big Manufacturing
Part (b)

(b)	
(iii) In some ways this can be checked	1
Doubt might be about how realistic the plans are	2
Need to confirm how the plans fit into overall budgets etc.	1
Any procedures already being followed (e.g. acquiring sites)?	1
Other relevant points	2
Limited assurance report at most in any case	
Available marks per marking scheme	20
Maximum for part (b)	15

Question 1(a)
April 2014

The Irish View
Part (a)

The final question we will examine in this part of the seminar is where a “current issues” question forms part of the Case Study – question 1 of the paper.

Here is an example from April 2014.

(a) Evaluate critically the appropriateness of the professional guidance on audit firm rotation and audit partner rotation in light of the necessity for auditors to be, and be seen to be, independent.

(10 marks)

Question 1(a)
April 2014

The Irish View

The important points to note about this question are that you are asked to “evaluate critically” the “professional guidance” on “audit firm rotation” and “audit partner rotation”.

Evaluate critically means that you consider how adequate (or otherwise) the professional guidance is in this respect. So, for example, you might ask

- Is the guidance reasonable and balanced?
- Is the guidance based on a reasonable presumption?
- Is the guidance sufficiently specific, or over-prescriptive?

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Question 1(a)
April 2014

The Irish View

- Do audit firms, by and large, adhere to it?
- Are guidelines enforceable by, for example, QC review?
- Does it effect all practices equally or, at least, fairly?
- Are there adequate (or excessive) provisions made for exceptions?
- Does adherence to guidelines place an undue financial burden on clients, or auditors?
- Does adherence to guidelines give rise to unintended consequences?

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Question 1(a)
April 2014

The Irish View

Here is the marking scheme in this regard:

- Description of audit firm rotation 1
- Description of audit partner rotation 1
- Importance in context of independence 1
- Some reference to current legal practice and/or established practice in Ireland or internationally 2
- Summary of current professional guidelines 2

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Question 1(a)
April 2014

The Irish View

- Brief review of advantages and disadvantages of audit firm rotation 2
- Conclusion on adequacy of current professional guidelines 2
- Appropriate references to academic research 2
- Available marks per marking scheme 13
- Maximum for part (a) 10

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Other improvements

Other deficiencies by candidates noted are as follows:

- ☐ Not reading the question properly
- ☐ Not answering the question asked
- ☐ Being unable to adjust when the focus of the question changes

All of these deficiencies were noticeable to a degree in the solution to Q1 August 2015.



Case Study
Q1 August 2015

The rubric section of Q1 from the August exam paper in 2015 was as follows:

REQUIREMENT:

(a) Recommend the principal audit procedures which should be performed in respect of:

- (i) the disposal of the subsidiary, and
- (ii) the non-controlling interest charge in the Group Income Statement.

(12 marks)

Case Study
Q1 August 2015

(b) Evaluate the audit risks in relation to the following aspects of the audit of the Frat Group for the year ended 30 June 2015:

- (i) The Earnings per Share
- (ii) The unrealised surplus on the revaluation of properties
- (iii) The currency translation differences
- (iv) The issue of share capital.

(16 marks)

August 2015
Question 1

Case Study
Q1 August 2015

(c) Discuss any concerns the auditor might have about the decision of the Group to credit the "gain on curtailment of retirement benefits" to the income statement as distinct from actuarial losses which are included in the pension plan liability figure within the Statement of Financial Position.

(8 marks)

(d) Prepare a briefing note for your team on the most important controls that the Frat Group should have in place to prevent and detect the misappropriation of funds by management and employees at the group's subsidiary companies.

(8 marks)

August 2015
Question 1

Case Study
Q1 August 2015

(e) Discuss the adequacy of the guidance provided by ISA 600 *Special Considerations – Audit of Group Financial Statements* in relation to the issue of non-consolidated entities under common control.

(6 marks)

[Total: 50 Marks]



August 2015
Question 1

Case Study
Q1 August 2015

Some of the main difficulties to arise were as follows:

In respects of parts (a) and (b) many candidates confused audit risks with audit procedures and interchanged both in their solutions.

If the question asks for audit procedures, then your answer should be something that auditors must do (e.g. recalculate profit/loss on the disposal of the subsidiary).

Also, try to avoid overusing the word "check" in respect of audit procedures – try to use a more specific word e.g. compare, re-perform etc.

August 2015
Question 1

Case Study
Q1 August 2015

A risk, on the other hand, is just a condition that exists. The identification of risks will, in practice, give rise to the devising of procedures to test for the risks but frequently – in an examination – you are asked merely to evaluate the risk. In this case, “evaluate” can be taken to mean “consider the seriousness of...”

For example, in this case EPS is considered a KPI so the auditor should be aware that there may be an effort to manipulate it; albeit that risk is mitigated somewhat by the fact that the NEDs check the figure in detail.

August 2015
Question 1

Case Study
Q1 August 2015

In part (d) the question “switches over” to look at the problem from the point of view of the client. It is vital for auditors in the real world to have this skill of being able to see the problem from the other side, as it were.

Many candidates were simply unable to do this (or failed to comprehend this part of the question properly).

Question 1(b) of the April 2014 paper (the Irish View case study) required a similar *volte-face* by candidates and was equally poorly answered.

Solution to
Case Study part (d)

Solution to
Q1(d) April 2015

Briefing Note
To: Audit Team for Frat plc and Frat Group Audit
From : A. N. Accountant
Re: Controls Frat Group should have in place to prevent/detect fraud at overseas subsidiaries.

We have been made aware that a substantial fraud has been perpetrated on the Frat Group by the Financial Controller of their Amsterdam division. Consequently, we have been asked to recommend the most important controls the Group should have in place to prevent and detect misappropriation of funds by management and employees at the group's subsidiary companies. These controls should incorporate, at a minimum the following:

Solution to
Q1(d) April 2015

- Authorisation of expenditure
- Group authorization for significant/unusual expenditure
- More than one cheque signatory for large cheques
- Review of supporting documentation by cheque signatories
- Appropriate authorization of electronic funds transfer
- Password protection of electronic transfers



Solution to
Q1(d) April 2015

- Controlled access to bank account details on supplier file
- Review of changes to supplier files
- Segregation of duties between invoice posting and payment to avoid payments being authorized on fictitious invoices
- Proper bank reconciliations
- Controls over access to payroll data
- Review and authorization of employees' expenses claims



Solution to
Q1(d) April 2015

- Review of costs against budget, which is sufficiently detailed to pick up inappropriate expenditure, including obtaining explanations for variances and comparisons to other subsidiaries
- Involvement of personnel department: to ensure that, staff take holidays, to encourage staff rotation around subsidiaries and to ensure that adequate references are obtained on recruitment
- Proper and consistent application of these controls at all the overseas divisions will minimize the chances of a recurrence of this type of fraud.



Question 1 (b)
April 2014

The Irish View

(b) Assess the control issues arising from the fact that The Irish View has no direct access to the contractor to whom they have outsourced the publication and processing of the e-newspapers.

(11 marks)

Note that this question does not directly concern the auditor. It asks about the control issues arising from...etc

Question 1 (b)
April 2014

Solution to
The Irish View

Assessment of the control issues with regard to the processing and publication of the E-Newspapers

The directors of The Irish View (TIV) are responsible for the control environment. Given that revenue from this

source now accounts for 15% of total revenues, the operations within the IT facility are an important aspect

of The Irish View's system of internal controls. Any errors are likely to lead to The Irish View receiving

incorrect proceeds of from the sale of e-newspapers.

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Question 1 (b)
April 2014

Solution to
The Irish View

The fact that TIV cannot readily check any of their details provided by the company to whom this work is outsourced means that there is no practical means of checking the information provided by the IT facility. This is made more difficult by the fact that the contractee is outside of the Eurozone and so there are translation issues associated with dealing with the receipts.

The IT facility will also be gathering personal information about The Irish View's customers that may be compromised if security is weak. These customers may hold The Irish View responsible if there are any leaks or other weaknesses in security (e.g. credit card details).

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Question 1 (b)
April 2014

Solution to
The Irish View

other weaknesses in security (e.g. credit card details).

Management of TIV will require the ability to check that the accounting issues handled by the IT facility are organized properly. As external auditors we will need to be satisfied that the arrangements in place to monitor and report on systems are adequate.



Question 1 (b)
April 2014

Marking Scheme
for The Irish View

- (b)
- Control environment 1
 - General points about consequences of outsourcing 1
 - Materiality of transactions processed by IT facility 2
 - Consequence of errors including receipt of incorrect proceeds 2
 - Lack of information for decision making purposes 1



Question 1 (b)
April 2014

Marking Scheme
for The Irish View

- (b)
- Translation/FX issues 1
 - Possibility and consequences of security breaches 2
 - Consequences of lack of access for EAs 2
 - Other relevant points 2
 - Available for part (b) 14
 - Maximum for part (b) 11
