Auditing Investigation and Assurance Services

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DEDICATION

This book is dedicated to all my students and staff.

FORWARD
Auditing Investigation, and Assurance Services been a subject prerequisite to proper accountability, there is the need for a made simple text that covers the theoretical and practical approach.

The insight and perspective of Dr. J.F. Adebisi are manifest in the logical and flowing presentations. The embellishments that are difficult to ignore are found in pictorial presentations on every chapter to enhance readers’ comprehensive understanding.

This book is therefore meant for lecturers, students of accounting in Universities and Polytechnics, research fellows on any of the subject areas in Auditing and Investigation, ICAN students, ANAN students and professional Accountants for knowledge updating.

Without any sense of evasion or purpose reservation, I wholeheartedly commend this text to the reading public. “In all thy getting, get understanding, acquire knowledge and sell it not”.

Bello-Gbenga B. (ACA, ACTI, AMNIM)
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Adebisi J.F. Ph.D, FCNA
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CHAPTER 1

STATUTORY AND REGULATORY FRAMEWORK OF AUDITING

INTRODUCTION

The auditor carries out his professional practice guided and regulated by both the laws of the land and the professional rules and regulations. In this chapter, let me start by discussing those regulations, rules and guidelines that the auditor has to obey in the discharge of his duties. This shall be looked at from two perspectives as follows:

i. Statutory framework
ii. Regulatory framework

1.1 Statutory Framework

We shall consider statutory provisions that have direct bearing on the principles and practice of auditing both in the public and private sectors in Nigeria. Basically, four (4) statutes are to be considered in doing this, we need to consider auditor’s qualifications, appointment, duties, rights, powers, privileges, responsibilities, liabilities, remuneration, removal, resignation and independence as provided in:

b. Companies and Allied Matters Act (CAMA) 1990
c. Banks and other Financial Institutions Act (BOFIA) 1991

1.2 Auditor – General’s and 1999 Constitution

Section 85:

1. There shall be an Auditor-General for the Federation who shall be appointed in accordance with the provisions of section 86 of this constitution.

The public accounts of the Federation and of all offices and courts of the Federation shall be audited and reported on by the Auditor-General who shall submit his reports to the National Assembly; and for that purpose, the Auditor-General or any person authorized by him in that behalf shall have access to all the books, records, returns and other documents relating to those accounts. Nothing in subsection (2) of this section shall be construed as authorizing the Auditor-General to audit the accounts of or appoint
auditor’s for government statutory corporations, commissions, authorities, agencies, including all persons and bodies established by an Act of the National Assembly, but the Auditor-General shall –

a. Provide such bodies with –
   i. A list of auditors qualified to be appointed by them as external auditors and from which the bodies shall appoint their external auditors, and
   ii. Guidelines on the level of fees to be paid to external auditors; and
b. Comment on their annual accounts and auditor’s reports thereon.

The Auditor-General shall have power to conduct periodic checks of all government statutory corporations, commissions, authorities, agencies, including all persons and bodies established by an Act of the National Assembly.

The Auditor-General shall, within ninety days of receipt of the Accountant-General’s financial statements, submit his reports under this section to each House of the National Assembly and each House shall cause the reports to be considered by a committee of the House of the National Assembly responsible for public accounts.

In the exercise of his functions under this Constitution, the Auditor-General shall not be subject to the direction or control of any other authority or person.

Section 86:

(1) The Auditor-General for the Federation shall be appointed by the President on the recommendation of the Federation Civil Service Commission subject to confirmation by the senate.

(2) The power to appoint persons to act in the office of the Auditor-General shall vest in the President.

(3) Except with the sanction of a resolution of the senate, no person shall act in the office of the Auditor-General for a period exceeding six months.

Section 87:
(1) A person holding the office of the Auditor-General for the Federation shall be removed from office by the President acting on an address supported by two-thirds majority of the senate praying that he be so removed for inability to discharge the function of his office (whether arising from infirmity of mind or body or any other cause) or for misconduct.

(2) The Auditor-General shall not be removed from office before such retiring age as may be prescribed by law, save in accordance with the provision of this section.

Section 88:
(1) Subject to the provisions of this Constitution, each House of the National Assembly shall have power by resolution published in its journal or in the Official Gazette of the Government of the Federation to direct or cause to be directed an investigation into –

(a) Any matter or thing with respect to which it has power to makes laws; and

(b) The conduct of affairs of any person, authority, ministry or government department charged, or intended to be charged, with the of or responsibility for –

i. Executing or administering laws enacted by the National Assembly and

ii. Disbursing or administering moneys appropriated by the National Assembly.

(2) The power conferred on the National Assembly under the provisions of this section are exercisable only for the purpose of enabling it to –

(a) Make laws with respect to any matter within its legislative competence and correct any defects in existing law; and

(b) Expose corruption inefficiency or waste in the executive or administration of laws within its legislative competence and in the disbursement or administration of funds appropriated by it.

Section 89:
(1) For the purpose of any investigation under section 88 of this constitution and subject to the provisions thereof, the Senate or the
House of Representatives or a committee or appointed in accordance with section 62 of this Constitution shall have power to-
(a) Procure all such evidence, written or oral, direct or circumstantial, it may think necessary or desirable, and examine or relevant to the subject matter;
(b) Require such evidence to be given on oath such evidence oath;
(c) Summon any person in Nigeria to give evidence at any place or produce any document or other thing in his possession or under his control, and examine him as a witness and require him to produce any document or other in his possession or under his control, subject to all just exceptions; and
(d) Issue a warrant to compel the attendance of any person who, after having been summoned to attend, fails, refuses or neglects to do so and does not excuse such failure, refusal or neglect to the satisfaction of the House or to the committee in question, and order him to pay all costs which may have been occasioned in compelling his attendance or by reason of his failure, refusal or neglect to obey the summons, and also to impose such fine as may prescribe for any such failure, refusal or neglect, and any fine so imposed shall be recoverable in the same manner as a fine impose by court of law.

(2) A summon or warrant issued under this section may be served or executed by any member of the Nigeria Police Force or by any person authorized in that behalf by the President of the Senate or the Speaker of the House of Representatives, as the case may require.

1.3 The Office of the Auditor General (States)
The instrument of appointment is the constitution of the nation. Section 126 of 1999 constitution of the Federal Republic of Nigeria states:
i. The Auditor-General for a State shall be appointed by the Governor of the State on the recommendation of the State Civil Service Commission subject to confirmation by the House of Assembly of the State.
ii. The power to appoint persons to act in the office of the Auditor-General for a State shall vest in the Governor.
iii. Except with the sanction of a resolution of the House of Assembly of a State, no person shall act in the office of the Auditor-General for a State for a period exceeding six months.

1.4 **Functions of the Auditor-General**

Section 125 states

There shall be an Auditor-General for each State who shall be appointed in accordance with the provisions of section 126 of this Constitution.

i. The Public Accounts of a State and of all offices and courts of the State shall be audited by the Auditor-General for the state who shall submit his reports to the House of Assembly of the State concerned, and for that purpose of the Auditor-General or any person authorized by him in that behalf shall have access to all the books, records, returns and other documents relating to these accounts.

ii. Nothing in subsection (2) of this section shall be construed as authorizing the Auditor-General to audit the accounts of or appoint auditor for government statutory corporations, commission, authorities, agencies, including all persons and bodies established by law by the Auditor-General shall:

   (a) Provide such bodies with:

   i. A list of auditors qualified to be appointed by them as external auditors and from which the bodies shall appoint their external auditors, and

   ii. A guideline on the level of fees to be paid to external auditors; and

   iii. Comment on their annual accounts and auditor’s report thereon.

   iv. The Auditor-General for the State shall have power to conduct periodic checks of all government statutory corporation, commissions, authorities, agencies, including all persons and bodies established by a law of the House of Assembly of the State.

   v. The Auditor-General for a State shall, within ninety days of receipt of the Accountant-General’s financial statement and annual accounts of the House State submit his report to the
House of Assembly of the State and the House responsible for public accounts.

vi. In the exercise of his functions under this constitution, the Auditor-General for a State shall not be subject to the direction or control of any other authority or person.

1.5 **Tenure of the Auditor-General**

Section 127 states:

1. A person holding the office of Auditor-General under section 126 (1) of this Constitution shall be removed from office by the Governor of the State acting on an address supported by two-thirds majority of the House of Assembly praying that he be so removed for inability to discharged the functions of his office (whether arising from infirmity of mind or body or any other cause) or for misconduct.

2. An Auditor-General shall not be removed from office before such retiring age as may be prescribed by Law, save in accordance with the provisions of this section.

1.6 **Companies and Allied Matters Act (CAMA) 1990**

S.357 CAMA 1990 requires auditors to make report to the members of the company on the financial statements of the company examined by the auditor. Here we shall consider pertinent provisions of the Act that affect the auditor, his status and responsibilities. Before proceeding to discuss the detailed provisions of the Act, let us understand that the three parties to an audit are:

a. Private Sector

b. Public Sector

The statutory auditor is that independent external person appointed to render or express an honest, independent and objective opinion on the
financial statements of an organization, as presented by the company’s directors, in pursuance of the provisions of CAMA 1990 for the private sector and the Auditor General in his capacity expresses his opinion on the financial statements of the parastatals as presented by the Accountant-General. This could be at Federal or State levels i.e. the public sector.

The shareholders are the owners of the company. They are the members of the company. It is them who pooled their resources together to fund the activities of the company. They bear the ultimate risk in the event of failure.

The directors act as professional managers. They are employed by the shareholders to manage the company’s resources. Periodically, the directors render account of stewardship. These accounts of stewardship are referred as the financial statements. It is pertinent to note that sometimes the directors are also members of the shareholders. This situation does not remove the statutory requirement of auditing the financial statements of the company provided the company is registered under CAMA 1990.

1.7 Appointment of the Auditors (S.357 CAMA 1990)

i. Each company shall, at each Annual General Meeting (AGM), appoint an auditor or auditors to audit the financial statements of the company. The appointed auditor(s) act from the conclusion of the AGM in which they were appointed to the conclusion of the next AGM.

ii. At any AGM, a retiring auditor, however appointed, will be reappointed without any resolution being passed at the AGM unless:
   a. he is not qualified for reappointment; or
   b. a resolution has been passed at that AGM appointing some other person instead of him or providing expressly that the retiring auditor shall not be appointed; or
   c. he has given the company notice in writing of his unwillingness to be reappointed.

iii. Where at an AGM, auditor(s) are appointed reappointed, the directors may appoint a person to fill the casual vacancy. The
company shall within one week of the powers of the director becoming exercisable, give written notice of that fact to the Corporate Affairs Commission (CAC).

iv. The directors are empowered to and may appoint the first auditors. The first auditors shall hold office until the conclusion of the first AGM. However:
   a. The company may at a general meeting remove any such auditor(s) and appoint in their place any other person who has been nominated for appointment by any member of the company. A notice of any such for appointment by any member of the company. A notice of any such nomination must have been given to the members of the company not less than fourteen (14) days before the date of the meeting; and
   b. If the directors fail to appoint the first auditors, the company may in a general meeting convened for that purpose, appoint the first auditors and there upon the powers of the directors to appoint the first auditors shall cease.

v. The directors may fill any casual vacancy in the office of the auditor. But while any such vacancy continues, the surviving or continuing auditor or auditors, if any, may act.

1.8 Qualification of Auditor (5.358 CAMA 1990)
   i. The provisions of the Institute of Chartered Accountants of Nigeria (ICAN) Act 1965 and the Association of National Accountants of Nigeria ANAN Act 76 of 1993 shall have effect in relation to audits carried out under CAMA 1990. This implies that the auditor must be a member of ICAN or ANAN and possesses practicing certificate.
   The following persons cannot be appointed as auditors of a company:
   a. an officer or servant of the company;
   b. a person who is a partner of or in the employment of an officer or servant of the company.
   c. A body corporate.

The above disqualification extends and applies to persons who in respect of any period of an audit were in the employment of the
company or were otherwise connected with the company in any manner.

i. a person shall also not qualify for appointment as an auditor of a company if he is, under (ii) above, disqualified for appointment as auditor of any other body corporate which is that company’s subsidiary or holding company, or would be so disqualified if the body corporate were a company.

ii. A firm is qualified as auditors of a company if, but only if, all the partners are qualified for appointment as auditors of it.

iii. No person shall act as auditor of a company at a time when he knows that he is disqualified for appointment to that office. And if an auditor of a company to his knowledge becomes so disqualified during his term of office, he shall thereupon vacate his office and give notice in writing to the company that he has vacated it by reason of that disqualification.

1.9 Remuneration of Auditor (5.361 CAMA 1990)
This section state that the remuneration of the auditors of a company:

i. In the case of an auditor appointed by the directors, may be fixed by the directors; or

ii. Shall subject to the above, be fixed by the company in general meeting or in such manner as the company in a general meeting may determine. It should be noted that auditor’s remuneration includes audit fees and expenses.

1.10 Removal of Auditors (S.362 and 5.364 CAMA 1990)

i. A company may by ordinary resolution remove an auditor before the expiration of his term of office, notwithstanding anything in any agreement between it and him (S.362).

ii. A special notice is required for a resolution at a general meeting of a company removing an auditor before the expiration of his term of office or appointing as auditor a person other than the retiring auditor (S. 364).

iii. On receipt of the notice, the company shall forthwith send a copy of it to the retiring auditor or the person proposed to be removed (S. 364).
iv. The retiring auditor or the person proposed to be removed has rights to make representations in writing of a reasonable length (S.364).

v. Where the retiring auditor or the person proposed to be removed has made any representations and requests their notification to members, the company shall, unless the representations where received by it too late for it to do so:
   a. in any notice of the resolution given to members of the company state the fact of the representation having been made; and
   b. send a copy of the representations to every member of the company to who notice of the meeting is or has been sent (S.364).

vi. If a copy and such representation is not sent out as required in.

vii. Above because that were received too late or because of the company’s default, the auditor may (without prejudice to his rights to be heard orally) require that the representations be read out at the meeting (S.364)

viii. Copies of the representations need not be sent out and the representations need not. Read out at the meeting if, on the application either of the company or of any other person claiming to be aggrieved, the court is satisfied that the rights conferred on the auditor are being abused to secure needless publicity for defamatory matter. The court may also order the company’s cost on the application to be paid in whole or in part by the auditor, notwithstanding that he is not a party to the application (S. 364).

ix. Where a resolution removing an auditor is passed at a general meeting of a company, the company shall within fourteen (14) days gave notice of that – fact in prescribed form to the commission and if a company fails to give the notice as required, the company and every officer of it who is in default shall be guilty of an offence and liable to a daily default fine of N100 (S. 362).

x. The above provisions do not deprive a person removed as an auditor from claiming compensation or damages payable to him in respect of the termination of his appointment as auditor or of any appointment terminating with that as auditor (S. 362).
1.11 **Resignation of Auditors**

S. 365 CAMA 1990 provides in relation to auditors resignation as follows:

i. An auditor of a company may resign his office by depositing a notice in writing to that effect at the company’s registered office; and may such notice shall operate to being his term of office to an end on the date of which the notice is deposited, or on such later date as may be specified in it.

ii. An auditor’s notice of resignation shall not be effective unless it contains either:
   a. statement to the effect that there are no circumstances connected with his resignation which he considers should be brought to the notice of members of the creditors of the company; or
   b. a statement of any such circumstances as are mentioned above.

iii. The auditor’s notice of resignation must, within fourteen (14) days, be sent by the company:
   a. to the commission; and
   b. if the notice contained a statement of any circumstances connected with the resignation, to every person who under the Act is entitled to be sent copies of the financial statements.

iv. The company or any person claiming to be aggrieved may within fourteen (14) days of the receipt by the company of a notice containing a statement of circumstances connected with the resignation, apply to the court for an order as set out under (v) below.

v. If on such application, the court is satisfied that the auditing is using the notice to secure needless publicity for defamatory matter, it may, by order, direct that copies of the notice need not to be sent out. The court may further order the company’s costs on the application to be paid by the auditor, notwithstanding that he is not a party to the application.

vi. The company shall within fourteen (14) days of the court’s decision, send to the persons mentioned in (iii) above:
   a. if the court makes an order as set out in (v) above, a statement setting out the effect of the order;
b. if not, a copy of the notice containing a statement of circumstances connected with the resignation.
c. If default is made in complying with the provisions of (iii), the company and every officer of it who is default shall be guilty of an offence and liable to a daily default fine of N100

On resignation of auditors, S.366 of CAMA 1990 further provides the followings:

i. Where an auditor’s notice of resignation contains a statement under S. 365, there may be deposited with the notice a requisition signed by the auditor calling on the director if the company for the purpose of receiving and considering such explanation of the circumstances connected with his resignation as he may wish to place before the meeting.

ii. Where an auditor’s notice of resignation contains such a statement, the auditor may request the company to circulate to its members before:
   a. the general meeting at which his term of office would otherwise have expired; or
   b. any general meeting at which it is proposed to fill the vacancy caused by his resignation or convened on his requisition, a statement in writing (not exceeding a reasonable length) of the circumstances connected with his resignation.

iii. If a resigning auditor request the circulation of a statement, the company shall (unless the statement is received by it too late for it to comply):
   a. in any notice of the meeting given to members of the company state the fact of the statement having been made; and
   b. send a copy of the statement to every member of the company to whom notice of the meeting is or has been sent.

iv. If the directors do not within twenty-one (21) days from the date of the deposit of a requisition under this section proceed to duly convene a meeting for a day not more than twenty-eight (28) days after the date on which the notice convening the meeting is given, every director who fails to take all reasonable steps to
secure that a meeting is convened as mentioned above shall be
guilty of an offence and liable to a fine of N500.

v. If a copy of the statement is not sent out as required because it
was received too late or because of the company’s default, the
auditor may (without prejudice to his right to be heard orally)
require that the statement shall be read out at the meeting.

vi. Copies of the statement need not be sent out and the statement
need not be read out at the meeting if, on the application of either
the company or of any other person who claims to be aggrieved,
the court is satisfied that the rights conferred by this section are
being abused to secure needless publicity for a defamatory
matter; and the court may order the company’s costs on such
application to be paid in whole or in part by the auditor,
notwithstanding that he is not a party to the application.

vii. An auditor who has resigned his office shall be entitled to attend:

a. the general meeting at which his term of office would
otherwise have expires; or

b. any general meeting at which it is proposed to fill the
vacancy caused by his resignation or convened on his
requisition to discuss the circumstances connected with his
resignation; and

c. to receive all notices or any other communications relating to
any such meeting which any member of the company is
entitled to receive; and

d. to do heard at any such meeting on any matters which
concerns him as former auditor of the company.

1.12 **Duties of Auditors (S. 359 CAMA 1990)**
The primary duty of the auditor of a company is to make a report to its
members on the accounts examines by the auditors, and on every
balance sheet and profit or loss account, and on all group financial
statements copies of which are to be laid before the company in a
general meeting during the auditor’s tenure of office.
The auditor’s report shall state the matters set out in schedule six (6) of
CAMA 1990. Schedule six of CAMA 1990 sets out those matters that
must be expressly stated in the auditor’s report as follows:
a. Whether the auditors have obtained all the information and explanations, which to the best of their knowledge and belief were necessary for the purpose of their audit.
b. Whether in their opinion, the company has kept proper books of accounts and proper returns adequate for the purposes of their audit have been received from the branches not visited by them.
c. Whether the company’s balance sheet and profit or loss account are in agreement with the books of accounts and returns.
d. Whether in their opinion and to the best of their knowledge the accounts give the information required by the Act and the manner required
e. Whether in their opinion the account gave a “true and fair view”.

In the case of the balance sheet, if the state of the company’s affairs as at the end of the financial year; and

In the case of the profit or loss account, of the profit or loss for the financial year.

f. In the case of a holding company submitting group accounts whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of the Act so as to give a true and fair view of the state of affairs and the profit or loss of the company and its subsidiaries so far as concerns members of the company.

iii. In addition to the report made to the members, the auditor, in the case a public company, also has a duty to make a report to an audit committee established by the company.

On the duties of the auditor, S. 360 CAMA 1990 further provides that the auditor should:

i. Carry out such investigations as may enable them to form an opinion as to the following matters:
   a. whether proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them;
b. whether the company’s balance sheet and (if not consolidated) its profit or loss account are in agreement with the accounting records and returns; and

ii. State so in their report if in their opinion proper returns have not been received from branches not visited by them and if the balance sheet and (if not consolidated) the profit or loss and account are not in agreement with the accounting records and returns, the auditors shall the fact in their report.

iii. If the requirements of Parts v and vi of schedule 3; Part I to III of schedule 4 to the Act are not complied with in the accounts, it shall be the auditor’s duty to include in their report, so far as they are reasonable able to do so, a statement giving the required particulars.

iv. It shall be the auditor’s duty to consider whether the information given in the director’s report for the year for which the accounts are prepared is consistent with those accounts; and if they are of opinion that it is not, they shall state that fact in their report.

1.13 **Rights of the Auditor**
This is covered under S. 360 to S.364 of CAMA 1990 and confers the following rights on the auditor:

i. Right of access, at all time, to the company’s books of accounts and vouchers (S.360);

ii. Right to acquire from the company’s officers such information and explanations as he thinks necessary for the performance of the auditor’s duties (S. 360);

iii. In relation to the company’s general meetings held during his tenure, right:
   a. To attend such meetings;
   b. To receive all notices of the other communications relating to any such meetings which a member of the company is entitled to receive, and
   c. To be heard at any such meetings, which they attend on any part of the business of the meetings, which concerns them as auditors (S. 363).

iv. Under S. 364 auditors have rights where there is a proposed resolution for their removal, to:
a. Receive a copy of the special notice required for a resolution at a general meeting of the company to remove the auditor;
b. To make representation writing of a reasonable length; and
c. To request that the representation be sent to members of the company.

v. Under S. 363, an auditor of a company who has been removed has rights to attend:
a. The general meeting at which his term of office would otherwise have expired; and
b. Any general meeting at which it is proposed to fill the vacancy caused by his removal; and
c. To receive all notice of, and other communications relating to, any such meetings which any member of the company is entitled to receive; and
d. To be heard at any such meeting which he attends on any part of the business of the meetings, which concerns him as former auditor of the company.

1.14 **Powers of Auditors in Relation to Subsidiaries (S. 367 CAMA 1990)**

Where a company has a subsidiary, then:

i. (a) if the subsidiary is a body corporate incorporated in Nigeria, it shall be the duty of the subsidiaries and its auditors to give the auditors of the holding company such information and explanations as these auditors may reasonably require for the purposes of their duties as auditors of the holding company.

(c) in any other case, shall be the duty of the holding company, as required by its auditors to do so, to take all such steps as are reasonably open to it to obtain from the subsidiary such information and explanation as are mentioned above.

ii. if a subsidiary or holding company fails to comply with the above provisions, the subsidiary or holding company and every officer of it who is in default shall be guilty of an offence and liable to a fine; and if an auditor fails without reasonable excuse to comply with (a) above, he shall be guilty of an offence and so liable.

1.15 **False Statements to Auditors**

This is contained in S. 369 CAMA 1990, which states that:
i. An officer of a company commits offence if he knowingly or recklessly makes to a company’s auditors statement (whether written or oral) which:
   a. conveys or purports to convey any information or explanation which the auditors require, or are entitled to require as auditors of the company; and
   b. is misleading, false or deceptive in a material particular.
ii. Such an officer shall be liable to imprisonment of fine of N500 or both.

1.16 Auditors’ Liabilities
CAMA 1990 requires the auditor to state whether a set of financial statements give a true and fair view. In doing so, the auditor should exercise reasonable skill, care and diligence before expressing such opinion. The Act does not define the amount of work to be done or the degree of diligence required to express this opinion. Specifically, S. 368 of CAMA 1990 provisions on liability of auditors for negligence are:
   i. A company’s auditor must exercise all such diligence and skill as is reasonably necessary in each particular circumstance.
   ii. Where a company suffers loss or damage as a result of the failure of its auditors to discharge the fiduciary duty imposed on them as set out above, the auditor shall be liable for negligence: and the directors can institute an action for negligence against him in the court.
   iii. If the directors fail to institute an action against the auditor, any member may do so after the expiration of thirty day notice to the company of his intention to institute such action.

Similarly, S. 643 of CAMA 1990 provides that: if any person in any return, report, certificate, balance sheet or other documents required by or for the purpose of any of the provisions of this Act willfully makes a statement which is false in any material particular knowing it to be false shall be guilty of an offence and liable to two years imprisonment or in lower court N1000 fine or four months imprisonment or both.

1.17 Banks and Other Financial Institutions
Act (BOFIA) 1991
S. 29 of BOFIA 1991 covers the appointment power and report of an approved auditor and provides that: Every bank shall appoint annually a person approved by CBN and referred to as “approved auditor;” whose duties shall be to make to the shareholders a report upon the annual balance sheet, and profit or loss account or the bank and every such report shall contain statements as to the matters and such other information as may be prescribed from time to time by Central Bank of Nigeria.

The appointed auditor shall be an auditor who is:

a. Having any interest in a bank otherwise than as a depositor; or
b. Who is a director, officer or agent of a bank; or
c. Which is a firm in which a director of a bank has any interest as partner or director; or
d. Who is indebted to a bank; shall not be eligible for appointment as the approved auditor of any bank.

Any person appointed as an approved auditor who subsequently:

a. Acquires such interest;
b. Becomes a director, officer or agent of that bank, or
c. Becomes indebted to a partner in a firm in which a director of a bank is interested as partner or director shall cease to be such auditor:

1.18 Insurance Act 1997

The provisions of CAMA 1990, BOFIA 1991, NAICOM Act 1997 and insurance Act 1997 are all relevant statutory provisions in the audit of insurance companies. However, where there is a conflict between CAMA 1990 (and other non-insurance statutory provisions) and any insurance statutory provision, the insurance law supersedes. At the conclusion of the insurance audit, the insurance Act 1997 states that the auditor must issue a certificate signed by him stating whether:

i. He has obtained adequate information from the books and records;

ii. The books of the insurer have been properly kept and the affairs and transactions of the insurer have been correctly recorded;
iii. The accounts and balance sheet are in accordance with the information given to him for the purpose of the audit;
iv. The accounts and balance sheet are in accordance with the applicable provisions of CAMA 1990 and Insurance Act No. 2, 1997;
v. The balance sheet and the profit or loss account, respectively give a true and fair view of the financial position of the insurer.

In addition to the above, an auditor is required to issue his certificate on prescribed form 20 under the Insurance Act

1.19 **Regulatory Framework**
The bodies that control the accounting profession have issued a number of recommendations and standards. These regulatory statements come in form of Auditing Standards and Auditing Guidelines.

1.20 **Auditing Standards**
Auditing standards are those statements that have been approved for issue by the control of the bodies that control the accountancy profession. Auditing standards lay down the basic principles and practices which auditors are expected to follow in the conduct of an audit. It is therefore mandatory for members in public practice to apply the relevant prescribed auditing standards when an audit is carried out.

It is however not practicable to establish a code of rules and procedures that will be elaborate enough to take care of all conceivable circumstances that may be encountered by an auditor. Such a code will, if available, be restrictive, and will therefore not promote developments in business and financial practices. However, when applying the auditing standards, the auditor must exercise his judgment in determining the auditing procedures applicable that will reasonably enable him to express his opinion on the financial that will reasonably enable him to express his opinion on the financial statements. The introduction of auditing standards may be viewed as a reaction by the auditing profession to criticism of auditors as evidenced by will-publicized scandals in respect of the published accounts of such companies as Worldcom, Erron, Cardbury, Distressed banks etc, all of which, in varying degrees caused embarrassment to the profession. The standards have, however, been criticized on the following ground:

i. They merely reiterate what is already “best practice”;}
ii. The policing of auditing standards by the profession will be extremely difficult if not impossible;

iii. Inclusion in the audit report of a statement to the effect that auditing standards have been complied with can be viewed as unnecessary since it must be taken that those performing the audit must exercise the professional standards formalized in the auditing standards if they are to perform their duties in compliance with current professional ethics, expectations and statute;

iv. The standard on qualified audit reports is viewed by those outside the profession as misdirected in as much as auditors and their clients should be more concerned with presenting accounts that do not require qualification than with constructing detailed rules for and forms of qualification.

1.21 Auditing Guidelines

These are those guidelines that have been approved for issue by the Councils of the professional bodies that control the accountancy profession and practice. The auditing guidelines are designed to help the auditor apply the auditing standards. In particular, they give guidelines on:

i. Procedures by which the auditing standards may be applied;

ii. The application of the auditing standards to specific items appearing in the financial statements;

iii. Techniques currently being used in auditing;

iv. Audit problems relating to particular commercial or legal circumstances or to specific industries;

v. The application of auditing standards to particular sector, industries or service organizations; and;

vi. Other matters relating to the proper performance of audit work.

Auditing guidelines are meant to be persuasive. There may be occasions when the auditor considers it appropriate to depart from the guidelines. The auditor should be prepared to explain the departure, if called upon to do so. Where explanatory notes were added to text of auditing guidelines. Existing pronouncements on auditing issued by various accountancy bodies have the same status as the auditing guidelines and will remain in force until withdrawn.
Auditors are expected to apply auditing standards and guidelines in the audit of any financial statements for the period on or after the date stipulated in each standard or guideline. It is recognized, however, that good practices have been established in the accountancy profession most of which are already embodies in the International Auditing Guidelines of IFAC.

The auditing standards or guidelines issued by a professional body in Nigeria will normally conform with the international standards and guidelines issued by IFAC. But where a standard or guideline issued by the professional accountancy body conflicts with IFAC standard or guideline, the local professional body’s standard or guideline will prevail because it is deem to understand the peculiarity of Nigerian companies or matters betters than IFAC.

**Auditing Guideline on Engagement Letter (AGI)**

This guideline gives guidance on one of the procedure to be followed before the commencement of an audit and is written in the context of audit appointments in Nigeria. The principles contained in this guideline should also be followed in the case of non-audit engagements. In such a case, if surely accounting services are being provided to a client such as a sole trader or partnership the engagement letter should make it clear that these services will be performed without any audit work being carried out. The Engagement Letter in whatever instance must be explicitly clear about the scope of the assignment and must contain major expectations in both sides.

**Auditing Guideline: Prospectus and the Reporting Accountant (AG2)**

The directors of the company are, solely responsible for the profit forecast and for the assumptions on which it is based. In his report, the reporting accountant should avoid giving any impression that the forecasts is accurate since profit forecasts, by their nature, are based on subjective judgments. The reporting accountant should however; review the underlying assumptions to ensure there are no material omissions or unrealistic assumptions.
The International Federation of Accountants (IFAC)
IFAC was established at the International Congress Accountants in Munich in 1977 to “develop and enhanced a coordinated worldwide accountancy profession with harmonized standards”. Through cooperation with member bodies, regional organizations, IFAC initiates, coordinates and guides efforts to achieve international, technical, ethical and educational guidelines for the accountancy profession.

One of the most importance roles of the IFAC is the issue, through its International Auditing Practice Committee (IAPC), of international auditing guidelines. To date the following international auditing guidelines have been produced:

i. The objectives and scope of the audit of financial statements.

ii. Audit engagement letters

iii. Basic principles governing an audit

iv. Planning

v. Using the work of another auditor

vi. Study and evaluation of the accounting and internal control in connection with an audit.

Supervision and Monitoring of Auditors
A standard provides a convenient yardstick for measuring performance and assessing efficiency. The existence and use of generally accepted auditing standards and procedures would promote acceptability and confidence in the financial statements audited by the members of the accounting profession in public practice.
CHAPTER 2
AUDITORS INDEPENDENCE

2.0 INTRODUCTION
The best known way of guarantying the independence of auditors is by securing the instrument for the appointment, tenure and retirement in the public service. For those auditors in private practice, their individual competence and adherence to the ethics of the profession serve as their safety valves. Millichamp (1996) opined that “The overall rule of Auditor’s independence is that an auditor must always approach his work the integrity and objectivity. He must approach-his work in a spirit of independence of mind”.
Auditor independence refers to the independence of the auditor from parties, other than shareholders, that have an interest in the financial statements of an entity. It is essentially an attitude of mind characterized by integrity and an objective approach to the audit
process. The concept requires that auditor to carry out his work freely and in an objective manner.

The purpose of an audit is to enhance the credibility of financial statements by providing reasonable assurance from an independent source that they present a true and fair view. This objective will not be met if users of the audit report believe that the auditor may have been influenced by other parties, more specifically company directors. Auditor independence is the most important factor in establishing the credibility of the audit opinion.

In the case of Auditor-General of each tier of government, he is the officer, under the relevant sections of the constitution of a country responsible for the audit and report on the Public Accounts of the Government. He also audits and reports on all persons and bodies by law. These establishments are entrusted with the collection, receipt, custody, issues or payment of Federal Public monies, or with the receipt, custody, issue, sale, transfer, or delivery of any stamps; securities, stores, or other property of the Government. The Auditor General is also responsible for the certification of the Annual Financial statements prepared by the Accountant General. The Auditor General has the authority to examine and ascertain in such manner as he may deem fit the accounts relating to public funds and property. The Auditor General is entrusted with the audit of accounts of statutory corporations, state enterprises, and public commercial institutions of the government. He is further authorized by statute to express his opinion on whether: The account have been kept properly; The public monies have been fully accounted for; The rules and procedures applied in the accounting were sufficient to secure an effective check on the assessment, collection ad proper allocation of revenues; Monies have been spent for the purposes for which they were appropriated; Expenditures have been made as authorized; The public accounts provide a true and fair view of finances of the government and the individuals bodies to which they refer; The financial transactions of governments and public bodies comply with relevant legislation, the authority of the National Assembly/Parliament and regulations issued by the relevant competent body; The financial affairs of government and public bodies have been managed with due regard to probity, the
government, public bodies and public monies have been managed with due regard to value for money and that officers have made the best use of the resources for which they are responsible. A down to earth truth is embedded in the 1999 constitution regarding the independence of Auditor General and of the State which shall be discussed later in this chapter.

2.1 The Basis for Independence of Auditors
Auditor’s independence is commonly referred to as the cornerstone of the auditing profession since it is the foundation of the public’s trust in the accounting profession. Since 2000, a wave of high profile accounting scandals has cast the profession into the limelight, negatively affecting the public perception of auditor independence. There are two important aspects to independence which must be distinguished from each other: independence in fact (real independence) and independence in appearance. Together, both forms are essential to achieve the goals of independence. Real independence refers to the actual independence of the auditor, also known as independence concerns the state of mind an auditor is in, and how the auditor acts in/deals with a specific situation. An auditor who is independent decisions even if there is a perceived lack of independence present, or if the auditor is placed in a compromising position by company directors/the executive. Many difficulties lie in determining whether a auditor is truly independent, since it is impossible to observe and measure a person’s mental attitude and personal integrity. Similarly, an auditor’s objectivity must be beyond question, but how can this be guaranteed and measured? This is why independence in appearance is of such importance. It is essential that the auditor not only acts independently, but appears independent too. If an auditor is in fact independent, but one or more factors suggest otherwise, this could potentially lead to the public concluding that the audit report does not represent a true and fair view. Independence in appearances also reduces the opportunity for an auditor to act otherwise than independently, which subsequently adds credibility to the audit report.

2.2 Independence of Auditor-General
Types of independence
There are three main ways in which the auditor’s independence can manifest itself. In general terms which are equally essential to the Auditor-General.

- Programming independence
- Investigative independence
- Reporting independence

Programming independence Wikipedia (2007) essentially protects the auditor’s ability to select the most appropriate strategy when conducting an audit. Auditors must be free to approach a piece of work in whatever manner they consider best. As an entity grows and conducts new activities, the auditor’s approach will likely have to adapt to account for these. In addition, the auditing profession is a dynamic one, with new techniques constantly being developed and upgraded which the auditor may decide to use. In recent time most entities are computerized and the auditor must be computer literate/compliant. The strategy/proposed methods which the auditors intend to implement cannot be inhibited in any way.

While programming independence protects auditors’ ability to select appropriate strategies, investigate independence protects the auditor’s ability to implement the strategies in whatever manner they consider necessary. Basically, auditors must have unlimited access to all company information. Any queries regarding a company’s business and accounting treatment must be answered by the company. The collection of audit evidence is an essential process and cannot be restricted in any way by the client company.

Reporting independence protects the auditors’ ability to choose to reveal to the public any information they believe should be disclosed. If company directors have been misleading shareholders by falsifying account information, they will strive to prevent the auditors from reporting this. It is in situations like this mean auditor independence is most likely to be compromised.

The independence of Auditor-General is similar to that of External Auditors of private sector but the degree of independence of the Auditor General is higher in that, it is a constitutional matter whereas that of External Auditors are under the Corporate Laws of the Nation. However, the idea of independence is universal and a global norm. so
we would attempt to bring to bare what the ethics of the accountancy profession says about the independence of auditors.

The independence of the Auditor General must always be specified in certain sections of a country’s constitution. In accordance with those sections, he is an independent person, who in the exercise of his duties and powers under this constitution is not subject to the direction or control of any other authority or person. These sections of the constitution ensure that the Auditor General does not work under pressure or interference from the Head of State, the President, Powerful Politicians, the Parliament or the Chief Judge. He is not to be directed or instructed on how or where to do his job. The Auditor General is immune from legal prosecution in the normal discharge of his duties during the period of his office or after he has left office. In some countries, before taking up his duties, the Auditor General shall take an oath, administered by the speaker of Parliament or Senate President, pledging to perform honesty and impartially the duties of this office abide by the laws guiding Audit function, and uphold the constitution of the country.

The salary, fringe benefits and other conditions of service for the Auditor General are always the same as those for the Chief Justice of the country. An Auditor General is expected to have an independent mind. Therefore, his objectivity must be beyond question when performing his duties or in the exercise of his powers. The independent mind of the Auditor General or his Representative could be jeopardized if:

- He is not professionally qualified and incompetent to face the challenges of his duties.
- He receives undue favour from his client; He accepts loans or gives loan to his client;
- He enters into family, Personal or social relationship with a client;
- His client has influenced his appointment as an Auditor-General;
- The Auditor-General shall not hold a political position and may not have a direct official role in any private or professional body or any activity he could benefit from using his position as the Auditor-General;
• He shall divest himself of any commitments, obligations, or investments, which would prevent a real or perceived conflict of interest.

The Auditor General however has the right to act as an officer of collaborate with, or participate in the activities of professional auditing accounting and standard-setting bodies, whose activities are not in conflict with the roles and operations of the audit office.

On leaving office he has absolute freedom of association. In Nigeria, the independence of the auditor general for the federation is provided for in section 85 (6) of the 1999 constitution. This section of the constitution does not empower any person, this section of president, the national assembly, the chief judge or any power politician to give the auditor general instructions on how or where to carry out his duties. Constitutionally, the Auditor-General is very independent in Nigeria. Let us demonstrate the import and weight of this independence.

Sometime in 2002, the federal government of Nigeria announce that, considering the huge amount of funds it released to the senate, the Federal Ministry of Works and Housing and some other key ministries, the Auditor-General for the Federation would commence the audit of the records of these ministries with a view to determining the degree of practice of accountability, probity, transparency and value-for-money, and adherence to due process by the accounting officers of these entities. The senate did not feel comfortable with this announcement and therefore drew the attention of the president to the provision of section 85 (6) of the Nigerian constitution which states “in the exercise of his functions under this constitution the Auditor General shall not be subject to the constitutional or control of any other authority or person” and accused him of a constitutional breach. The senate’s argument was that the announcement was tantamount to directing or instructing the Auditor General on where to do his job.

The senate therefore threatened to set into motion constitutional processes to remove the president from office should the Auditor-General carry out that instruction. The executive intention was silenced. The Auditor-General cannot be competent enough to know what to do, how to do and where to do.
The integrity of every audit engagement is the independence of the auditor. Independence as ascribed to the auditor is not a mere lip service. It is the public expectation and the icon of professionalism. Independence in relation to the auditor is a state of the mind. This is such that the auditor has no inhibitions or restrictions. He should be free to think the way he chooses, to ask whatever questions or make any observations he considers appropriate without the underlaying fear of being misunderstood or misinterpreted. His position as auditor in all cases and under all circumstances must be secured such as not to inhibit or hampers his independence. Even the nonpayment of his fees should not constitute a constraint to his independence. The International Auditing Guideline (IAG3) specifies independence as one of the basic principles of auditing. Hence independence is assumed wherever auditing is undertaken.

Both in statutory audits and private engagements, the auditor is expected to exercise independence in the performance of his job. This is necessary for him to give an objective and unbiased report for all statutory audits, the auditor is considered to be independent.

Practically however, it is impossible for the auditor to be absolutely independent as envisaged in the law since he needs to maintain a good relationship with the Directors/Board Members who actually pay his fees. Nonetheless, the independence of the auditor is very important for any successful audit.

The independence of the auditor is not just a matter of fact. It is also a matter of the attitude of his mind and the expression of his opinion. By his conduct, he must be seen to be truly independent.

2.3 Auditors Independence in the Private Sector
The shareholders become more confident in the validity and reliability of financial statements if they are satisfied that the auditor conducted his auditing functions objectively and honestly.

Consequently, the Companies and Allied Matter Act 1990 has in various ways legislated for the protection of the auditors independence,
as contained in Sections 357 – 369 of CAMA 1990 already discussed in Chapter 1.

2.4 **Audit Committees**
In order to further protect the auditor’s independence in public companies, the Companies and Allied Matters Act, 1990, requires public companies to set up audit committees whose duties, inter alia, comprise the following:

- The appointment of external auditors; assisting auditors in obtaining information; Reviewing the audited accounts of the external auditors;
- Evaluating the adequacy of internal controls in the company;
- To ascertain whether accounting and reporting policies of the company are in accordance with legal requirements and agreed practices;
- To review the scope and planning of audit requirements;
- To review the findings on management letters in conjunction with the external auditor and departments responses there on.
- To make recommendations to the Board of Directors on matters relating to removal and remuneration of auditors.
- Authorize the internal auditor to carry out investigations into any activities of the company.

The formation rules for audit committees are set out in Sec. 359, subsection 5 of the Act:

- The membership shall be a minimum of two and a maximum of six members; no member shall be entitled to remuneration.
- A shareholder can nominate a proposed member of the committee by giving 21 days notice of such nomination to the secretary of the company.
- Equal representation from the shareholders and non executive directors.

2.5 **Drawbacks of Audit Committees:**
The concept of audit committees is to protect the independence of the auditor, but it is not without its own draw backs:
- The membership is, and can be influenced by the executive directors, especially where the company produces vital commodities such as beer, cement, etc.
- Committees generally are too slow to convene, and too long to come out with a unanimous decision.
- Politics, personality clashes and in-fighting can mar the progress of audit committees.
- The Act provides for the formation of Audit Committees, but fails to specify the academic and or professional qualifications of members; it is therefore possible that some of the members may not be experienced enough for the task before them.
- The Act prohibits remuneration to members of Audit Committees. It therefore becomes doubtful as to whether the members will be fully committed and independent. Members may not want to be harsh to point out audit flaws especially where such findings will offend directors, from whom, they know, they will benefit in one way or the other.

All the above setbacks notwithstanding, audit committees have been found, useful, and witnessed acceptance worldwide, especially in United States, Great Britain, and Nigeria.

2.6 Independence and Professional Bodies
Professional bodies are as much concerned about the auditor’s independence as the shareholders, because it is their reputation that will be tarnished if auditors keep compromising their independence. Consequently, professional bodies now issue ethical standards which every member should comply with in order to steer away from the pressures that could erode his independence. Some of these guidelines are as stated below:

i. Fees: The fees which the auditor derives from one client should not be more than 16% of his total annual audit fees, else he becomes slavish to that particular client in the fear of losing out.

ii. Personal Relationship: Close relationships and familiarity with client’s staff should be avoided; audit staff should be rotated over the years to avoid development of close relationships.

iii. Financial Interest: Seeking financial assistance from the client should be avoided, except in rare cases, where it is the client’s
normal business to give financial assistance. Similar prohibitions should apply in relation to the client company.

iv. Acceptance of good and service: This should also be avoided by the auditor. Any gift that will induce the auditor to water down his report should be politely rejected.

v. Conflict of Interest: The auditor should avoid putting himself in apposition of conflicting interest’s e.g carrying out staff requirement and auditing the same staff for a client installing an accounting system and auditing the same for a client, and some others. The ethics of accountancy profession clearly prohibits the auditor form doing anything that could jeopardize this work.

vi. Incoming and Outgoing auditors: S.363 provides the auditor with many rights; Professional bodies require an incoming auditor to find out the reasons for replacing the outgoing auditor; this is a way of protecting the independence of both auditors.

2.7 The Impairments to Auditor’s Independence
The above guidelines and legislations notwithstanding, the auditor should recognize certain circumstances likely to erode his independence, and steer from such positions as safely as possible. Some of these circumstances are considered below:

(a) The small company and the small audit firm:
This situation tends to build up a very close relationship, as the tendency is for the small firm to struggle to keep as many clients as possible. In the process, he renders all sorts of services, e.g. incorporation, recruitment, staff training, systems design, auditing and tax computation for one and the same client. This undesirable situation should be avoided. It becomes friendly o family affairs. The auditor can no longer perform his functions as a professional. He will have to compromise on many grounds even when he knows it is unethical.

(b) The large company and the small audit firm:
The danger here is the auditors submission to manipulations for the fear of losing a big client, from who accrues a big fee. Many a time, the auditor struggle to meet up with the requirements of the law and
professional standards. In order to remain relevant, the auditor submits to directors’ dictates.

(c) The small company and the large audit firm: The tendency here is for the client to look up to the auditor for assistance in all aspects of his business, even in rendering book-keeping services, secretarial, training trusteeship, project management, etc. This can lead to unnecessary encroachment on the auditor’s independence.

(d) The large company and the large audit firm: The approval is to audit the large company on a continuous basis, and to deploy an audit staff to the company’s audit for exposure and training purposes. In the process, both staffers may get too familiar, and begin to collude. In the extreme cases, such audit staff can change employment to the client’s company.

(e) In all the above cases, it is not necessarily the provisions of the Law or the ethical guidelines that matter. What matters most even without these guidelines are the conscience and the integrity of the auditor as a person. The golden rules of the accountancy profession coined as ethical code of conduct include: Integrity, confidentiality, competence, objectivity and independence.

2.8 **Improving the Auditor’s Independence:** The auditor’s independence is so important to all groups (both the owners and users) of his report that none of them has relented in his efforts to finding a lasting solution to the threat on the auditor’s independence. Consequently a number of suggestions have been made in recent years towards the improvement of the auditor’s independence. These include the followings:

(a) Appointment by government or government agent such as Corporate Affairs Commission: Sec. 357 (ii) of CAMA 1990 states that were the Directors fail to fill vacancy for Auditor, the Corporate Affairs Commission will do. There is a belief or opinion that shareholders are often concerned about their returns and about who audits their companies, especially in public companies involving a large number of shareholders. This class of people is of
the view that a more, well informed body such as the Corporate Affairs Commission should better make the appointment of auditors. This will be okay except for the main argument against this move that such appointment is likely to be more costly and witness unnecessary delay and technical complications.

(b) Legal prohibition of financial interest in client companies: There is yet no legal prohibition for an auditor to hold financial interest in his clients companies. At the moment, that prohibition is persuasive and merely ethical. Now that corruption has eaten deep into our entire systems, one can advocate for legal prohibition of auditors from having financial interests in the client’s business.

(c) Rotation of auditor’s appointments: It has become a nightmare that endless automatic reappointment of auditors to office erodes independence. It is therefore suggested that the government legislate that audit appointments should last for a specific period, may be three or five years after which another auditor is appointed. This is now the position in some States of the Federation for Government audits and para, status.
CHAPTER 3
STARTING A NEW AUDIT

3.0 INTRODUCTION
It should be made clear that an audit involves the examination of and the expression of an opinion on the financial statements of an enterprise by the appointment of an auditor. In pursuance of that appointment and in the case of a statutory audit, that the matters to be reported upon are laid down in the Companies and Allied Matters Act, 1990.

Before commencing any audit work. And Auditor should agree in writing, vide an engagement letter, the precise scope and nature of the work to be undertaken

3.1 Engagement Letter
An engagement letter is, therefore, a letter written by an auditor to his client specifying the scope and nature of work he is going to do. It is a form of letter of agreement between the Auditor and his Client.

3.2 When to Send a Letter of Engagement
1. To all new clients before any professional work has been started.
2. To all existing clients who have not previously had such a letter.
3. When there is a change of circumstances e.g new management, extra duties, a significant new auditing guideline. It shall be reviewed every if there is a need for a revised letter.

4. In the case of a group of companies, an engagement letter shall be sent to such member company to the group that is to be audited by the firm. The letter should make it clear that the client, not the auditor, is responsible for the preparation of financial statements that give a true and fair view and maintaining records and a system of internal control which is appropriate to the enterprise.

3.3 Contents of a Letter of Engagement
The letter of engagement should contain the following items:

1. Frauds or Irregularities:
The responsibility for the prevention and detection of fraud and error rests with management (Directors) and this responsibility is fulfilled mainly through the implementation and continued operation of an adequate system of internal control. The engagement letter should clearly state that it is not the main purpose of an audit to discover frauds and irregularities but to express an opinion and that the examination should be relied upon to disclose all irregularities that may exist. The auditor should explain that he will plan his audit so that he has a reasonable expectation of detecting material misstatements in the financial statements resulting from irregularities and frauds. If a special examination for irregularities, which goes beyond the scope of the audit, is required by the client then this should be specified in the engagement letter.

2. Management Representation:
Where appropriate, the auditor should confirm that, prior to completion of his audit, he may seek management’s representation on certain matters affecting the financial statements.

3. Accounting, Taxation and other Services:
The auditor may undertake services for his client in addition to his statutory duties as auditor. The letter should delineate clearly the accountant’s and the client’s responsibilities in relation to these services to the day to day book keeping, the maintenance of all accounting records and the preparation of financial statements.
If purely accounting services are being provided to a client, such as a sole trader or partnership, the letter of engagement should make it clear that this is done without any audit work being carried out. In the case of taxation services, the responsibility for the various procedures such as the preparation of tax computation and the submission of returns to the relevant authorities should be clearly set out either in a section of the main letter, or in a separate letter where necessary.

4. Fees:
Mention should normally be made of fees and the general basis on which they are computed and rendered. Although the Audit Committee would here agreed with the Auditor but the Auditor should spell out the payment schedule.

5. Agreement of Terms:
The client should be asked to signify his agreement to the contents of the engagement letter by signing a copy and returning the same to the auditor.

6. Indication that the auditor will report area of weaknesses.

3.4 Purposes of the Letter of Engagement

The Purposes of an Engagement Letter Are:

1. To define the extent of the auditor’s responsibilities.
2. To minimize the possibility of any misunderstanding between the management of the enterprise and the auditor.
3. To document and confirm the auditor’s acceptance of the appointment, the objectives and scopes of the audit.
4. To specify the extent of his responsibilities, and the form of his reports.
5. To inform and educate the clients of other functions performed by the auditor.
6. To confirm in writing any verbal arrangement.

3.5 Acceptance of Appointment:
Before accepting the appointment of a new audit, the following factors must be given elaborate consideration:
1. (Legal S. 358 CAMA 1990)
- The auditor must be a member and hold the practicing certificate of any approved accountancy profession body i.e (ICAN or ANAN) in Nigeria.
- Must not be an officer or servant of the company.
- Must not be a partner or employee or an officer servant of the company.
- Must not be a body corporate.

2. Ethical:
- Must not accept appointment if too great a proportion of the gross fees of the practice is derivable or to be derived from a particular client.
- Where there is personal relationship by blood or marriage. Where there financial involvement in the affairs of the client’s enterprise.
- Where loans are received from such a client. Where there is conflict of interest for example, advising a client’s company in dispute with another client’s company.

3. Practical:
Ability of the audit firm to discharge its audit duties efficiently and effectively.
Availability of the needed expertise, for example, computing.
- Availability of staff with appropriate qualifications and experience to carry out the duties.

3.6 Planning the Audit
The factors that should be considered when planning a new audit are:
(a) The social, economic and technological events, which have effect on the business.
(b) The accounting system and degree of reliance on internal control system of the organization.
(c) The number of audit staff needed to carry out the audit.
(d) The skills and experience and audit staff need to acquire.
(e) The effect of any changes in legislation of accounting practices;
(f) The timing of audit visit;
(g) Other works to be performed in addition to the audit.

3.7 Incoming Auditor:
Before accepting appointment of a new auditor, the incoming auditor should carry out the following steps:

a. The proposed auditor should seek client’s permission to contact the existing auditor.

b. If the permission is declined, he should refuse the appointment.

c. If permission is given, the proposed auditor should request, in writing, to existing auditor of any reason, which the existing auditor is aware of, that will preclude him from accepting the appointment.

d. Before replying the question in (3), the existing auditor should seek for the client’s permission to do so.

e. If permission in (4) is not given, the existing auditor should inform the proposed auditor, who in turn, should decline the appointment.

f. If permission in (4) is given, the existing auditor should supply all relevant information to the proposed auditor.

3.8 The Reason for Seeking Professional Clearance is:

(a) It protects the existing auditor, where the change is proposed, to interfere with his professional duties.

(b) It protects the proposed auditor and the member of the company who may not be fully aware of the circumstances of the proposed change.

(c) It serves as professional courtesy between accountants in private practice so as to ensure that a change of appointment is properly carried out.
CHAPTER 4

PLANNING AND CONTROLLING AN AUDIT.

4.0 Introduction

It is very important to consider the issues and matters that the auditor must put into consideration in planning and controlling an audit assignment. Such issues and matter will include the following as:

i. Review the client’s operational background with regard to its financial, legal and personal positions;

ii. Assessment of the nature of client’s business and the industry in which it operate;

iii. Establishing the materiality levels, statistical sampling and sampling size;

iv. Ascertaining the area of audit risk and the consideration of inherent risk, control risk and detection risk;

v. Analyzing the consistency of financial and related information by substantive analysis (including analytical review);

vi. Evaluating the Management Information System (MIS);

vii. Designing, Documenting and Re-evaluation of the audit plan;

viii. Evaluating the level of reliability to be placed on internal audit;

ix. Reviewing the relationship between external and internal audits Allocation and supervision of work and responsibilities.

x. Allocation and supervision of work and responsibilities.

4.1 Background of client’s Business Operations
In doing this, the auditor should consider background information about the client operational background in the following ways:

i. Current financial statements and other relevant information;

ii. The auditor’s knowledge of the industry in which the client operates;

iii. Information about the integrity and business reputation of the prospective client’s stakeholders and management and their relationship with the outgoing or retiring auditors, in case there exists such situation.

The evaluation of management and stakeholders gives the auditor an indication of whether they are responsible and reputable people and whether the auditor may reasonably expect meaningful representations and full disclosure during the engagement. The level of the auditor’s existing knowledge about management and stakeholders influences the extent to which the auditor undertakes strategies for the collection of useful information about the company and its operations.

Previous auditor(s): Before agreeing to an appointment, the auditor usually enquiries of the predecessor auditor, if any. The auditor shall first explain to the client the need to make such enquiries and request permission to do so. The nature of issues to be discussed may include the following, as appropriate:

i. The integrity of the client’s Board of Directors/ Management and the major promoters

ii. Problems or areas of conflict with management as to accounting principles, audit procedures or other significant matters;

iii. The previous Auditor’s willingness to continue to provide professional services to the client.

iv. The intended change(s) to be effected during that audit exercise e.g. introduction of computers, Asset Registers etc.

4.2 Nature of client’s business and industry

To be able to identify the critical audit objectives and to determine the focus of the audit work, the auditor needs to understand the client’s business and the current risks facing the client’s business. The auditor obtains useful knowledge of his client’s biz, both from an independent view point and from the client’s perspective, in the following ways:
(a) The client’s current business activities and results. For example, who are the major suppliers, customers, and related parties?
(b) The client’s corporate objectives including management’s strategies for attaining the set goals.
(c) The client’s competitive position. For example, the markets in strengths and weaknesses and action taken by the client to respond to competition.
(d) The business environment in which the client operates. For example, legal, regulatory, economic and technological environment.

4.3 Identification of the risks facing the business
The auditor considers the risks facing the client’s business and whether these risks are likely to affect the financial statements and therefore have audit implications. The causes of these risks may be factors affecting the business environment of the client, or factors affecting the industry or economy generally, for example:

4.4 Audit Risks
We are rarely able to obtain conclusive audit evidence that the financial statements are free of material misstatements. Instead, we base our audit opinion on reasonable audit assurance. Because examining some, rather than all persuades us, of the information available to us there is always a risk that we may unknowingly issue a report expressing an unqualified audit opinion on financial statements that are materially misstated. This risk is referred audit risk. To limit audit risk to an acceptably low level we:

i. Consider the risk of material misstatements in the financial statements;

ii. Use more judgment to determine to nature, timing and extent of substantive audit procedures to obtain sufficient appropriate audit evidence as to whether the financial statements are free of material misstatements.

a. Inherent Risks
This is the risk that significant misstatements, both intentional and unintentional, may occur, disregarding the effectiveness of internal control to prevent to detect and correct such misstatements. Inherent
risk results from the external factors, pressures and forces brought to bear on the organization as well as from some internal factors.

Misstatements occur when there is a failure to capture process or report data correctly or misstatements are introduced into the data at any time. The number and size of misstatements depend on many conditions or events relating to the clients’ businesses. These conditions or event can be dividend between those that are: companywide or specific to individual financial statement assertions.

When the inherent risk is assessed, the combined effects of the above two conditions or events are considered. The assessment of inherent risk is an audit judgment: the risk that significant misstatements may occur, disregarding internal control.

b. Control Risk
The auditor assesses the effectiveness of internal control to provide reasonable assurance that significant misstatements are prevented or defected and corrected, at the level of audit objectives.

The intrinsic limitations of internal controls means there is always a risk that significant misstatements may occur and remain undetected. These limitations may be due to:

i. Resource constraints and the need to consider the cost of internal control in relation to expected benefits;

ii. The limit of human judgment and such human failures as simple errors or mistakes due to carelessness, distraction, mistakes or misunderstanding of instructions;

iii. The ability of management to override internal controls;

iv. The possibility of collusion of two or more people inside or outside the organization; and

v. The reality that breakdowns may occur.

The risk of internal control failing to prevent, or detect and correct, significant misstatements are referred as control risks. If we consider internal control to be effective in preventing, or detecting and correcting significant misstatements, we asses control risk as low. If we consider internal control to be ineffective in preventing, or detecting
and correcting, significant misstatements, or we control, we assess control risk as high. During audit planning, we obtain an understanding of internal control and make preliminary assessments of control risks of each audit objective (assessments are preliminary until our tests of controls are completed).

c. Risks of Significant Misstatements
This is the combination of inherent and control risk. The result for the assessment of the risks of significant misstatements can be summarized as follows:

i. If we assess the risk of significant misstatement as low, we believe that a significant misstatement in the financial statement assertions covered by the audit objective is unlikely.

ii. If we assess the risk of significant misstatements as high, we believe that a significant misstatement in the financial statement assertions covered by the audit objectives is likely.

The following general guidelines may be useful:

i. The higher the inherent risk, the more assurance management requires from the internal control process;

ii. If the risk of significant misstatements is low, usually it is because internal control effective;

iii. When inherent risk is low management requires less assurance from the internal control process.

iv. Risk of significant misstatement always exists at some level for an audit objective, substantive audit procedures are required to address the risk that is present.

d. Detection risk
Substantive audit procedures are selected to achieve audit objectives to obtain audit evidence as to whether financial statement assertions are free of significant misstatements. The risk that the substantive audit procedures fail to detect such significant misstatements is referred to as detection risk. There are two general types of substantive audit procedures that can be applied: analytical procedures and test of details. Accordingly, detection risk is made up to two components namely: analytical procedures risk and test of details risk.
e. Consistency of financial and relate information
Using substantive analysis, the auditor analysis the consistency of financial and related information. The auditor through analytical review identifies significant financial statement accounts, class of transactions and financial statements assertions. Based on the results of the analysis of relevant information and discussions with management, the auditor identifies the significant financial statement account balances and classes of transactions.

The significant financial statement accounts usually are apparent from the auditors’ discussions with management and his understanding of the business. Significant means more than the amount of the balance in the account. This is because the balance the balance is the net result of the transactions that flow through the account. An account with a small monetary balance such as cash may be significant because it is the net result of two significant classes of transactions, cash payments and cash receipts. The account balances reflect the classes of transactions (including accounting estimates, internal transfers and allocations) recognized during the period. These include:
   i. Routine transactions
   ii. Non-routine transactions
   iii. Accounting estimates
The auditor identifies the significant classes of transactions in these three categories. They are used when assessing the risk of significant misstatements.

4.5 Types of Audit:
Audits are classified according to their (a) nature and (b) their procedures.

a. Classification by Nature:
These are:-
(a) Statutory Audits
(b) Non-Statutory Audits
(c) Special Audits
(d) Investigations
i. Statutory Audits: These are audits carried out within the aegis of legislation usually based on the compulsory audit requirements of the CAMA 1990. In this regard, the requirements of the controlling statute should be noted, and preparation made to comply with them.

ii. Non Statutory Audits: These are audits not undertaken as a requirement of legislation (the CAMA 1990). It does not matter whether the entity is corporate or not. As long as it is not borne out of legislative compulsion, then it is a private audit. Such audits can be called for by a chairman or chief executive taking up a new appointment, or wishing to investigate fraud or irregularities; or by partners or managers of noncorporate establishments wishing to know the financial position of their business.

iii. Special audits: Special audits are audits carried out on specialized business entities such as banks, insurance companies, etc. not involved in the general business of buying and selling and or production of goods for such audits, the auditor should well in advance conceive their peculiar problems and how to deal with them.

iv. Investigations: This involves a special investigation of fraud, irregularity or other forms of inquiry, culminating in a professional report and advice by the auditor, who may or may not be qualified. Investigations are not carried out by legislations, but at the discretion of the client.

b. Classification of audits by procedures

i. Procedural Audit: This involves the audit of the company’s system of recording and processing of transactions with a view to finding out whether adequate controls exist. A management letter is usually issued thereafter.

ii. Balance Sheet Audit: Usually common in USA, this involves approaching audit from verification of balance sheet items backwards to the day books, instead of the other way round. It
is like starting from unknown to known. This type of audit is appropriate where there is a sound internal control.

iii. Completion Audit: Otherwise known as year-end audit, and comically referred to as post mortem audit, this involves a once for all audit after the year end, and usually after the period’s accounts have been prepared or is nearing completion.

iv. Interim Audit: This occurs before the year end auditing, usually in big companies with large number of branches or transactions, and it becomes necessary to carry out some of the routine auditing functions before the year end audit, when the essential issues would be concentrated upon.

v. Continuous Audit: A statutory audit can be carried out on a continuous basis in agreement with the company; usually where the company is too large, and operates cash based system where a post mortem audit will be relatively risky. The disadvantages here are the possible collusion of the audit and client’s staff, and the relatively high cost involved.

vi. Internal Audit: Internal auditing is an instrument of internal control established by the management to carry out investigations and audit of all the sensitive areas of the business on a continuous basis. The internal auditor is therefore employed, remunerated, directed and dismissed by the management, and may or may not be qualified.

4.6 Short Term Audit Planning
Short term audit planning is carried out after the long term audit planning has been done with, and the commencement of the auditing proper foreseeable imminent. This usually follows the following pattern.

Engagement letter: This is written to form the basis of the contract between the auditor and his client. Addressed to the client by the auditor, the usual contents are matters relating to:
- Description of the nature of the audit.
- Stipulation of the estimated period of completion
- The audit fees and manner of their payment
- The responsibilities of the directors and the auditors, respectively.
- The scope of the auditor’s work.
- Audit of divisions and branches
- Any location problems
- Audit staff welfare facilities required other auditors
- Relations with the internal auditor
- Need for letter or representation from the management
- Non-reliance on the auditor to uncover irregularities and fraud.
- Any agreement relating to book-keeping, taxation etc. which are separate from auditing.

4.7 Sorting out the Audit Files:
A most important aspect of Short Term Planning is the sorting of audit files.

Audit files are compiled to provide a proof of work done; basis for training; basis for planning future audits; and basis for quality control.

There are three types of audit files, namely, Permanent File, Current File and Correspondence File.

i. The Permanent File: Contains such relatively permanent information and documents as:
Memorandum and Articles of Association; names of key staffers and directors; location, organization chart, list of accounting records, accounting manuals, staff conditions of service, internal control questionnaire format, audit programmed format, copy of letter of engagement, and any other relevant information.

ii. The Current File: Contains such information and documents as:
- Accounting manual; ICQ relevant to the particular audit; updated audit programmed, check list of ratios and legal formalities, schedules relating to the current audit work; letters of
confirmation from debtors, banks, creditors, solicitors and stockbrokers queries and observations, management letter, and any other relevant current information.

iii. The Correspondence File: Contains copies of all correspondences with the client and other parties relating to the conduct of the audit e.g. joint auditors, associates, etc.

4.8 Planning the Administrative Aspect of the Audit:
This relates to planning in relation to:- manpower requirements in terms of quantity, quality and duration of use; stationeries required in terms of quantity; movement costs; staff welfare, time of completion, and order of communication between the field audit staff and the head office, etc.

4.9 Factors Affecting Audit Planning:
The factors that determine the size and nature of resources allocated to a particular audit are:-
   (a) Nature of Audit: Investigations, special audits and year-end audits require a higher caliber staff and bigger time budget than interim audits.
   (b) Distance from client’s Establishment: The longer the distance, the more elaborate the planning. In distant audits, use of associates may be considered for cost reduction.
   (c) Timing: If the year-end audit falls in the peak of the firm’s audit work, an interim audit maybe considered, to reduce the volume of work and time of completion of the year-end audit.

4.10 Advantages of Good Audit Planning:
These, among others are:-
Effective and efficient execution of audits, minimum costs, timely completion of audits, judicious use of staff, stationeries, time and other resources, basis for audit staff training and identification and removal of obstacles well in advance.

4.11 Audit Planning: Co-operation with the Internal Auditor:
At the planning stage, the auditor should sort out the level of co-operation he should share with the internal auditor. He should be guided as follows:

a. Where the Internal Auditor is qualified: In this case, the level of co-operation and reliance should be high. The internal auditor should assist the external auditor in understanding the system and internal controls, in producing draft accounts, effecting audit journals, providing answers to previous year’s audit queries, and ensuring that statutory guidelines are complied with.

b. Dedication: Qualification is not necessarily a license for automatic co-operation. The internal auditor’s level of dedication to his duties should be also ascertained. His management letters should be assessed, and his seriousness in follow-up of queries considered. If all these are positive, the level of co-operation with him should be high, if not, it should be reviewed downwards.

c. If the Internal Auditor is not qualified: In this case, the level of co-operation should be minimal. His assistance may be restricted to such routine functions as effecting debtors circularization, bank confirmation letters, letter of representation, cash counts, branch visits, stock counts, provision of files, giving information, and some others.

d. Where the Internal Auditor and the Directors have close relationship: where this occurs, the level of cooperation should be brought down to the lowest level. Yet, the risk and judgment of the external auditor as to whatever level and mode of cooperation he establishes with the internal auditor remains his and his alone.

4.12 Bases of Auditing:
No matter how efficient an audit planning is, the auditor must fully address a number of fundamental issues before moving into the auditing proper; as such issues form the foundations and corner stones of the auditing function. These issues are considered below.
C. Audit Evidence:
It is necessary that the auditor obtains as much evidence as possible to substantiate whatever opinion he expresses, the possible to substantiate whatever opinion he expresses, the protections given to him by legislation and decided cases not withstanding. The information, both oral and written, and both internal, which the auditor obtains in the process of reaching his reported opinion, makes up his quantum of audit evidence.

Types and Sources of Audit Evidence: Audit evidence can be oral or written. Using Internal Control Questionnaire (ICQ), or informal interview processes, the auditor can obtain audit evidence, which may or may not be written. The evidence may also be internal or external.

Internal sources include: Books and accounts, observations, stock taking arrangement, tangible assets, employees, ratios and other statistical data.

External sources include: Newspaper publications; debtor’s confirmation of balances; banks confirmation of balances, and supplier’s information.

5. Criteria of Audit Evidence: No matter the source of audit evidence, an important fact is that it must be sufficient/complete; relevant; reliable and consistent.

6. What passes for the above criteria on the circumstances, for example: The auditor’s knowledge of the business; the degree of the error involved; the significance of the error in terms of the expected level of public attention; and the complexity of the subject matter. It is therefore left for the auditor to relate.

7. The level of the sufficiency of his audit evidence to the needs of the circumstances and anticipated users.

8. The nature and source of the audit evidence determines the auditor’s level of reliance on a given set of audit evidence. Consequently he
prefers; documentation evidence to oral evidence; external evidence to internal evidence; his own computational evidence, and evidence given by officials not involved in the operation of the subject matter. Finally, audit evidence must be consistent when netted against all evidences on the same issue.

9. Procedures in obtaining audit evidence: Audit evidential materials are derived by:
Inquiry; compliance test, substantive test; observation; computation of statistical data; comparison of the accounts against underlying records; and reviews.

D. Materiality in Audit:
1. Materiality is synonymous with significance and relativity. Hence, at is significant in one dimension may be insignificant in another: The issue is not whether an item is big or small when considered in isolation. An item is considered material for audit purposes if considered significant and sufficiently relevant in reaching an opinion in the circumstances, such that a
   - Non disclosure
   - Misstatement or
   - Omission
Of the item will distort the validity of the view purportedly given by the account.

1. Dimensions of Materiality: Materiality is considered in relation to the circumstances of the case, but the following form the modicum by which materiality had been determined over the years.

2. The amount is related to the total of the accounts: Hence, N1,000.00 will be considered material in accounts with a balance sheet total of N3,000.00

3. Materiality should be related to the size of the company: Hence, whilst a sum of N6m may be written off as immaterial in the accounts of, say, Shell BP, same may be considered material for a medium sized private company.
4. Statutory requirement: may require the disclosure of a specific item e.g. directors fees, audit fees, etc. In this circumstance, such item must be disclosed at whatever value it is, big or small.

5. An apparently small item may generate inquiry, and assume materiality. For example, a sum of NSO stated as the price paid for a company’s car appears anomalous, and can become material in effect.

6. Approximation: Is yet another aspect of materiality. The degree of accuracy required in the value of an item differs from one item to another. One may approximate such items as depreciation, training costs, etc. but one needs be exact in such statutory related items as investment income, director’s fees, etc; you have to be exact, no matter the size of the item.

7. Materiality and the auditor: Materiality concept is useful to the auditor in two ways. It helps to direct his attention only or mostly to material items during his conduct of various tests. Secondly, materiality concept enables the auditor to consider whether to qualify his report or not, in relation to a given error or irregularity.

CHAPTER 5
INTERNAL CONTROL SYSTEMS

5.0 INTRODUCTION
From an auditing perspective, any system devised by an organization with a view to safeguarding its assets is regarded as an internal control
system. This chapter dwells on the subject on the subject internal control with emphasis on the designing of such controls, their required qualities and relevance to the work of auditors.

**Definition of Internal Control**
The Institute of Chartered Accountants in England and Wales (ICAEW) has defined internal control as not only internal checks and internal audit, but all systems of control both financial and otherwise, established by the management of an organization in order to safeguards its assets and promote operational efficiency. Many authors and audit practitioners consider this definition very comprehensive. However, to speak at a much simpler level, an internal control system can be defined as any mechanism that the management of an organization puts in place to ensure adequate protection of the organization’s assets against illegal use, theft and other fraudulent abuses as well as the control of its liabilities.

**5.1 Component of Internal Control Systems**
From a general perspective, internal control systems in organizations can be developed around the following basic components:
   i. Internal audit
   ii. Internal checks (checks and balances); and

a. Internal Audit
This is the type of exercise that internal audit staff carry out in order to guarantee smoothness of operations, control and prevent fraudulent activities and ensure compliance. Internal auditing remains very essential for all organizations whether they are large or small. However, for small organizations that are not able to set up internal audit departments, they can actually engage the service of the professional accountants and consultants to carry out the duties meant for internal auditors.

In terms of functions, internal auditors are not meant to have any executive powers but are required to offer advice and make suggestions and recommendations. Where error of principle and or practice are discovered, internal auditors are people to ensure that practice are discovered, internal auditors are people to ensure that such errors are
corrected and appropriate measures taken to guard against future occurrence. Thus, from a general perspective, internal auditing is to serve as a mechanism for achieving internal control though the following means.

(i) Carrying out routine check: that is the audit of very entry as it arises or soon afterwards.
(ii) Back Reconciliation: regular checking of bank statements against the cash book and supporting vouchers.
(iii) Routine inspection: the regular checking of different sections of an organization and work carried out.
(iv) Special investigations: carried out whenever the need arises suspected frauds and other abnormalities.
(v) Payments: the internal auditor should always scrutinize payment documents for the purpose of endorsement.

b. Internal Checks
As part of internal control, organizations are required to put in place, what auditors refer to as internal checks or simply “check and balances”. By this, it means a way of organizing operations in all section of an organization in such a way that no single individual is allowed to initiate a transaction and concludes every aspect of it alone. For example, where a particular item of expenditures is to be paid, internal check should be put in place to ensure that;
   i. Senior officials approve the application
   ii. A payment voucher is raised by a clerk in line with the approval
   iii. If voucher is approved, a cheque is written by a different clerk
   iv. The cheque is signed by two or more officers who are different from the writer, and
   v. Cashing or delivery of cheques to payees are done by the cashier in the most appropriate manner

It should be noted that checks and balances are necessary in all areas of operation including stores, sales; purchases cash office, salaries, production, computer, etc. through these checks and balances another individual in the normal course of his duties automatically checks the work of one individual. Expectedly, this arrangement not only helps in
detecting fraud and errors, but also deters workers from venturing into fraudulent activities.

C. Physical Controls
These are all various physical measures that organizations take in order to safeguard their resources. Among the various measures in this category are the following:

i. Acquisition of adequate insurance policies against fire, burglary, money in transit, etc.
ii. Use of safes for custody of valuables such as cash, cheque, certificates, etc.
iii. Keeping of adequate number of security personnel to ensure vigilance such as regular checking at entrances,
iv. Regular rotation and transfer to staff, and ensuring the keeping of annual leave at the appropriate time.

5.2 Conditions Necessary or Establishing Good Internal Control Systems
It has been established that good and effective internal control systems can only be set up successfully where contain conditions are provided. Among such conditions are the following:

i. Availability of adequate number of high quality personnel
ii. Good organization structure
iii. Adequate job description and schedule of duties for staff.
iv. Well established lines of authority and control
v. Complete and sound accounting systems.

a. High Quality Personnel
It is obvious that all internal control measure require qualitative personnel to implement, which make it necessary to ensure that qualitative staff in terms of training, experience, character, reliability, etc. are hired to run the affairs of organization. Most importantly this should apply particularly to departments, sections posts that are highly sensitive. By way of example, it is: a known fact that regular balancing of cash books is a strong element of external control, but unqualified
and not properly trained? The same situation applies to all other sensitive posts in organizations.

b. Good Organization Structure
An organizational structure is the hierarchical outline of the flow of functions authority and control in an organization. It shows functional relationships between superiors and subordinates in organizations. The existence of such a structure assists maintenance of internal control because with it, staffs generally get to know the particular persons to report to. That means where a subordinate is to be checked by a superior, both parties will know where they belong in terms of functional responsibilities. Similarly in designing internal control systems, the organizational structure becomes a reference point so as to know where to put certain controls and who to be made responsible for the maintenance of such controls.

c. Adequate job description
It is imperative to have adequate job descriptions for all levels of activities in an organization if an effective internal control system is desired. The job description is meant to show what each functional position requires in terms of responsibilities. Where control measures are emphasized, the job description should specify how measures are to be implemented by those concerned. For example a cash supervisor’s job description may state that the supervisor is responsible for checking and confirming the balancing of cash books by cahiers on daily basis. He shall all be countersigning regularly. Such a description of what a particular position entails is very necessary and will assist greatly in the establishment of internal control systems.

d. Schedule of duty for staff
Unless each staff is assigned specific duties for which he will be held responsible, there cannot be any guarantee of maintaining good internal control systems in an organization. In practice, a staff is only responsible for lapses in his area of jurisdiction or where he owes a duty to act. As such, it is practically wrong for any staff to get involved in an operation that is not part of his schedule of his duty. In the manner, a staff that performs an act can be acquitted on the grounds that performed the said act in the manner prescribed in his schedule of
his duty even if what he did was wrong. The simple lesson her is that, any act that is deigned to help in maintaining adequate internal control must be built into the schedule of duty of all the staff involved. In addition, all the necessary control requirements must be communicated to the staff officially.

e. Established Authority and Control
Unless there are clear regulations specifying who is authorized to treat matters officially and what control measures are available under given circumstances, it may not be easy to maintain a functioning internal control system. It is therefore necessary to have in place proper working rules and the manner of their implementation spelt out. Similarly such rules should be well communicated to all staff. For instance, rules may exist recommending that company vehicles are only to be driven by designated drivers or that all vehicles must be parked at a particular time after closing hours. It will therefore be necessary to ensure that these measures are enforced and corrective measures taken where they are not. In the absence of this, any effort to provide good internal control system may not likely succeed.

f. Adequate Accounting System
Internal control system and accounting systems are so inextricable that without the late the former cannot succeed it is common knowledge that accounting system provide for a various books and records necessary for documenting transactions. Such systems also provide for the use of source documents. Like vouchers, receipts, invoices and the preparation of final accounts of financial statements. Subsequently, if all these elements of an accounting system are not properly kept, there is no guarantee of establishing an effective internal control mechanism. In view of this, therefore all organizations thinking of developing good internal control systems must first start by ensuring the adequacy and robustness of their accounting systems.

5.3 Limitation of Internal Control Systems
Internal control systems can have their effectiveness impaired by a number of factors amongst which are the following:

- Collusion
• Fatigue
• Abuse of power
• Lack of supervision and
• Poor communication

A. Collusion:
This is a situation in which two or more persons connive to put heads together in order to beat an internal control system with fraudulent intention. Incidentally this happens to be the most common enemy of internal control systems and indeed the easier way of wrecking such systems. It is also important to note further that most fraudulent activities in organization take place because those vested with the responsibilities of enforcing internal controls have for personal reasons agreed to compromise their roles. Examples are in fact numerous in this area, non-the-less we can afford to take the following few.

(i) Ghost Workers or Pay Roll Fraud: This takes place where pay roll clerks connive with officials like heads of personnel, cashier, pay supervisors, heads of finance, chief executives and even bank officials in some cases, for the fraud to succeed.
By an arrangement the pay roll clerk compiles pay schedule and inserts some fictitious names.
At the next state, the supervisor allows the schedules to go through with the hope of receiving a share of the inflated salary bill.
The person writing the salary cheque is also made aware of his ‘share’ and writes the cheques including the ghost persons’ salaries.

Those signing the cheques will also sigh fraudulently and sometimes fictitious bank accounts are opened in collusion with bank officials so that salaries relating to the ghost workers are lodged in such fictitious accounts and cashed subsequently. At the end of the ideal’ each person that played a role is compensated accordingly. With such a network, as portrayed above, an internal control system certainly has no chance of being effective.

(iii) Stores Fraud: An act of collusion can also happen in stores where store keepers collide with work supervisor, finance officers, chief
executive and outside contractors to dupe their organizations. In such situations the process may go as follows:
- Maintenance officers or some departmental heads simply raise fake requisitions in respect of some regularly used items.
- The chief executive officer is then convinced to approve the fictitious expenditure for payment by the finance officer.
Meanwhile some fictitious stores received and issued vouchers are raised by the stores officer to acknowledge the receipt of the fictitious supplies and their supposed subsequent issuance.

In fact nowadays there are instances where fictitious contractors are required to first of all deposit in cash the ‘shares’ of the various interest groups before the payment cheques are released to them. As far as collusion is concerned, there is very little that internal control systems can achieve except that sometimes trouble may likely brew up among the colliding parties at the time of sharing the illegally siphoned funds. This is probably the only time that the outside world will get to know about a perpetrated collusion.

B. Fatigue
This is a situation in which an individual performing a certain function gets tired as a result of work overload. This often results in loss of concentration in which case the person may fail to accomplish what is expected of him. For this reason, an internal control system is affected. Here again there are many cases to draw examples from.

For instance, in many pay offices and banks, cashiers are often exposed to so many hours of work with hardly any provision for breaks. This particularly applies to peak periods. Knowing well that cashiers’ work is always sensitive, a little losses of concentration on their part can lead to serious problems. For instance good control measures always suggest that cashiers must all the time scrutinize documents tendered by payees before effecting payments. Similarly all cash to be paid must be properly counted by cashiers. However, the condition of fatigue can make cashiers not to scrutinize payment documents very well or count all cash very well before paying out. These may in turn result in cashier’s making payments to wrong persons or over paying some payees. As a further example, we can visualize the issue of security
personnel engaged to watch over properties. Where such personnel are not given adequate provisions to have enough rest before reporting for duty and the unexpected happening.

C. Abuse of Power
This is the misuse of power and authority by some officials in organizations at the expense of the internal control systems put to protect the assets of such organizations. Evidence has shown that some times officers by virtue of being in-charge take things for granted not minding the implications of their actions. Abuse of powers by entrusted officers often undermines the effectiveness of internal control systems. Take for instance a situation where a company has as it’s internal control policy a rule that all official vehicles must be parked at its premises by 6.00pm. This policy notwithstanding, some officers may go about driving the said vehicles during late hours in violation of the internal control policy. Why is it so? of course because they have abused their powers. Some officers may as the case may be, ask their drivers to hand over to them the keys to their official cars and thereafter proceed to where ever they desire. If for any reason such vehicles are lost to some robbers late at night, it may not be because of lack of good internal control system but because some officers have decided to abuse their powers.
Other cases of abuse of powers include instances where officers receive cash advances or use their positions to grant unauthorized credit facilities to themselves of their companies in violation of established credit policies and guidelines. This applies mostly to banking institutions.

D. Lack of Supervision
Internal control systems would normally require the implementation of certain laid down control procedures by individual workers in organizations. For example, cashiers are usually required to balance their cashbooks daily. Similarly, designated signatories are always required to ensure proper signing of documents as evidence of compliance with internal control systems and the authentication of transactions. However, in as much as tasks are assigned to individuals, there is most importantly the need for follow up to ensure the ascertainment of the extent of compliance. In view of this, it becomes
necessary to ensure that regular routine supervisory checks are carried to assess the level of compliance with all internal control measures. Such supervisory checks are to provide a reasonable assurance that:

i. Laid down internal control measures are implemented
ii. Associated problems are detected early and solutions proffered, and
iii. New measures are suggested where existing ones become weak and ineffective.

As a final note, let it be understood that internal control systems are not time, people will certainly get to understand how such systems work and thus the tendency to try to circumvent them. As such, it is always necessary to cultivate the practice of reviewing and changing internal control systems and procedures from time to time. By so doing the desired effectiveness of such systems stand is to be achieved.

E. Poor Communication
Sometimes lack of proper understanding of internal control procedures, which may result from poor communication, can to a large extent affect the quality of internal control systems. It is therefore a recommended practice to ensure that;

i. The whole systems of control are documented. That means to put on record all the procedures pertaining to the various internal control systems. This can be done either through simple narration or the use of flow diagrams.

ii. We make available all relevant aspects of our internal control systems to the affected operating staff in the form of operating manuals (MOPS). Avenues are provided where all relevant staffs are taught how to play their roles towards achieving the objectives of all staff should be properly briefed on what documents they are required to sign, where to sign, and how many copies to sign, when to sign and to whom to pass such documents thereafter.

iii. All communications are passed on time particularly if they involve situations requiring prompt actions. From the forgone it has become abundantly clear that proper communication of all internal control measures in unambiguous terms is necessary if such measures are to achieve their desired aims.
CHAPTER 6

QUALITY CONTROL IN AUDITING

Consequent upon the above development, in business parlance globally the auditor has now engage a number of strategies towards improving the editing of its auditing standards, in order to avoid, or at least minimize the audit risks relating to negligence and loop holes.

Some of these strategies are:

i. Use of Hot Review: these are reviews carried out by a senior manager of the audit firm, and who did not take part in the audit. The review, as the name implies, is carried out immediately after the completion of the audit, as soon as the audit team arrives
from the field. At that time the exercise is still very fresh in the
memory of the staff

ii. Use of Peer Reviews: these are reviews carried out by collegiate
audit firms, completely, with a view to bringing more objectivity
in assessing the quality of the audit in terms of coverage, current
applications and compliance with prevailing standards and
auditing guidelines. This helps to bring a local audit to an
international standard.

iii. Use of Joint Audit: by the use of joint audit, the objectivity and
coverage values of the auditing become more assured, and
auditing risks reduced. This is because the audit firms involved
will pool their resources together along with their experience and
area of competitive advantages e.g. ICT, Engineering company
audit etc.

iv. Staff Selection & Staff Training: conduct of formal staff training
processes such as seminars, lectures, workshops on a continuous
basis, usually by the establishment of a separate training
department.

v. Use of Auditing Guidelines and Standards: by ensuring
maximum use of Auditing Guidelines, and ensuring compliance
with Statements of Accounting Standards (SAS) and
International Accounting Standards (IAS) where applicable.

vi. Self Discipline Applications: Professional Auditors are expected
to apply firm adherence to the professional ethics. These ethics
are rules, norm and orchestral code of conducts that will attract
the clients ad the public to response confidence in the auditor’s
work. These includes:
- Objectivity
- Integrity
- Confidentiality
- competence

Audit Committees
1. In order to further protect the auditor’s independence in public
companies, the Companies and Allied Matters Act, 1990, requires
Public Companies to set up audit committees whose duties, inter
alia, comprise the following:
i. The appointment of external auditors; assisting auditors in obtaining information.
ii. Reviewing the audited accounts of the external auditors;
iii. Evaluating the adequacy of internal controls in the company;
iv. To ascertain whether accounting and reporting policies of the company are in accordance with legal requirements and agreed practices;
v. To review the scope and planning of audit requirements;
vi. To review the findings on management letters in conjunction with the external auditor and department’s responses there on
vii. To make recommendations to the Board of Directors on matters relating to removal and remuneration of auditors.
viii. Authorize the internal auditor to carry out investigations into any activities of the company.

2. The formation rules for audit committees are set out in Sec. 359, subsection 5 of the Act:
i. The membership shall be a maximum of six members; no member shall be entitled to remuneration
ii. A shareholder can nominate a proposed member of the Committee by giving 21 days notice such nomination to the secretary of the company.

1. Drawbacks of Audit Committees: The concept of audit committees is to protect the independence of the auditor, but it is not without its own drawbacks:
i. The membership is, and can be influenced by the executive directors, especially where the company produces vital commodities such as beer, cement etc.
ii. Committees generally are too slow to convene, and too long to come out with a unanimous decision.
iii. Politics, personality clashes and in-fighting can mar the progress of audit committees.
iv. The Decree provides for the formation of Audit Committees, but fails to specify the academic and or professional qualifications of members; it is therefore possible that some of the members may not be experienced enough for the task before them.
v. The Decree prohibits remuneration to members of Audit Committees. It therefore becomes doubtful as to whether the members will be fully committed and independent.

vi. Members may not want to be harsh to point out audit flaws especially where such findings will offend directors, from whom, they know, they will benefit in one way or the other.

All of the above set-backs notwithstanding, audit committees have been found useful and witnessed acceptance worldwide, especially in United States, Great Britain, and Nigeria.

Testing the Controls Ascertained in the System.
One thing is to be told, or to ascertain that controls exist in the system. Yet, another is to ensure that in practice the said controls are being operated to testing the operation of those controls on which he wants to place reliance. It is only after this he can confidently make up his mind that:
- Controls exist, and are complied with in practice in the processing of transactions OR
- Controls exist but are not generally complied within practice.

The auditor uses a number of techniques in achieving this objective. These are:
- Walk through tests
- Compliance tests
- Internal Control Evaluation (ICE)
- Sampling techniques

These techniques are considered variously below:

1. Walk through tests:
As the name implies, walkthrough involves picking up a transaction randomly, and following it up through the relevant system of controls e.g. from authorization to recording and custody, with a view to testing whether the expected laid down books and controls were observed in the processing of the transaction.

Immediately, the auditor would begin to create a bird’s eye view of the client’s control system in practice, and so begin to shape up his mind
on the extent and direction of further and detailed tests to be carried out.

2. Compliance Test:
Depth Tests: Depth Test is a more formalized and detailed extension of walk-through-test, carried out on the controls applicable to randomly selected transactions within a given function. Let us assume that the following are the controls laid down by JOFAD NIGERIA LTD for its sales function in relation to its sales function in relation to its sale of heavy equipment.

1. MD approves customer’s order and routes to Sales Dept.
2. Sales Clerk prepares invoice, using order
3. Sales Invoice is checked against order by two clerks separately.
4. Sales invoice is approved by Sales Manager and Director.
5. Stores Manager approves Stores Issue Note and Way Bill.

In carrying out compliance test on this function, the Depth Test Sheet will be designed to feature all the above controls on the processed order, and to ensure that the said controls were of the transactions being tested e.g.

DEPTH TEST FOR SAMPLED SALES INVOICE
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15

HEADINGS REPRESENTED
1. = Date of Invoice……………………………………………
2. = Name of Customer…………………………………………
3. = No. of Invoice………………………………………………
4. = Description of goods………………………………………
5. = Quantity……………………………………………………
6. = Amount N……………………………………………………
7. = Invoice Checked by…………………………………………
8. = Invoice Checked by …………………………………………
9. = Order No……………………………………………………
10. = Invoice approved by…………………………………………
11. = Stores Issue Note No & Date……………………………
12. = SIR approved by ……………………………………………
13. = Remarks....................................................................................... 
14. = Name, Signature Auditor staff................................................. 
15. = Date of Assignment....................................................................

Depth Test is therefore usually done on a wide analysis sheet considering that all the data in 112 above shall be marshaled horizontally, with ‘comments of the Audit Team Leader’ column at the end.

How to Analyze Depth Test Sheet:
In analyzing a depth test sheet, the audit staff has to be extra intelligent and meticulous. If for example the date of the sales invoice precedes the date of the order, this should be viewed as abnormal and noted same should apply if the quantity, type and brand on the order differ from those on the invoice. Along the line, all the approvals required on each document should be seen to the evidenced by the relevant signatures and on the proper sequence of dates.

Internal Control Evaluation (ICE):
An important compliance test technique (ICE) is a set of control questions carefully designed to affirm YES or NO to determine the overall strength or weakness of key operating functions, such that ‘YES’ affirms weakness, whilst ‘NO’ affirms strength, e.g.

i. Is it possible to receive goods without being ordered for?

ii. Is it possible to pay for supplies before the Internal Auditor’s certification?

iii. Is it possible to obtain Touring Advance without retiring the previous ones?

iv. Is it possible to take stock on charge without physical inspection?

v. Is it possible to effect increment in salary without an Approval Variation Order?

vi. Is it possible for the cashier to prepare vouchers and with cheques from them?

vii. Is it possible to carry I.O.U to another accounting year?

viii. Is it possible to award a contract without passing through the Tenders Board of the company or organization?
Internal Control Tests and the Auditor:
The objective of the above tests is to ascertain whether the internal controls provided by the management are adequate, and can provide a meaningful and reliable basis for preparing financial statements.

Sometimes, weaknesses in the system are revealed where such weaknesses are considered not material enough to cause a qualification of the audit report. In the circumstances, it will be sufficient to bring such weaknesses to the notice of the of the management, whereupon it becomes the responsibility of the management to implement the recommendations.

Where the control weaknesses are fundamental enough to cause a qualification of the audit report, the auditor shall not only discuss the issues with the directors, but will also reflect them in his audit report.

Management Letter:
Management letter is the medium by with the auditor transmits or route the control weaknesses identified in the system to the management. It is important to state this is not a statutory letter, but one issued at the discretion of the auditor.

Features of Management Letter:
1. A management letter is therefore principally addressed to the Management Director, being the head of the management.
2. The letter should be clearly headed as management letter, stating the auditing year covered, and the date of issue.
3. Each observation should be grouped under separate headings.
4. Each weakness or error revealed must be backed up with evidential data.
5. The points raised must first be cleared with the Chief Accountant and other relevant officials before being reported upon
6. The point raised must be material enough to require the attention of the management
7. The reporting needs not give the impression of witch hunting and persecution objective. It should extol politeness and objectivity
8. The language and presentation used should be appropriate to the client’s level of comprehension
9. The letter should be signed by the auditor, and a copy filed in the Current file, with appropriate cross-references.

Sample:
The Managing Director/CEO
Jofad Royal Nig. Ltd.,
Lokoja.
Kogi State.
31/03/2008

Through The Director of Finance & Accounts
Dear Sir,

Management Letter 2007 Audit

We have completed the audit of your Company, and have the following exceptions to bring to your notice.
1. 2006 Management Letter: We reviewed ur 2006 Management Letter with a view to ascertaining the extent to which you have complied with out recommendations, and or followed up issues of weaknesses highlighted therein.

Findings
We found that although there was a relatively high degree of compliance, some pertinent issues were yet to be attended to:

The issue of implementing salary increase with due variation order with respect to promotions of officers in the company. This has not been copied with as contained in the previous manager letter Ref. MLo 1 dated 18th April, 2006.

Management letters are not written for routine sake, but to highlight the high-risk weaknesses in the system to the management for timely corrections.
We therefore advise that appropriate steps be taken as recommended.

2. Custody of the Corporate Documents:
We observed there was no clear cut guideline on the custody of your corporate documents. We expect that vital documents relating to the status and operations of the company be made readily available to us e.g. Memorandum and Articles of Association, Minutes of Board Meetings, Mission Statement, Major Contracts files as well as litigation files.

3. IOUs:
IOUs are evidenced on pieces of papers which are later destroyed on repayment. We would recommend a procedure where there is a recorded chronology of IOUs for record and control purposes. We sensed that some of the IOUS were not approves by the management. The cashier used his position to favour whoever he wished to grant IOUS.

4. Fixed Asset Record
You have implemented our recommendation on the installation and use of Fixed Asset Register.
But there is no provision therein to show the date of purchase and location of the asset.
This should be corrected to maximize the uses of Fixed Asset Register.

5. Personnel Records:
We examined your personnel files with a view to finding out their state generally. Findings: A number of anomalies came to light, and which we think, should be rectified immediately by those concerned before our next audit:

Employees
Anomaly/omission

1. Talatu Ndakwo
   - No Letter of Application
   - No Acceptance of offer of employment
   - No C.V.

2. Dayo Aare
   - No appointment Letter
- No C.V.

3. Aletofa Bode - No Acceptance of offer of Appointment
   Industry Trainee
   - No record of success in the file.

6. Bank Reconciliation Statement
Bank statements are not prepared in relation to all your banks account;
negligence and weak control; and should be corrected.

7. Statutory Deductions
We observed that neither PAYE nor NPF deduction were made during
the period. These may be used for or against you in relation to
government largesse, qualification Tax Clearance Certificate etc., and
should not be taken lightly.

8. Staff Rotation
Staff rotation as a major tool of internal control in business
organizations, is not seen to be practiced by your company with a total
number of 8 staffers remaining on the same job for several years.
The uses of this tool as a means of staff training and fraud safeguards
can not be overemphasized.

9. Conclusion
We shall highlight on other areas in our next audit, and report thereon
accordingly.

We are expressing our profound gratitude to your good selves for the
opportunity given us to serve, and assure you of our best at all times.

Yours faithfully,

S.O. Akanbi B.Sc, MMP, ACTI, CAN
Audit Manager
For Principal Partner

LETTER OF REPRESENTATION:
At the concluding stage of the audit, the auditor wants to ensure that all external confirmations have been received, e.g. debtors, banks and creditors confirmations. At the same time, or shortly thereafter, he should turn his attention to internal confirmation from the directors to issue a certificate in respect of the various representations they made to him in relation to the audit. In the early days, such confirmation was called Directors’ Certificate; now we refer to it as Letter Representation.

The objective of Letter of Representation is to place on record as an evidential material the representations of the directors on significant matters in relation to the accounts.

Another objective or use of the letter is to remind the directors their responsibility for the correctness of the information contained in their account of stewardship; although this is not to imply that the auditor is relieved of his professional responsibility of duty and care.

The letter should be signed by the director, especially with regards to matters which involve opinion, such as obsolescence, wear and tear of plant, adequate provisions of bad debts, etc.

To this extent, letter of representation serves three purposes namely:
- as a verification procedure in relation to assets
- as a reminder to the directors of their responsibility for the correctness of the accounts, and
- as an evidential material from the top of the management in relation to the audited accounts.

The letter should be signed by and obtained from the Chief Executive, or various from the executive directors directly responsible for the representations.

Although usually drafted by the auditor, the letter should be on the headed paper of the client.

The letter should not mince words that the effect of the letter is to place commitment on the director for their representations. For this reason, it
is advisable to get the letter recorded in Board Minutes, so that all other directors will be fully aware of the letter and its implications.

Contents of Letter of Representation:
The following appear to embrace virtually all the items usually included in letters of representation:

General 1.
1. Disclosure to the auditors of all accounts, books and records including minute books.
2. Consistent application of accounting policies
3. Events occurring after balance sheet date.
4. Compliance with specific legislation
5. Outstanding litigations

Assets
1. That the company has a satisfactory title to its assets
2. Adequacy of depreciation
3. Basis of valuing stocks
4. Adequacy of provisions for obsolescence
5. Reliability of debtors
6. Amount of capital expenditure authorized by the board, and amount contracted for at balance sheet date.

Liabilities
1. That all known liabilities have been provided for
2. The disclosure of all known contingent liabilities
3. Disclosure of all secured liabilities

Profit and Loss Account
1. Disclosure of all extra-ordinary, exceptional and non-recurring, and prior year items.

Example

Letter of representation

Jofad Royal Nig. Ltd.
Letter of Representation

1. We confirm to the best of our knowledge and belief the following representations to you in connection with your audit of the company’s financial statements for the year ended 31st Dec., 2007.

2. We acknowledge as directors our responsibility for the financial accounts which you have prepared for the company. All the accounting records have been made available to you for the purpose of your audit, and all the transactions undertaken by the company been properly reflected, and records in the accounting records.

3. However, we shall take necessary steps to rectify the anomalies highlighted in your management letter to us. In the same vein, we shall endeavour to make available to you all the records demanded by you.

4. Please, be prepared to undertake the preparation and installation of our Fixed Assets Register as we need a professional touch in that area.

5. To the best of our knowledge, there have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements.
Yours faithfully,

Alexander Abu
On behalf of the Board of Directors

LETTER OF REPRESENTATION AND THE LAW
Where Director Fails to Sign the Letter of Representation:
Directors are now becoming aware of the legality behind the various administrative actions they take. They are fully aware of the provisions of sec. 369 of the CAMA 1990 which makes it a criminal offence punishable by imprisonment for one year or N500 fine or both for conveying any information or explanation which is false, misleading or deceptive in a material particular.

For this reason, some directors decline to sign Letter of Representation. Some may insist that since the letter is supposed to come from them that they should do the draft in their own way. When they are allowed to do this, a lot of loopholes are apparent; in the final analysis it amounts to refusal to co-operate.

The auditor’s remedy in the circumstance is not far to fetch. Sec 360(3) of the Act empowers him to call for auditing related information front officers and staff of the company, and to report any non-compliance to the shareholders.

In the event that conflicts arise in this respect, the auditor should avail himself of this provision, and include the noncompliance in his audit report.
CHAPTER 7
AUDIT SAMPLING AND PROGRAMMING

7.0 INTRODUCTION
The purpose of an audit of financial statement is to express an opinion on them. In order to achieve this objective, the auditors performs compliance ad substantive tests on the various components of the financial statements to enable him obtain and evaluate appropriate audit evidence. Ideally, to support his audit opinion, the auditor should examine all transactions, all items in an account balances and all controls for the period under review.

The auditor may decide to carry out his testing on the whole item in which he intends to draw conclusion. He may, however, decide to pick some representatives among the whole items, test them and form his opinion as if he had tested every item.

According to ISA 539, audit sampling is the application of audit procedures-to less than 100% of the items within an account balance or class of transactions to enable auditors obtain and evaluate evidence about some characteristics of the items selected in order to form or assist in forming a conclusion concerning the population which makes up that account or class of transaction.

7.1 Reasons for Audit Sampling
(a) It is often impracticable to carry out 100% audit testing because of the large number of items of transactions, assets, liabilities and owner equity items to be examined.
(b) In order to meet the auditor’s reporting Deadline 100% audit testing may be impracticable.
(c) Carrying out 100% audit testing may be time consuming and therefore uneconomical.
(d) 100% audit testing may be tedious and may reduce the audit to mere routine procedure, which could detract from the objective of the audit.
(e) It is possible for the auditor to reach conclusion by way of sampling procedures instead of conducting 100% audit testing.
(f) The audit objective is not to report on the accuracy of the financial statements but on its truth fairness. Consequently, the auditor does not need to examine all the items.

7.2 Circumstances where Audit Sampling may not be Appropriate
1. Where the auditor is put upon enquiry
2. Where the internal control procedures are weak and 100% audit testing is feasible
3. Where the transactions under review is one recurring in nature and is material
4. Where the items are unusual or extraordinary
5. Where the items are specially required to be disclosed in the financial statements by law or other professional requirements
   Where the items within the class of transactions, assets, liabilities and owner equity items are few and are individually material.

7.3 Stages Involving in Audit Sampling
There are four stages in the audit sampling process
1. Planning the sample
2. Selecting the items to be tested
3. Testing the items selected
4. Evaluating the results of the tests.

1. Planning the sample
In planning the audit sample, the audit should consider the following important matters.

(a) The audit objectives: The auditor should consider the specific audit objectives to be achieved. This will enable him to determine the appropriate audit procedure of combination of procedures to perfume.

(b) The population: The relevant population of items to be tested and the sampling unit. The auditor should ensure that the population form which he draws the sample is appropriate for the specific audit objective.

(c) The simple size: The auditor should determine the appropriate sample size.

(d) The sampling unit: Q the invoice, GDN, GRN.

(e) The definition of error in substantive test.

(f) The definition of deviation in compliance tests.

(g) The tolerable error or deviation rate

(h) The expected error/deviation rate

(i) The assurance required.

(j) Stratification.

2. Selection of items to be tested
After planning the audit sample, the auditor must select the items to be tested. The sample procedures should ensure that the items selected are representatives of the population of sub-population. There are several methods available to an auditor for selecting items:

a. Random Selection Method
Under this method, the sample items are selected by reference to random number obtained from random tables or generated by calculators or computers. The sampling units within the population are assigned serial identification number. Sampling units whose corresponding identification number appear in the randomly generated number is included in the sample. Sample produce by the random sample selection method is usually unbiased. Also, the systematic approach involved compels the audit or to consider all key issues.

b. System Selection Method
Under this technique, the first item of the sample selected by reference to random number obtained from random tables or generated by calculator or computers. Thereafter, item appearing at regular predetermined intervals are selected and included in the sample. The sample produced is usually unbiased. Also, the methodical approach involved compels the auditor to consider all key issues.

c. Haphazard Selection Method
This simply involves choosing items subjectively but avoiding bias. The auditor does not make use of random numbers. Where it is properly applied, the sample is usually unbiased. Also, no special skills or knowledge are required. It is consuming.

d. Stratified Selection Method
This means driving the population into sub-populations. It involves firstly, the reclassification of the population into sub-populations of homogeneous items. Secondarily, separately selecting sample items from each sub-population. Anyone or the above mentioned sample selection methods may be used when selecting samples from the sub-population.

e. Block Selection Method
This is simple choosing at random one block of item e.g. all invoices in a particular month. This common sampling has none of the desired characteristics and is not recommended.

f. Multi-Stage Selection Method
This method is appropriate when data is stored in two or more levels. It is used where the population is organized in a hierarchy such that the sampling units are below the topmost echelon of the hierarchy. The sampling process progressively starts with a selection of item at the top of the hierarchy until items below them are selected.

g. Value Weighted Selection
This method uses the currency unit value rather than the item as the sampling population.

3. Testing the sample:
This involves the conduct of compliance or substantive procedure as appropriate on the sample selected. During the testing, various techniques such as inspection, observation, computation and enquiry can be used.

4. Evaluating the Result of the Audit Test:
Having carried out the audit on items selected, the auditor should properly evaluate the results obtained. The evaluation process involves the following:
   i. Analysis of the evidence obtained during the test in order to ascertain error or whether there is non-compliance with controls.
   ii. Project the error or deviations discovered during the test to the population as a whole.
   iii. Consider the risk of having reached a wrong conclusion, which is generally referred to as audit risk.

Audit Sampling Methods (or Techniques)

Sampling methods fall into two main categories:
- Non-statistical (judgmental) sampling methods; and
- Statistical sampling methods

The distinction between statistical and non statistical sampling methods derives from the extent to which the auditor uses judgment in determining the sample size, selecting the sample items and evaluating the test results.
Non-statistical sampling methods are those in which the auditor relies on his judgment in the determination of the sample size, selection of sample items and in the evaluation of the test results.

Non-statistical sampling methods are also referred to as judgmental sampling methods. This however, does not imply that the auditor does use his judgment where he adopts a statistical sampling method. Whether or not a statistical sampling method is used, the auditor relies on his judgment in establishing the audit objectives, the target population; the sampling units; the error or deviation conditions, carrying “out the procedures, analyzing errors or deviation conditions noted in the sample and in assessing the sampling risk.
Advantages of Statistical Sampling Methods
These include the following:
1. To impose a formal discipline on the auditor, this compels him to consider all relevant factors when planning the audit sample.
2. They are unbiased.
3. The accurate size of the sample to be used can be estimated.
4. The degree of probability of the representatives of the sample can be estimated.
5. They invariably result in a smaller sample size than other traditional methods.
6. The results obtained can be expressed in precise mathematical terms.
7. They promote the standardization of audit sampling procedures
8. It is defensible.
9. It is efficient because manageable sample sizes are considered.
10. It can be used by lower grade staff that would be unable to apply the judgment needed by judgment sampling.

Disadvantages of Statistical Methods
1. It is inflexible
2. Audit judgment is secondary to precise mathematics.
3. The procedures involved can prove to be lengthy and unwisely in certain circumstances.
4. Knowledge of statistical sampling is essential
5. They may inhibit the initiative of the auditor
6. Unlike with the non-statistical sampling technique, the auditor can test for only one objective as a time.
7. The time spent with mathematics will be better spent on auditing.

Conditions that must be present before Statistical Sampling Method can be used.
Circumstances under which the statistical audit sampling method can be used include:
1. The audit test must have a single objective
2. The population must be homogenous
3. The population must be large
4. Every unit in the population must have an equal chance of being chosen.
5. Every item in the population must be uniquely, for example, by serial numbering.

Advantages of Non-Statistical Sampling Methods
Advantages include the followings:
1. They are less time consuming
2. They are well understood and refined by experience
3. They do not require any special skills or knowledge in statistics.
4. The auditor is able to achieve more than one audit objective through a single test.
5. The auditor can bring his judgment and expertise to bear on the quantity of the sample.
6. They are practicable and in consonance with business realities.
7. No time is wasted with mathematics; instead all the audit time is devoted to auditing.

Disadvantages of Non-Statistical Sampling Methods
These include the following:
1. No quantitative results are obtained.
2. They are unscientific and the results obtained cannot be quantified.
3. The sample sizes are usually too large and accordingly, may be uneconomical.
4. They often result in personal bias in the selection of the sample.
5. The conclusions drawn by the auditor cannot be independently verified.
6. They inhibit the standardization of audit sampling procedures.
7. Because of the absence of a systematic approach to the audit sampling, the auditor may not consider all relevant factors during the sampling process.
8. There is no real logic to the selection of the sample or its size.
CHAPTER 8
AUDIT RISK

8.0 INTRODUCTION
Audit Risk
Audit firms are continually trying to reduce audit cost while at the same time reducing audit risk. This has led to the idea of risk based auditing being in some sense of distinct approach to auditing. Audit as progress from being a largely substantive testing process through a largely system based process into a risk based method which uses a range of audit techniques including substantive testing, internal control compliance, analytical review and the use of inherent factors.

Audit Risk means the chance or damage to audit firm as a result of giving an audit opinion that is wrong in some particular. Damage to the firm may be in form of monetary damages paid to a client or third party as compensation for loss caused by the conduct (for e.g. negligence) of the audit firm or simply loss of reputation with the client or the business community. A wrong audit opinion means, for example, saying the accounts show a true and fair view when in fact, they do not.

8.1 Normal Audit Risk
1. All audits involve risk. However strong the audit evidence and careful the audits, there is always a possibility of an error or fraud being undetected.
2. If there is an indication that audit risk is normal:
   a. Auditor shall organize his office and staff in a competent manner.
   b. Follow the auditing standards and guidelines
If this is done, the Auditor is unlikely to be found negligent and to have to pay damages as a consequence of fraud or error not discovered by him.

8.2 **Indications that risk is normal are:**
   i. Past experience indicates risk is normal
   ii. The management and staff of the client are competent and have integrity.
   iii. The internal control system is well designed.
   iv. The client is old established and is not subject to rapid changes
   v. The Board of Directors are actively engaged in the company control; and leadership is of good quality.
   vi. The Board of Directors are competent, non executive directors are good and a sound audit committee.

When audit risk is normal, then auditor may approach his audit by relying on:
   (a) Key controls
   (b) Substantial terms
   (c) Analytical review

8.3 **Higher Than Normal Risk**
Some audit assignments involve high audit risk. The majority of audit contains, at least, one area of high risk.

8.4 **Indication of Higher Than Normal Risk are**
1. High gearing
2. Liquidity problems
3. Poor management
4. Lack of controls or poor book keeping/Accounting system
5. Recent changes of owners/control
6. Dominance by a single person
7. Rapid staff turnover
8. Frequent changes of accounting policies
9. The existence of ‘put on enquiry’ situations
10. Previous experience

8.5 **The Audit Approach in High Risk Must be:**
i. Skeptical
ii. To use high caliber and experience audit staff
iii. Collection of a wide range of audit evidence in each area.
iv. Meticulous preparation of audit working papers
v. Probing of all high-risk areas to the bottom
vi. Extreme care in drafting the audit report.

8.6 Audit Work Risk
All audit work involves normal risk and high normal risk. This is because there is always possibility of accounts containing a misstatement due to error or fraud.
The risk arising from audit work may include:

- Failure to recognize ‘put upon enquiry’ situations
- Use of the wrong procedures in a particular situation.
- Failure to perform necessary audit work because of time or cost considerations.
- Failure to detect error or fraud due to error of judgment.
- Failure to draw the correct inferences from audit evidence.

8.7 Audit Firm and Audit Risk
Audit Firm should organize its affairs in such a way as to minimize the risk of paying damages to clients or other arising out of negligence work.

8.8 Features of Firm which may minimize Risk are:
1. Proper recruitment and training of audit personnel
2. Allocation of staff with appropriate ability to particular audits.
3. Planning of the work of the firm in a relaxed and disciplined way.
4. Two-way communication with staff in matters of general concern.
5. Use of audit manuals, which conform to the audit standard and guidelines
6. Use of precise and frequently updated letters of engagement.

8.9 Operations of Audit Risk
Inherent factors include background knowledge of the Client and past audit record indicating no special difficulties. It was once stated that “in the absence of evidence-to the contrary, what has held true for the client in the past will hold true in the future”.

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Essentially, auditing is the gathering of evidence about each of past of the accounts but as absolute assurance is impossible; there is always some element of residual risk which has to be accepted, which is a matter of judgment.

Overall-Risk = (inherent Risk x Control Risk x Analytical Review Risk x Substantive Risk).

Thus, if for example, an audit situation was examined, found to be material and the risk factors assessed, the following set of figures might be assembled. (The area may be debtors).

Overall acceptable risk 5% = (5 chances of 100 of giving a wrong opinion).

Inherent Risk = (client is old established, well managed and no problems have been encountered in the area previously) 50%.

Control Risk = (Internal Control System is strong, unchanged from last year, little possibility of management control) 20%.

Analytical Control Risk = (figure tie up with credit sales, with previous years and with budgets subjects to small changes stemming from different external conditions) 50%.

Thus, Substantive Risk = \( \frac{\text{Overall Risk}}{\text{Inherent Risk} \times \text{Control Risk} \times \text{Analytical Review Risk}} \)

Where OR = Overall Risk
IR = Inherent Risk
CR = Control Risk; and
AR = Analytical Review Risk

By Substitution, we get

\[
= \frac{0.05}{0.5 \times 0.2 \times 0.5} = \frac{1}{100}
\]

This means the audit assurance required from substantive testing is 100% - 100% = i.e. no assurance is required. Assurance from the other sources of evidence is sufficient to support an audit opinion with 5%
risk. But if you change the control risk from 20% to 30%, then the substantive risk becomes 67% and the level of assurance required from evidence source substantive testing is only 33% (i.e 100-67).

i.e. 

\[ 0.05 \times 0.3 \times 0.5 = 0.67 \]

\[ 1 - 0.67 = 0.33 \text{ or } 33\% \]

8.10 Definitions of Terms used in the Model

1. Inherent Risk: The risk attached to any particular population/industry/item. It is the risk of peculiar nature e.g. keeping expire drugs in the pharmacy department as closing stock.

2. Control Risk: This is the risk that internal controls will not detect and prevent material errors because it is most likely that there is outright omission.

3. Detection Risk: This is the risk that the auditor’s substantive procedures and analytical review will not detect material errors. The object of the audit is not targeted to finding errors.

4. Substantive Test: To provide audit evidence as to the completeness, accuracy and validity of the information contained in the accounting records and/or in the financial statements of the client.
CHAPTER 9

THE AUDITOR IN A MECHANIZED ENVIRONMENT

9.0 INTRODUCTION
The nature of the auditor’s work is centered in the examination of books of accounts. But the advent of mechanization of accounting processes has eliminated books, and replaced them with computer software in form magnetic tapes, discs, etc. and this change has altered the auditor’s attitude to his work.

What has changed however is the method of keeping the record of his work. The auditing objective has remained the same.

9.1 The Problems which EDP Systems Pose to THE AUDITOR:
- EDP systems take time to study and understand. Errors are difficult to trace.
- Internal control is difficult to set up as a result of centralization of most accounting functions in the computer.
- Audit trail is lost, as data are entered directly to the computer.
- Sorting is difficult because source documents are often kept away, and reliance placed on stored data.
- Deletion of data occurs when old data are deleted on magnetic tapes to accommodate new ones. This presents problems of audit trail.
- Fraud takes time to uncover, and could build up to millions of Naira before discovery.
- Computer is feared and regarded as infallible; the tendency is relaxation and fear of supervision.
- The use of micro software involves control loss because micros are stored in dispersal i.e. at different managerial centres.

Among the above general problems, there are certain specific problems which the modern EDP systems have brought on the procedural work of the auditor. Some of these and their suggested remedies are considered below:

9.2 Specific Audit Difficulties and their Remedies
i. Absence of primary records:
   - Totals and subtotals normally given by daybooks are not easily verifiable.
   - Where there are large numbers of transactions of same kind the system may deal with these in total such that test checking in derail becomes extremely difficult.

REMEDIES
   - Serial numbering of all prime documents in order of first entry in accounting records
   - Serial numbering of batches and then the permanent first of batches in serial order.

Lack of cross-referencing between primary and secondary records due to direct posting by computer:
Remedy: remedy is the instruction of a suitable cross-referencing system (which would of course also be in the client’s interest)

ii. Code numbers replace names: List of code numbers should be supplied to the auditor. Where possible, narratives should be translated in a nominal account. Records of standard transactions should be printed on specially designed stationary giving printed details.

iii. Make-up of ledger Balances: Debits and credits are not related to each other.

REMEDIES
   - Use of code on either side of account for contra purpose.
   - The regular identification of items making up balances should be incorporated as part of the normal accounting system.

iv. Absence of ledger: This applies especially to purchases. Where payment duly authorized is made on invoices only.

REMEDIES
- The original documents (or copies in case of sales) must be field in suitable binders.
- Maintenance of effective accounts with the aid of machine lists.
- The re-introduction of conventional ledger accounts where justifiable.

9.3 Internal Control Considerations and EDP System:
This has been dealt with under internal control, but shall be revisited hereunder from another perspective.
(a) The areas mostly affected by the mechanization of internal control. This is because there is no primary record, nr large number of staff, etc. consequently; different, internal control frameworks have been devised to ensure reliability and completeness of records in an EDP system.
(b) These internal controls, among others, are:
- Installation of the hardware must be appropriate to the needs and types of the business.
- Employment of intelligent and trained staff. Design, development and application of new a system that will take care of all possible types of errors and fraud at all stages of operation.
- Proper division of work among staff.
- Proper control of stored data.
- Establishing proper laid down procedures.
- Full documentation and all recording of all activity.
- Application of adequate conversion check i.e conversion of computer prints outs to manual, based on records for comparison and presentation of more detailed verifiable information. All new procedural applications must be formally accepted and authorized in writing by the management.
- Proper control over systems development and programming staff.

9.4 Changes in the Application of Audit
WORK IN AN EDP SYSTEM

Just as the EDP system has wrought problems to bear on the work of the auditor has also devised a number of strategies to cope with such problems. Some of these are:

i. Systems design: In manual system, the audit is involved at the auditing stage. But in EDP system, he is involved at the design stage to ensure that all required controls are built into the system.

ii. Timing of audit checks and visits: Checks and visits are limited to about once or twice a year in manual systems. By contrast, they are carried out at short intervals, and almost continuously in EDP systems. This is because of continuous or incessant:
   - over-writing of magnetic tapes
   - changes in filling order/arrangement

iii. Systems Review: EDP systems are relatively voluminous and technical. To cut down on time cost, the auditor must devise a means of quickly identifying the primary controls and concentrating on them to achieve his objective in the shortest possible time.

iv. Audit Tests: Manual controls rely on controls over individuals; by contrast, EDP systems rely on controls over batch of items. Computers are correct in calculations; consequently, the auditor in an EDP environment concerns himself more on controls on controls and programmes not on calculations.

Computer rejects inputs which are not regular in the contest of laid down procedures; the auditor therefore follows the reason for rejection and their ultimate disposal to a logical conclusion.

The technicalities involved in EDP systems have compelled the auditor to maintain specialist staff, and to spend a relatively good time and money on staff training and development. In order to contend with problems relating to loss of audit trail, the auditor in an EDP system make a greater use of:
   - Special print out
   - Comparison of EDP total with budgets, previous period totals, etc.
   - Combination of manual and EDP related techniques where appropriate.
- More audit visits, and
- More vigorous audit planning.

9.5 Problems in the Audit of Small Sized EDP Systems.
Some of the problems facing the auditor in the audit of small sized mechanized accounting systems are as follows:

a. Small companies can afford only micro computers. Such computers require no formal computer environment. Consequently, no physical controls are established. As a result, staff can easily tamper with and or corrupt the files. In micro systems, files are held by floppy disc, which can be stolen, thereby losing a whole record of data. The client’s computer is often fully understood by one person, unlike in large systems with larger staff. This normally gives room to fraud. There is the tendency to operate smaller systems with low grade staff. Where such applies, there will be relatively high rate of errors. A build up of error can go on undetected; but this may not be possible among a highly skilled staff. User departments, out of fear or ignorance, loss interest in computer: so there is less participation by the departments.

There is relatively no internal control, with the result that a larger volume of data is verified.

b. Use of computer Bureau: Sometimes a company may find it more convenient to buy out computer services that buy its own computer hardware where such occurs the auditor is faced with further induced problems in the course of valuating some of these problems in the use of external computer services are as follows.

The company’s internal control hazards nom are built around:
- The point of internal processing
- The point control in the bureau and
- Return of output to user company: moreover
- Print outs may not be produced at the time they are required.
- Not all changes in the system may be communicated to the auditor, and the auditor may not be called to participate in design changes.
- Programmes may not be designed to specifically suit the exact needs of the auditor.

CHAPTER 10

SPECIALIZED AUDIT

10.0 INTRODUCTION
The principles of auditing have universal applications to all auditors to carry out audits of various concerns. Acknowledgment of these principles should enable the audit or to carry out audits of various concerns.

Certain types of audits however, to require specialized knowledge and, in some cases, familiarity with statute and regulations other than companies and Allied matter Act, 1990. It is essential that such knowledge be thoroughly assimilated prior to commencing the audit assignment. The audit work programme should incorporate steps designed to satisfy the requirements of all relevant statues and regulations.

In practice, audit firms prepare checklists in respect of the specialized audit which act as aid memories in ensuring that the provisions of relevant statues and other provisions are reviewed for compliance.

10.1 Audit of Banks
Main provisions of the Banks and other Financial Institutions Act Minimum Paid up Capital.
Banks and other Financial Institutes shall maintain minimum Paid up capital as follows:
   b. Discount House N200m
   c. Mortgage Institutions N100m
   d. Finance House N5m
   e. Community Bank N5m
   f. Stock Brooking Firm N20m.

Reverse Requirements
Every bank shall maintain a reserve fund and shall out of its net profit for each year (after due provision made for taxation) and before any dividend is declared, where the mount of the reserve fund is:
   a. Less than the paid-up share capital, transfer to the reserve fund a sum equal to not less than thirty percent of the profits: or
b. Equal to or in excess of paid-up capital, transfer to the reserve fund a sum equal to not less than fifteen percent of the net profits.

Dividend Payment
No Bank shall pay dividend on its shares until:
   a. All its preliminary expenses, organizational expenses, share selling expenses etc have been completely written off.
   b. Adequate provisions have been made to the satisfaction of the CBN for actual and contingent losses on risk assets, liabilities, off balance sheet commitments etc.
   c. It has complied with any capital ratio requirement as specified by the CBN

Restrictions on loans and advances
The following restrictions are applicable to all licensed banks-
   a. A bank shall not without the prior approval in writing of the CBN grant a loan or credit fertility to any person or group of its legal lending limits which is 35% of the bank’s shareholders funds unimpaired by losses.
   b. A bank shall not grant any facility against the security of its own shares
   c. A bank shall not permit to be outstanding unsecured advances or credit facilities in excess of N1m to its directors or director related companies.

Investments
A bank may acquire or hold investment in any agricultural, industrial or venture capital in Nigeria subject to the following conditions:-
   a. The venture capital company is set up for the purpose of promoting the development of new venture in Nigeria.
   b. The shareholding by the bank is in small or medium scale industries and agricultural enterprises as defined by the CBN
   c. Under Universal Banking, the scope of investment by banks now wider. Bank can invest in capital market, insurance, etc regulatory authority.
d. Banker’s committee also requires banks to contribute 10% of their profit before tax for, investment in small and medium scale industrial enterprises in Nigeria.

Liquid assets
Specific-liquid asset of banks shall consist of all or any of the following:
  a. Currency notes and coins which are legal tender in Nigeria
  b. Balances at the CBN
  c. Net balances at any licensed bank (excluding unlearned effects)
  d. Treasury bill and certificates issued by the Federal Government
  e. Inland bills of exchange and promissory notes rediscount able at the CBN
  f. Such other negotiable instruments as may from time to time be approved by the CBN.

Return to CBN
Every bank shall submit to the CBN and NDIC mid-month, monthly and quarterly returns not later than 5 days after the 15th of every month for mid-month return, 10 days after the last day of each month for monthly returns and not later than 14 days after the end of each quarter of such other interval as the CBN may specify, a statement

Mid Monthly Returns
  a. The asset and liabilities of the bank
  b. An analysis of advances and other assets, at its head office and branches outside Nigeria in such form as the CBN may specify from time to time.
  c. Foreign assets and liability position.
  d. Other information and statistics, document etc as the CBN may specify.

Monthly Returns
  a. Profit on interest rates
  b. Statement of assets and liabilities
  c. Break down of other liabilities forward to the CBN
  d. Break down of other assets
  e. Report on external assets and liabilities,
f. Schedule of placement with other banks
g. Schedule of taking from other banks
h. Schedule of negotiation certificates of deposits NCDs held.
i. Schedule of negotiable certificates of deposits NCDs issued.
j. Schedule maturity profile of assets and liabilities.
k. Report on total credit granted
l. Report on credit allocation by sectors, borrowers and interest rates.
m. Report on cost of funds
n. Report on deposit ownership
o. Report on leading above the statutory limit
p. Schedule of foreign exchange purchases form other banks.
q. Schedule of foreign exchange sales on other banks.

Quarterly Returns
a. Profit and loss account
b. Report on total credits granted.
c. Report on structure of deposits
d. Report on non-performing credits.
e. Report on non-performing other assets
f. Report on non-performing off balance sheet engagements
g. Report on non-credits by sectors.
h. Report on credits to officers, directors, principal, shareholders and their related interests.
i. Report on top users of funds.
j. Foreign exchange interest repatriation and distribution.
k. Report on distribution on naira proceeds of interest repatriated.
l. Foreign exchange holding by authorized dealers.

Semi-Annual Returns
a. Report on investment in shares
b. Report on corporate profile
c. Report on branch network
d. Report on bank’s directors
e. Report on bank’s shareholders
f. Report on managements and top officers.

Publication of Financial Statements
Subject to prior approval in writing of the CBN, a bank shall not later than 4 months after the end of its financial year:
   a. Caused to be published in a daily newspaper printed in and circulating in Nigeria and approved by the CBN
   b. Exhibit in a conspicuous position in each of its offices and branches in Nigeria.

NDIC Premium
Every bank shall insure its qualifying deposit with Nigeria Deposit Insurance Corporation and a premium of 1% of 15/16 of such deposit of payable to the corporation as at 31st December each year. Insider deposit such as directors, staffs, and deposit specifically to collateralize a credit facility are excluded for the purpose of the premium calculation. The NDIC as the insurer of deposits guarantees full payment of all depositors of amount up to N100,000 in case of banks liquidation. Further liquidation dividends are payable to depositors who had more than N100,000 as at the time of liquidation when the assets of the banks are realized, if any.

CBN Monetary and Fiscal Policy Guidelines
The CBN issues monetary and fiscal policy guidelines. The applicable policies for 2004/2005 are as follows:
   a. Liquidity ratio 40% discount houses-60% of deposit in treasury bills.
   b. Cash reserve ratio 9.5% (total deposit liabilities, certificate of deposit, promissory notes, other deposit)
   c. Capital adequacy ratio-ratio of capital to total risk-weighted asset 10%
   d. Bank loans to total deposit 80%
   e. Credit ceiling not applicable to banks not classified as distressed
   f. Exchange rate policy-Market determined through the DAS
   g. Interest rate policy-deregulated to be a function of ruling MRR i.e. 4% above current MRR
   h. Sectoral allocation of loans- not applicable
   i. Open market operations to be used
   j. Stabilization securities not applicable
   k. Moral suasion etc.
Responsibilities of Banks External Auditors to the Supervisory Authorities

Banks auditors are required to forward two copies of their audit reports to the CBN no later than three months after the end of bank’s financial year in addition, report on frauds and forgeries committed during the accounting year shall accompany the audited reports. Each bank shall continue to communicate to the CBN, the appointment, re-appointment, termination and resignation of the banks external auditors stating the reason for such action.

Report of the Auditors to the Members of “PPA Bank Plc”

We have audited the financial statements of ABC Bank Plc set out on pages to which have been prepared on the basis of the accounting policies on pages to respective responsibilities of Directors and Auditors.

The bank’s Directors are responsible for the preparation of the financial statement which gives a true and fair view of the state affairs of the bank and comply with banks and other financial institutions Act 1991 and the companies and allied matter Act 1990. In doing so they should ensure that:

- Proper accounting records are maintained
- Internal control procedures are instituted which as far as is reasonable, safeguard and prevent and detect fraud and other Irregularities.
- Applicable accounting standards are followed
- Suitable accounting policies are adopted and consistently applied
- Judgments and estimates made are reasonable and prudent, and the going concern basis is used, unless it is inappropriate to presume the bank will continue in the business.

Basis of opinion

We conducted our audit in accordance with the international standards on auditing issued by the International Federation of Accountants (IFAC). An audit includes examination on a test of evidence relevant to the amounts and disclosures in the financial statements. It also includes
an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the bank’s circumstances consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain information and explanations, which we considered provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material miss-statement. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements and assessed whether the bank’s accounting records had been properly kept. We have obtained all information and explanations and had received proper returns from branches not visited by us for the purpose of our audit. The assets of the bank have been properly valued and adequate provision made for diminution in value therefore.

Opinion

In our opinion, Bank had kept proper books of accounts and the financial statements are in agreement with the books. The financial statements drawn up in conformity with the generally accepted accounting standards in Nigeria, give a true and fair view of the state of affairs of the bank subject to injection of funds proposed by the directors to overcome the identified symptoms of going concern problems at 30th April, 2004 and of the profit and cash flow for the year ended on that date and have been prepared in accordance with the companies and allied matter Act 1990, Banks and Other Financial Institutions Act, 1991 and relevant circulars issued by Central Bank of Nigeria.

JOHN DELE & CO.
Certified National Accountants
Date: August 31, 2005
Jos, Nigeria.

10.2 Audit of Building Society
The purpose of a building society is to raise funds from individuals who deposit their money in share accounts.
A building society primary function is therefore the lending of money to the public for the purchase of property (which provides security for the loan advanced) a function commonly carried out by the banks and other financial institutions.

Funds are provided by deposits and share accounts. A share account is similar to a bank deposit account but represents equity in the building society. An individual can both deposit and withdraw money from a share account.

The following points may be noted in the audit of the building society.

1) The audit should go through the rules and regulations of the society and see how far they are being followed it up.
2) He should examine the capital structure of the society; and find out the number of its members and also their shareholdings. He should meticulously inspect the minutes of the various meetings legally held.
3) He should also examine the internal check system in operation in the society.
4) He should vouch the receipt of cash on share and deposit accounts with cash book and counterfoils of receipts issued.
5) He should vouch the loans granted to the borrowers (mortgagees) by reference to the agreements.
6) He should properly check the applications and payment of cash for the mortgages.
7) He should verify the value of the mortgage loans in the balance sheet and must carry out effectively a cash account and society investments.
8) He should verify the assets and see that the stock is properly valued.
9) He should properly check in whose custody are the deeds of properties.
10) He should ascertain that the redemption of mortgages are followed.
11) Lastly, the audit should ensure that the accounts of the society are prepared in accordance with the provision of the law.
10.3 Audit of Insurance Companies
Main provision of Insurance Act 2003
(a) Paid up capital:
The minimum paid up capital to be maintained by operators in the industry shall be follows:
1. Life insurance business-not less than N150million but now mandatory for N2billion by December 31, 2007.
2. General insurance business-not less than N200million, as equally been increased to N2billion by December, 2007.
Life business is divided in three categories:
a. Individual life insurance business.
b. Group life insurance and pension business
c. Health insurance business
General insurance business is divided into eight categories
a. Fire insurance business
b. General accident insurance
c. Motor vehicle insurance business
d. Marine and aviation insurance business
e. Oil and gas insurance business
f. Engineering insurance business
g. Bonds, credit guarantee and surety ship insurance business 10% 0 and 20% of the minimum paid up capital must be deposited with the CBN as security deposit to attract interest at CBN MLR for existing and new insurance companies respectively.
1. Composite insurance business, not less than N350million.
2. Insurance brokerage and loss adjusters, not less than NS million
3. In the case of re-insurance business, not less than N350 million.
(b) Reserve Requirement
Every insurer shall maintain technical reserves based on the type of business being carried out by company.

General Insurance: An insurer shall in respect of it general business maintain three types of reserve i.e.
Reserves For Un-expired Risk: This shall be credited with 45% of net premium of other non-life business and 25% of net premium of marine cargo insurance.

Reserves For Outstanding Claims: This shall be credited with an amount equal to a total estimated outstanding claims incurred but not reported at the end of the year under review.

Contingency Reserves: There should be a contingency reserve to cover fluctuations in securities and variations in statistical estimates. This reserve should be accumulated until it reaches the amount of minimum paid up capital of 50% of net premium which ever is higher.

Life Insurance business: An insurer in life business keep two types of reserves i.e.

General Reserve: An insurance company in life business shall maintain general reserve equal to the net liabilities on all the policies in force as determined by and the time of an actuarial valuation.

Contingency Reserve: This shall be credited with 1% of premium or 10% of net profits which ever is greater and this shall accumulate up to the minimum paid up capital.

Re-insurance: A re-insurer shall maintain a general reserve be credited with no less than 50% of gross profit where reserve is less than up capital of 25% of gross profit were reserve is equal to greater than paid up capital.

(c) Investment
An insurer shall at all time in respect of the insurance business transacted by it in Nigeria, invest assets equivalent to not less than the amount of funds in such business as shown in the balance sheet of the company. The insurance funds can only be invested as follows:
- Securities specified under the Trustee investment Act
- Shares in other securities of co-operative societies.
- Loans to building societies approves by the commission.
- Loans on real property, machinery and properties in Nigeria.
- Cash deposit or bill exchange accepted by a Nigeria bank.
- Such deposit investments as may be specified.

No insurer shall:
  a. In respect of its general business, invest more than 25% of its assets in real property of
  b. In respect of its life insurance business, invest more than 35% of its assets in real property.

(d) Publication of Financial Statement:
Every insurance Company submit to the commissioner of insurance approved audited accounts and cause name to be published in national newspaper printed in and circulating in Nigeria as approve by the commission not later than 30th September each year.

Solvency margin: An insurer, other than life business, shall maintain at all assets in Nigeria over its liabilities in Nigeria, consisting of:
  - Reserves for un-expired risks.
  - Reserves for outstanding claims
  - Reserves for claims but not yet reported
  - Funds to meet other liabilities.

The margin shall not be less than 15% of the gross premium income less re-insurance premium paid out during the year under review or the minimum paid up capital whichever is greater. The auditor shall issue a certification on oath stating the extent to which the insurer has satisfied the margin of solvency required under this decree.

10.4 Audit of Lawyers Practice
Lawyers provide the link between a client and his advocate. Lawyers prepare the various documents that are necessary. They have to incur expenses on behalf of clients, and of course, have to incur expenses for their office.

Expenses incurred on behalf of customers are included in the bill for services rendered. The cost journal is ruled with two columns one indicating costs incurred on behalf of clients and the other to indicate
cost incurred in running own office. Bills rendered for service are known as “profit costs”

Lawyer keep amount deposited by client to meet expenses in a separate banking account. The amount lying in such account should equal to balance shown in clients (Expenses) Account.

Lawyer brings into account the work in progress that is costs incurred in work still not completed. But since they cannot sue their client, they create a reserve equal to the debts for services rendered and work in progress. In other words, they keep their on cash basis. This applies to accounts kept by all professional men.
1. He should ascertain that all expenses incurred pertain to the business of the client. He should carefully examine the relevant documents.
2. He should be able to properly separate the personal expenses of the lawyer from the client’s to ensure there is no mix up.
3. He should confirm the deposits receive from clients through the counterfoils of the receipts with entries in the cash book.
4. The auditor should verify the reserve and work-in-progress account in order to avoid duplication of entries.

10.5 Audit of Government Ministries and Local Governments.
The special audit considerations are discussed under the following headings:
   a. Internal control systems
   b. Capital accounts
   c. Revenue income
   d. Expenditure
   e. Verification of assets and liabilities
   f. Review of budgetary statements
   g. The auditor’s report.

   a. Internal control system:
The auditor should review the internal control system to ensure that it is adequate in the audit of government institutions, generally the auditor has a greater responsibility as regard fraud. He must accordingly bear this in mind throughout the audit. An internal audit is the recognized arrangement for securing a continuous and thorough check upon the
financial transactions of the ministries and local governments. The auditor should appraise the internal audit function thoroughly in order to ascertain the extent which he can rely upon it.

b. Capital Accounts:
The statutory method of raising capital moneys by ministries and local authorities, by loan, makes it necessary for these are statutory provisions which control borrowed money, and the following points should be observed when auditing the capital accounts.

1. Practically all expenditure out of loan must be covered by an official sanction. The auditor should examine the loan sanction received in order to verify the amount sanctioned and the purpose.

2. Expenditure chargeable to loan may include the wages of permanent workmen employed on capital projects. In general, the salaries of officers may not be so charged except those which can be identified to specific office wholly engage on the capital works whose offices would be abolished if the capital projects were completed or suspended.

c. Revenue Income:
The income of revenue local authorities and ministries are derived from many sources and may collect in a number of departments. The auditor must assess the effectiveness of the internal audit and decide examples which underlie the examination of income are:

1. Those satisfactory arrangements are in existence for calculating and recording sums due, and that these operations are performed independently of the staff charged with duty of collection.

2. The standing order, financial regulations or minutes of authority include detailed instructions for the control sums received by officers in the outside of their official duty and the frequency with which they bank.

3. That the approval of the local authority or of a committee thereof should be obtained before any sums are written off.

4. That all income has been credited to the proper accounts.

5. That all income received is paid into the bank promptly; any delay may be merely neglect the officers concerned or due to bad system of accounting, but it may be equally.
CHAPTER 11

AUDIT EVIDENCE

11.0 INTRODUCTION
Evidence consists of information and data that can be verified, relevant to the matter under consideration and can influence the auditor in arriving at an opinion. Auditors rely on documentary evidence more than other types of evidence.

11.1 The Reliability of the Following Types of Documentary Evidence is as Follows:
   a. Auditor’s direct, personal knowledge obtained through physical observation and his or her own mathematical computations is generally considered the most competent evidence
b. Conformation received directly by the auditor from third parties have high degree of reliability as far as the auditor is concerned Evidence from this source is more reliable so long as the third parties is independent of the client and is competent to supply the information required. The reason for this high degree of reliability is that the client has no opportunity to alter the external evidence. An example of such evidence is a certificate received from the client’s banker confirming bank balances or any documentary evidence obtained directly from independent external sources.

c. Document produced by the client to the auditor and prepared by outsiders may not be as reliable but are still very valuable audit evidence. Evidence from this source is reliable because the auditor can always check the authenticity with the third party. In addition, if the client alters the relevant figure, the alternation may be revealed by audit tests. An example of evidence prepared by outsiders is an invoice related by the client from a supplier in respect of goods supplied.

d. Documents produced to the auditor by the client and prepared by client staff are likely to be less reliable than the types of evidence described in (a) to (c). The reason for this is that the document can be prepared to conceal the vital details or to falsify amounts in order to cover frauds and irregularities. However, internal evidence is used extensively when it is produced under satisfactory conditions of internal control.

Internal evidence may circulate outside business. As a result, the reliability is increased because of its acceptance by outsiders. An example of such evidence is a paid cheque issued by a client to a third party. The paid cheque is sufficient evidence that the name payee has recovered that amount stated on the cheque. Not all internally generated documents circulate outside the business. Nevertheless, most of the evidence from this source would still be perfectly acceptable to the auditor so long as the system of internal control is satisfactory.

For example, Goods Received Notes (GRN) prepared by the stores can be checked against purchase orders and supplied
invoices. The reliability of this type of evidence depends on the effectiveness of internal control over the purchase cycle. Internally generated documents provide a significant part of the evidence available to an auditor.

e. Verbal and written representations given by client’s officers, directors, owners and employees are generally considered the least component evidence and should be corroborated with other types of evidence.

f. The auditor should usually compile a schedule of account ratios from the client’s records. Such ratios may be compared with those of previous years so that unusual variations can be investigated. This evidence described by the auditor is circumstantial as opposed to the direct evidence described in (b) to (d) this circumstantial evidence is, however, very useful because it assist the auditor to asset the reasonableness of the figures in the client financial statements.

To be considered competent, evidence must be valid and relevant. The above hierarchy of evidential matter helps you understand the relative competence and persuasive power of different kinds of evidence.

11.2 Characteristics of Good Evidence
The availability of audit evidence is a necessary but certainly not a sufficient condition for absolute reliance on the figures presented for audit. Paragraph 4 of the Auditor Operational Standards States that the auditor should obtain “relevant and reliable auditor evidence sufficient to enable him draws reasonable conclusions there from”. Audit evidence therefore has three basic qualities Reliability, Relevance and Sufficiency. That gives necessary audit confidence that the auditor requires before be can include figures in the financial statements.

1. Reliability:
   - The audit evidence must be reliable in terms of the source from which it is obtained as well as the consistency of the evidence
in relation to other evidence obtained. The extent to which reliance may be placed on any particular evidence is a matter of judgment and can only be assessed in the light of the circumstances. However, the following generalizations are usually valid.

- As a general rule, written evidence is more reliable than oral evidence. Evidence generated by the auditor is usually more reliable than evidence from within the organization.
- The auditor will generally rely on evidence, which tends, to correlate with the supplementary evidence already gathered from other sources. He will usually be put on enquiry where evidence from one source is at variance with evidence from other sources. He will, in this circumstance, do further work in order to ascertain the true position.

2. Relevance:
   - The auditor should ensure that evidence collected is relevant to his overall audit objective. The objective itself should necessarily lead to the forming of an audit opinion.
   - The auditor needs to ask, if the evidence collected will be put to the greatest possible use and where alternative sources of evidence exist. If that source is the most relevant and time efficient. The audit evidence obtained by the auditor should lead the auditor to conclude on an objective or on a section of his job and hence contribute towards forming his opinion on the financial statements. If the evidence cannot lead to an objective satisfy an audit test, then it is not relevant.

3. Sufficiency:
   In determining the sufficiency of audit evidence, the auditor will be required to assess the following:
   (a) The level above which errors becomes unacceptable i.e. Materiality;
   (b) The acceptable degree of risk that errors above this level remain undetected i.e. audit risk;
   (c) The difficulty time required and cost obtaining evidence.
   (d) The auditor will have to decide on the size of errors that affect the fairness of the accounts. This entails a preliminary
estimate at the planning stage, which may be amended during the audit depending on the circumstances. The materiality limit decided upon will dictate the size of samples to be tested and the audit evidence obtained there from. The auditor will also assess the audit risk involved in his materiality limit and this will also form the basis of determining the sufficiency of audit evidence.

(e) The practicability of obtaining evidence will also be a factor in deciding on the materiality limit. If, in an attempt to achieve too high a degree of confidence, a low level of materiality is set, then transactions to be tested will be too many and will result in over auditing.

11.3 Fundamental Statements and Assertions

1. The Directors of a company produce or cause to be produced financial statements. In doing so, they are asserting that:
   a. The individual terms are:
      1. Correctly described
      2. Show figures which are mathematically correct of fairly estimated.
   b. The accounts as a whole show a true and fair view.

The idea to grasp in the producer of a set of figures making assertion about ideas in the accounts when he puts them in the accounts. The sort of assertions he is making are the following:

1. Existence of physical things: The physical asset in the Balance sheet exist and are owned by the company, conversely non appearance of any type of asset implies that the company does not own it.
2. Existence of non physical things: The non physical assets on the Balance sheet (debtors, goodwill etc.) and also the liabilities exist and have value.
3. Assertions about past events: This applies to the profocial loan account, which is summary of a series of past events. For example, we can say total sales were N1billion.
4. Assertion of quantities: There can be simply statements like cash in hand was N100,000.00 which is obtained by counting.
5. Assertion of qualities: This is usually implied than expressed e.g. are the debts of N200,000 collectable?
6. Mathematical assertions: Any figure which is the result of mathematical calculation (mainly by addition, subtraction and balancing of accounts) is correct, because the calculations were correctly done.

For example, when we look in an item in a balance sheet and bank overdraft is N1million. Including this item in the balance sheet, the directors are making these assertions:
   a. There is a liability to the company’s bankers.
   b. That, as at the balance sheet date, the liability was N1million.
   c. That the amount is agreed by the bank
   d. That the overdraft is repayable on demand, if this were not so, it would be clearly stated.
   e. The overdraft was not secured. If it were secured, this fact would need to be stated.
   f. Memorandum and Articles of Association.

Therefore, if no claim of bank overdraft appeared in the Balance Sheet, it would represent an assertion by the Directors that no overdraft liability existed at the balance sheet date.

Basic Techniques for collecting Evidence
   1. Physical examination and count
   2. Confirmation this should be in writing and external sources.
   3. Examination of original documents which should be compared with the entries in the books i.e. Vouching.
   4. Re-computation Additions, calculations, balance, extractions, etc.
   5. Retracting book keeping procedures Checking of postings.
   6. Inquiry-Auditors should form the habit of asking questions as this is necessary and a valid technique.
   7. Correlation seeking internal consistency in records and accounts.
   8. Observation seeking for oneself is the best possible confirmation especially in connection with internal control system.

However, auditor requires a habit of always seeking confirmation of oral answers.

Test Checking
It is not always necessary to obtain evidence about each individual transaction. The modern approach is to obtain evidence about each type of transaction by examining a representative sample of each type. This is called test checking and it is applied as much to assets and liabilities as to routine transactions. The size of the sample to be tested depends on:

a. The strength of the internal control system.
b. The number of items involved
c. The materiality of the items.
d. The nature of the item.
e. The audit risk attached.

CHAPTER 12

AUDIT OF STOCK AND WORK-IN-PROGRESS

INTRODUCTION
Stock and work-in-progress (or inventories) have been the subject of more attention and discussion in many years, and shall still occupy that position, than any other asset appearing in the financial statements of organizations. The reasons for the importance attached to stocks and work-in-progress is as follows:

i. Stocks and work-in-progress usually constitute one of the largest items in the balance sheet of manufacturing or merchandizing organizations. A relatively small error may therefore have a material impact on the sold in the trading account and therefore have a direct impact on reported profit.

ii. The use of different accounting bases may result in significant different reported profit in the same organization depending which accounting bases is applied. Statement of Accounting System (SAS) 4 on stock sand work-in-progress represent an attempt at standardization and has narrowed reported financial position of the enterprise.
iii. Year-end stocks and work-in-progress directly affect the cost of goods the difference to a certain extent.

iv. Different bases of valuation may be used for various sub-classifications of stock such as:
   a. Raw materials
   b. Consumable stores
   c. Goods in the process of production (particularly when some parts are brought, while other are manufactured); and
   d. Finished goods

v. Auditors may have problems identifying certain specialized items, let alone commenting upon the reasonableness of their valuation, for example, jewelry or chemicals.

vi. Inventories have been shown to be most susceptible to major errors and manipulations.

**Categories of stock**
The categories of stock which the auditor is likely to meet with in practice include:

i. **Raw materials**: These are materials intended with to be used as input during processing. They are often purchased locally or off shore.

ii. **Finished goods**: These are either manufactures of purchased for resale in the case of a merchandizing concern.

iii. **Components**: These are finished products in their own right and may be purchased or manufactured by the organization. Components are assembled with other parts to obtain the final products.

iv. **Supplies**: These are consumables.

**Management’s responsibility over stock**
It is the duty of management to establish an adequate system of controls over stock and work-in-progress, to adopt a consistent and appropriate basis for accounting over stock and work-in-progress, to properly value stock and work-in-progress and to ensure, so far as stock and work-in-progress is concerned, that the financial statements comply with CAMA 1990 and any other relevant regulations.
Management is to setup adequate internal controls over stock and work-in-progress. Important components of the controls are the organization of stock counts. Management’s objectives in carrying out stock counts include:

i. To provide a basis for determining the quality required for the valuation of stocks and work-in-progress.
ii. To verify the existence of stocks and work-in-progress.
iii. To provide a basis for checking the correctness of stock records.
iv. To verify the condition of stocks and work-in-progress.

In order to achieve the above objectives, the stock count exercise must be properly planned, organized and controlled. Essentially:

i. Those taking part in the stock count should be:
   a. Persons familiar with the stock items concerned;

ii. Written stock taking instructions should be issued by the organization to all staff taking part in the count., the written instructions should cover the followings:
   a. The timing and location of the stock count.
   b. A description of the stocks to be counted and their estimated quantities and values.
   c. Full details of the duties of all personnel involved.
   d. Provision for the suspension of the movement (or if impracticable strict control) of stocks during the count.
   e. The division of stock taking areas into sections for control purposes
   f. Arrangements to ensure proper “cut-off”. Dispatch documents should have been raised for all goods in which property has passed to the customer (the related stocks having excluded from the count if still on the premises). Likewise all goods received (regardless of whether they are yet on the premises) should be accounted for along with the related liability.
   g. Provision for the identification and segregation of goods held for their parties, so that they are not recorded as part of the organization’s stock.
   h. Confirmation and recording of organization’s stock held by third parties.
   i. Provision for the identification of slow moving, obsolete or damaged stocks.
j. The maintenance of records detailing all stock movements during the count if complete suspension is impracticable.

k. The noting of last number of goods received and goods dispatched records.

**Year-end and continuous (perpetual stock taking procedures).**

An organization may adopt a continuous (perpetual) or year-end stock taking strategy. A continuous stock taking strategy is that in which items of stock are counted throughout the year in such a way that each item is counted at least once during the year. Where the perpetual inventory system is in use, the adoption of a continuous (perpetual) stock taking strategy is imperative. This is because under a perpetual inventory method it is necessary that each item is counted regularly to ensure that discrepancies arising for whatever reasons are identified within a reasonable period of time.

High value items and items that have high rate of turnover are counted more frequently than other items. It should be noted that the existence of a perpetual inventory system does not obviate the need for management to consider whether there should be a full physical count of perpetually counted stocks at least every few years. Continuous stock taking strategy has the following advantages:

i) They enable irregularities involving stocks to be identified and corrected promptly.

ii) They are more effective as deterrent against irregularities by the storekeeper and his staff.

iii) They help generate reliable stock values for the preparation of interim management accounts.

iv) They often obviate the need for production stoppages, as is the case where stock counts are carried out at the year-end.

Where stock is based on records substantiated by continuous or periodical physical stock taking, the procedures should ensure that:

i. Adequate stock records are kept up-to-date.

ii. Each stock counts have surprise elements.

iii. If the checking is continuous, it is done systematically during the year, or if periodic, at suitable times such as when stocks are low or have reached a specific order point.
iv. All differences are properly investigated and the record adjusted accordingly. A schedule of differences with action taken should be maintained.

Valuation of stock and work-in-progress
It was noted earlier that the basis of valuing stocks might have significant impact on the reported profits and financial position of an organization. The fact that the method of valuation demand degree of judgment means that this is an area open to disagreement between auditors and directors.
SAS 4 provides that stocks and work-in-progress should, subject to some exceptions, be stated at the lower of cost or net realizable value. Below, we state how costs and net realizable value are determined.

Components of cost
Cost components in the valuation of stocks and work-in-progress include all costs incurred in getting the stock to its present locations and condition, and comprises in particular of:

i. Cost of purchases: This includes purchase price, carriage inwards, etc. Note that where it is impossible to match stocks on hand against specific invoices, the only acceptable policies to be applied to arrive at an approximation are:
   a. First-in-First-out (FIFO): This is the method of computing the value of closing stock based on the assumption that the first items in stock or acquired are the first ones used in production or consumed.
   b. Average unit: This is also called weighted average unit cost where it consistently approximates historical costs. Under this method, the closing stock is assigned a value determined by a weighted average of the cost of opening stock and all acquisitions during the period. Calculation may be made on a continuous basis after each acquisition or at fixed intervals.
   c. Specific Identification: Under this method, items of stock specifically identified by particular attributes and assigned their values.
d. **Standard Costs**: This is a method of computing the value of costing stock based on predetermined cost. For this method to reflect the actual cost; cost variances should be properly allocated and the standard costs regularly reviewed to ensure they are in line with actual costs.

e. **Adjusted Selling Price this is also called**: “Retail inventory method” and sometimes is simply calculated as “selling price less an estimated profit margin”. This is a method of determining the value of closing stock in which the historical cost of stock is estimated by applying the gross profit margin to the retail value of items or groups of items in stock. The amount so determined is then deducted from the retail price to arrive at the value of the stock.

Latest purchase price, Last-in-First-out (LIFO) and Based stock valuation methods are not recommended by SAS4

a. Latest Purchase Price: Under this method, the value of closing stock is determined by applying the cost of the latest item purchased to the number of items on hand.

b. Last-In-First-Out (LIFO): This is a method of computing the value of closing stock based on the assumption that the last items purchased are the first issued or consumed.

c. Based stock valuation: Under this method, a minimum level of stock, carried at the historical cost of acquisition, is held at all times. However, any additions to or excesses over the base stock are carried at different bases such as FIFO, LIFO, etc.

ii. The cost of conversion: This includes direct labour costs, direct expenses such as royalties ‘payable on units’ products and any overheads which relate to the production function. Where the intrinsic value of a product appreciates by virtue of storage costs should be included in determing the “costs” of the product.

iii. Net realizable value (NRV): This is the estimated amount for which stocks can be sold in the ordinary course of business during the next accounting period, after allowing for estimated further costs of completion and costs arising on sale. It is realizable value” should be on an item-by-item or batch-by-batch
basis and not on a global basis. Replacement costs should not be used as a criterion for valuing stocks as it takes into account a loss greater than that expected to be incurred, or of a loss which will not materialize at all. Replacement cost means the amount for which the goods could have been manufactured or bought immediately before the balance sheet date.

Valuation of plantation products, arable products and live stocks.
The principles enumerated above for the valuation of stocks and work-in-progress is easily applicable to manufactured and purchase items. Because of this peculiar nature, special considerations are involved in the valuation of plantation products, arable products and live stocks. These special considerations are set out in SAS 4 and are discussed below:

Plantation Products
The problem in valuing plantation products derives from the fact that a plantation does not usually start to produce until after a long gestation period. All cost associated with land preparation, planting, pruning and development should be accumulated and amortized over the life of the plantation. Where the planting is done in batches, cost of such batches, where possible should be separately accumulated. This will enable the revenue of each batch to me matched with the cost.

Each year, the cost of plantation output should be valued at the proportion of the cost accumulated for the quantities harvested plus the cost of harvesting and transporting them to the point of sale. It is acceptable to use average cost of production in assigning a value to the quantities harvested and those yet to be harvested as most plantation products are homogenous. Plantation crops which yield product within the first year of being plated should valued in the same way as arable products.

Arable products
In valuing arable products, three distinctive operational stages in their production for which cost be accumulated are recognized. These
operational stages and the harvested crops stage. (growing crops) stage, and the harvested crops stage.

i. The valuation of tillage should be based on the accumulated costs of labour and usage of machinery for preparing the land for planting, ploughing and fertilizer spreading.

ii. In valuing in-ground crops, the relevant components include the costs associated with tillage, labour, seeding, weeding, disease control and the attributable cost of machinery used.

iii. The valuation of harvested crops involves the correct determination of actual input costs, labour, depreciation and storage costs at the time of harvest, and the proper allocation of group costs to the portion harvested to ensure that the value of harvested cost includes all the cost incurred from tillage to harvesting.

Most farm products are perishable or deteriorate quickly; therefore, it is appropriate to make reasonable provision for deterioration or normal spoilage based on industry norms after consultation with experts. Where there is an adequate record keeping and an appropriate cost accounting system, cost should form the basis for the valuation of arable products. In other situations, the net realizable value basis should be used.

The use of official prices for valuing stock is generally not preferred, except where they are below cost. The prices are intended market value, with recognition for profits.

Livestock
The following three approaches to the valuation of livestock are generally accepted in use:

i. Cost approach: The value is based on the actual cost incurred on each category of livestock.

ii. Net realizable value (NRV): The value is based on the expected returns following for the costs of fattening, preparation for sale and selling.

iii. Appraised value: A professional valuer, taking into consideration the current market value, the mortality factor and the relative marketability of the breed or class of stock, determines the value.
It is usually difficult to determine the actual number and the existence of livestock, especially animals that graze. It is also difficult to identify the various stages of their development. The above problems often require the services of experts for their resolution.

For the purposes of cost accumulation animals may be segregated on the basis of their age, breed, sex or productivity. Appropriate detailed records of costs should then be kept and such costs accumulated in accordance with the categories named above.

Such records help in the allocation costs incurred for livestock are essential for determining the profitability of different categories of livestock.

Livestock raised primarily for its products rather than for consumption. For example, dairy cattle or egg-laying poultry should be valued on a different basis. The cost of bringing such livestock to the point of maturity should be accumulated. These costs should then be amortized over the estimated productive lives of the livestock.

**Long-term contracts**

On long-term contracts, Statements of Accounting Standards (SAS) 5 provides that profit should not be taken on uncompleted contracts until the outcome of the contract can reasonably be foreseen. Profits should be calculated by reference to total contract price compared with estimated total cost (i.e. cost to date plus estimated further costs) and a proportion taken to reflect work done to it i.e. work certified to contract price.

The above is in accordance with the concept of prudence; revenue and profit being considered realized when they could be assessed with reasonable certainty. SAS 5 maintains that in accounting for construction contract, every organization should use either the:

i. Completed-contract method, or

ii. Percentage-of-completion method.

The method selected should beconcertedly applied in compliance with SAS 1 (Disclosure of Accounting Policies).
Components of cost
Cost components in the valuation of stocks and work-in-progress include all costs incurred in getting the stock to its present locations and condition, and comprises in particular of:

i. Cost of Purchases: This includes purchase price, carriage inwards, etc. Note that where it is impossible to match stocks on hand against specific invoices, the only acceptable policies to be applied to arrive at an approximation are:
   a. First-in-First-out (FIFO): This is the method of computing the value of closing stock based on the assumption that the first items in stock or acquired are the first ones used in production or consumed.
   b. Average Unit: This is also called weighted average unit cost where it consistently approximates historical costs. Under this method, the closing stock is assigned a value determined by a weighted average of the cost of opening stock and all acquisitions during the period. Calculation may be made on a continuous basis after each acquisition or at fixed intervals.
   c. Specific Identification: Under this method, items of stock specifically identified by particular attributes and assigned their values.
   d. Standard Costs: This is a method of computing the value of costing stock based on predetermined cost. For this method to reflect the actual cost; cost variances should be properly allocated and the standard costs regularly reviewed to ensure they are in line with actual costs.
   e. Adjusted selling price this is also called: “Retail inventory method” and sometimes is simply calculated as “selling price less an estimated profit margin”. This is a method of determining the value of closing stock in which the historical cost of stock is estimated by applying the gross profit margin to the retail value of items or groups of items in stock. The amount so determined is then deducted from the retail price to arrive at the value of the stock.

Completed-contract method
Under the completed-contract method, revenue is recognized when the contract is completed. Costs incurred on the contract and billings are accumulated until the contract is completed. No interim charges and credits are made to profit and loss account. Under billings and over billings should be reported as part of working-in-progress.

Sometimes, there are costs to be incurred at the end of the contract which may not be material to warrant regarding the contract as yet to be completed. Such costs are provided for and the contract is treated as completed. In the construction industry, this is referred to as practical completion stated. The completed-contract method should be used for:

i. Short term contracts; and
ii. Long-term contracts where it is very difficult to have reliable estimates or forecasts of both costs to completion and the percentage of contract executed.

Under the completed-contract method the following assumptions or conditions are applicable:

i. Foreseeable losses should be charged to profit and loss account in the period they are identified. For the purposes of establishing foreseeable losses on anyone contract should not be set off against anticipated profits of other contracts.

ii. Where a long-term contract comprises clearly identifiable segments, foreseeable losses arising from one or more anticipated profits arising from others.

iii. A contract should be regarded as completed only when all the activities relating to it are accomplished. In a situation where the additional costs required to.

iv. Complete the contract are not significant, provision should be made for such costs and the contract treated as completed.

v. General and administrative expenses relating to a particular period should be charged to the profit and loss account of the period. These are not contract costs.

Percentage-of-completion method
The percentage-of-completion method should be used when the following conditions are met:

i. There is a contract in which the following terms are included:
a. The goods or services to-be provided and received
b. The frequency of inspection of work-in-progress and the certification procedures for billing purposes.
c. The manner of billings for work done and the terms of payment.

ii. The contractor has an adequate estimating process and the ability to estimate reliably both the cost to completion and the percentage of contract executed.

iii. The contractor has a cost accounting system which adequately accumulates costs to final work in a manner consistent with his estimating process.

The percentage-of-completion method is considered to give a fair measure of activities performed in each accounting period and the resultant revenue. Thus, revenue is adequately matched with cost in the accounting period.

Under the percentage-of-completion method, the proportion of revenue in relation to the work done should be determined in one of the following ways:

i. The percentage of estimated total revenue that the incurred costs to date bear to the estimated total costs;

ii. The percentage of total contract value that the certifiable work done to date bears to the estimated total value of the contract.

Where the revenue computed under the cost to completion exercise is lower than either of the amounts arrived at in the paragraph above, the revenue to be recognized should be that derived under the cost to completion exercise. Under this cost to completion exercise, it is usual to establish that the revenue is not overstated by computing the estimated total cost completion and comparing it with the total estimated revenue.

Audit objectives over stock and work-in-progress
The objectives that the auditor should seek to achieve when auditing stocks and work-in-progress are as follows:

i. To assess the system of internal controls to determine whether they are reliable.
ii. To ensure that an appropriate basis of accounting is applicable to stocks and work-in-progress.

iii. To ensure that cost of sales for the financial period and stocks at the end of the period are accurately stated and in particular to establish:
   a. The accuracy of cut-off.
   b. The physical existence and quantities of stock
   c. The title of stock
   d. The accuracy of stock evaluation at the lower of cost or not realizable value.
   e. That adequate provisions have been made for slow moving, obsolete or damaged stock.
   f. Those inter-divisional and inter-company profits on stock have been eliminated.

iv. To ensure whenever appropriate that the financial statements comply with the provisions of CAMA 1990 and any other relevant provisions.

Audit tests and procedures over stock
The audit activities necessary to satisfy the above audit objectives will involve the following tests:
   i. Tests on stock quantities;
   ii. Tests on stock valuation; and
   iii. Analytical review procedures.

Tests on stock quantities
Auditors verify the physical quantities of stock mainly by attending the organization’s stock count. There is at present no legal requirement for an auditor to attend and observe a physical stock count, or to perform independent counts on a test basis to verify the accuracy of inventory quantities and the inventory. In fact it should be stressed that:
   i. It is not the auditor’s duty to take stock
   ii. The auditors should make it clear to management that the reason for their attendance is to satisfy themselves as to the effectiveness of the application of the client’s procedures.

The work of the auditor where he attends the stock count can be discussed under three phases as follows:
i. Before the stock count (planning stage)
ii. During the stock count (execution stage)
iii. After the stock count (follow-up-stage)

The audit procedures that should be carried out before the stocktaking, during the stocktaking and after the stocktaking are set out as follows.

**Before the stocktaking (Planning Stage)**

The auditor should:

Review prior year’s audit working papers to ascertain matters noted during that audit which have relevance to the current year’s audit as far as stock is concerned.

i. Discuss stocktaking arrangements with management.

ii. Consider the location of the stock and assess the implication of this for the control and recording of the stocks.

iii. Review the system of internal control relating to stock, so as to identify potential areas of difficulty.

iv. Consider any internal audit involvement, with a view of determining the reliance which can be placed thereon.

v. Select for audit coverage a representative selection of locations, stocks and procedures, giving particular attention to high value items where these form a significant proportion of the total stock value.

vi. Arrange to obtain from third parties confirmation of stocks held by then or where such stocks are material when compared to be sufficiently independent or reliable, then arranging where possible to attend a stocktaking at the third party’s premises.

vii. In exceptional circumstances, establish whether the nature of the stock is so specialized that an experts help would be required to verify quantities or identify the nature and condition of the stock.

viii. Examine the way the stocktaking is organized and review the clients stocktaking instructions and their communication to those involved in the stocktaking. If the instructions are found to be inadequate, the auditor should discuss the matters with the client before the stock take, with a view to improving the instructions and, where appropriate, the stock control system generally.
**During the stocktaking (Execution Stage)**

The auditor should:

i. Observe whether the client’s staffs are carrying out their instructions properly, and record how all the points which are relevant and material to the stock being counted are dealt with.

ii. Make test counts to obtain assurance that only valid stock and indeed, all valid stock have been included in the counts records and that these have been stated correctly. When carrying out test counts the auditor should particularly consider those stocks which he knows, either from the stock records or from his prior year working papers, to have a high value, whether, individually or as a category of stock. He should select items both from count records and from the physical stocks and should check one to the other to gain assurance as to the accuracy of the count records.

iii. The auditor should see that the client deals properly with movements of stock during the count and should identify it for subsequent testing with the stock records and accounting records to satisfy himself that the cut-off is been properly made.

iv. Gain from his observation an overall impression of the quantity of stock held and its condition, to confirm his initial planning procedures and to support, in principle, the stock figures eventually appearing in the financial statements, should also obtain information about the stock’s condition, age and movements. For example, by discussion with storekeepers.

v. Compile working papers recording his observations, and those that he has carried out during his attendance. The working paper should, where relevant, include the followings:

   (a) Details of the sequence of stock sheets and the serial numbers of the last goods inwards and outwards- notes before and the first ones after, the stocktaking date.

   (b) Details of samples of stock selected by the auditor comparison with the final stock records.

   (c) Photocopies of, or extracts from, rough stock sheets for comparison with the final stock records.
(d) Items actually counted in the auditor’s presence or by the auditor himself

(e) Details of tests carried out to ensure the proper treatment of, for example, slow moving or damaged stock, work-in-progress, customer stocks, stock purchased from other group or associated companies, and containers.

(f) Details of tests made to ensure that all stocks have been counted and that all queries raised by the clients during the count have been satisfactorily cleared.

(g) A record of attendance with details of the audit test carried out and any audit checklists completed.

(h) Details of instances where the procedures were not satisfactorily carried out (Normally the auditor should resolve such matters with the client’s before the stocktaking is completed).

(i) The conclusions reached as to whether or not the stocktaking was satisfactory, and hence provide realizable evidence supporting the stock figure in the financial statements.

After the stocking (Follow-up-stage)
The auditor should follow-up the matters on his working papers at the time of the count by:

i. Checking the cut-off using details of stock movement and numbers of the last goods inwards and outwards in conjunction with records of sales and purchases.

ii. Testing that the final stock sheets are complete, checking the numerical sequences of the stock sheet by tracing sample items from the information recorded in the working papers.

iii. Ensuring that any continuous stock records have been adjusted and reconciled to the physical count and the differences have been investigated; and

iv. Checking final stock ‘sheets for pricing, extension casting, summarizing and officials’ signatures.

v. Following up all queries.
Procedures where stock counts are carried out other than at the year-end
Where stock counts have been carried out by the organization at date other than the year end date, additional audit work is performed to ensure that the stock quantities at year-end properly take updated. The additional audit work to ensure that the stock has been properly updated includes the following:

i. If date of physical count is remote from the date of balance sheet, consider whether client’s stock records are sufficiently dependable to rely upon to produce year-end stock figures or whether another physical counts is required.

ii. Test a sample of receipts of raw materials per quantity records against GRNs and a sample of GRNs against the quantity records.

iii. Tests a sample of raw materials per the quantity records against raw material requisitions or production schedule, as appropriate, and trace batches through work-in-progress and packaging into finished goods records.

iv. Compare yields achieved with standard yields and consider treatment of usage variance

v. Test a sample of transfers to finished goods against completed production booked out of work-in-progress and packaging.

vi. Test movements between different client locations.

vii. Test sample of dispatch notes against finished, goods records and a sample of movements out of finished goods against dispatch notes.

viii. Perform test count at the time of the audit and comparing with quantity records.

Procedures to ensure that there is proper cut-off over stock quantities
Cut-off procedures in relation to stock ensure that there is proper correlation between stocks, purchases and sales at the cut-off date. They ensure that stock transactions up to the cut-off date are properly reflected in the quantities of stock transaction up to the cut-off date are properly reflected in the quantities of stock as at that date. The audit work that should be carried out to verify cut-off includes:
i. Ascertain and assess the organization’s own procedure for ensuring correct cut-off. The conclusion on this initial assessment will determine the sample size of the further cut-off test mentioned below.

ii. Select a sample of GRNs for goods received immediately after the date and a sample of GRNs for goods received immediately after the date and checks the correlation between the date of receipt of the goods and the date of booking the increases in stock and the appropriate creditor.

iii. Select a sample of GDNs for goods delivered to customers prior to the cut-off date and sample of GDNs for goods delivered after the date and check the correlation between the date of dispatch and the date of booking the decrease in stock and the appropriate debtor.

iv. Review arrangements for ensuring proper cut-off between various categories of stock (e.g. raw materials, work-in-progress, finished goods etc) and between locations, select a sample of movements and check that they are recorded promptly and accurately.

v. Obtain additional assurance on the accuracy of the cut-off from work on reconciling suppliers’ statements and from the debtors’ circularization.

vi. If the date of the stock count differs from the balance sheet date, it will often be necessary to perform these tests as at both dates.

vii. Look for evidence of possible cut-off difficulties. For instance, the organization may be under pressure to achieve its forecasts or budgeted results, a high proportion of annual sales may occur in the last month of the year, or the nature of the product and enterprise’s accounting policies may leave room for argument as to the point at which a sale may properly be booked.

Procedures where stock quantity is based on perpetual inventory (or continuous stock counts)
Where stock is based on records substantiated by continuous or periodical physical stocktaking, procedures should be carried out to ensure that:

i. Adequate stock records are kept up-to-date
ii. Each category of stock is checked at least once a year and a record or such checks maintained.

iii. If the checking is continuous, it is done systematically over the year, or if periodic, at suitable times such as when stocks are low or have reached a specific reorder point.

iv. Differences are properly investigated and the records accordingly adjusted. A schedule of differences with action taken should be maintained.

v. There is an element of surprise in each stock count.

**Appropriate specific procedures:**

i. Check that the physical inventory program is running according to the timetable laid down at the beginning of the period. If the plan is not been met, see what steps the organization is to ensure adequate coverage by the year-end.

ii. Attend during some of the counts carried out by the perpetual inventory stock takers and/or test count a sample of items to establish adequacy of procedures.

iii. Ascertain and follow up reasons for major difference between physical and recorded quantities during the period.

iv. Review and test cut-off procedures.

v. Stock records covered by perpetual inventory will usually be listed and agreed with the relevant control accounts at near the year-end. Consider the adequacy of the procedures planned to carry out this exercise and ensure that adequate work is performed to check the listing.

**Test on the valuation of stocks and work-in-progress**

Stocks and work-in-progress, except in unusual cases, should be valued at the lower of costs and net realizable value. Costs may be arrived at by applying the FIFO, average cost or standard costs or specific invoice basis. Where any of these bases have been selected, the auditor must ensure that they are correctly and consistently applied. Suitable audit tests that could be carried out by the auditor include:

**Raw materials**
i. If no standard costing system and assuming FIFO: Vouch prices of supplier’s invoices. The vouching should be directed towards suppliers’ invoices for the last deliveries prior to the accounting date. If the quantity of stock is greater than the quantity of the last delivery, the excess should be evaluated at the price of the previous delivery, and so on until the quantities form the most recent deliveries equal the quantities in stock otherwise in such cases stock is being valued at later invoice price and not FIFO cost.

ii. If standard costing system: Test postings of suppliers’ invoices to raw materials account (at standard prices) and to price variance account (difference between standard and actual costs). Note that in most cases where there is a standard costing system, there is little if any, purpose in performing the typical year-end, price tests against suppliers’ invoices which are carried out for FIFO purposes.

iii. If average cost system used: Here the following audit procedures will be desired:
   a. Test posting to raw materials account against suppliers’ invoice.
   b. Test arithmetical calculation of average costs.
   c. Consider the implications of any pricing errors discovered in the above tests for the raw material content of work-in-progress and finished goods.

Work-in-progress and manufactures goods
Under some accounting systems the figure of work-in-progress is derived solely costing records. Physical checking of work-in-progress will often not be possible by methods similar to those adopted for stocks.

Where it is not possible or practicable to identify the work-in-progress with either the components which have gone into it or the products which will emerge from it, the auditors will be particularly concerned to ascertain: The costing systems from which the work-in-progress figure is arrived at:
   i. Whether the costing systems is realizable and in particular whether it is integrated with the financial account.
ii. The extent to which checks are made by preference to statistical output of main products and of by products (if any) which ought to be obtained from materials used.

iii. The system of inspection and reporting thereon to enable allowance to be made in the costing records for scrapping and rectification.

iv. The basis on which overheads are dealt with in the costing records.

v. Any profits element included for which adjustments is required.

The procedures to verify the values of work-in-progress and manufacture goods include:

i. If no standard costing system exists:
   a. Test raw material content against formulation of engineering specifications as appropriate and where relevant, suppliers’ invoices to transfers from raw material accounts.
   b. Test direct labour content against production control records of expected hours per job or batch and/or against actual hours booked by direct labour to jobs or batches.
   c. Check cost of direct labour contents against hourly wage rates, including normal overtime, houses etc.
   d. Cross check direct labour content per unit against total available direct labour hours in the period and total units of production.

   a. Check that all properly allocable overheads and only these overheads which are properly allocable are included in valuation.
   b. Check that overheads are applied to work-in-progress and finished goods by an appropriate method which takes account of normal levels of production.
   c. Check that overheads content represents approximately the same proportion of annual actual overheads that work-in-progress and finished production in stock bears to annual production.
   d. Consider the implication of the above enquiries for the labour and overhead content stocks.

ii. If standard costing system exists:
a. Test raw material content of standards against product formulation or engineering specification and the prices used against approved standard costs.
b. Test calculation of standard hours.
c. Test direct labour contents of standards against the rates used against standard labour rate.
d. Test credits to payroll accounts and debits to production against.
e. Check correct treatment of labour rate and efficiency variance and any remaining balance on direct labour payroll accounts.
f. Test overhead content evaluated at standards.
g. Test credits to overhead expense accounts and debits to production against completed job or batch cards and standard overhead rate.
h. Examine calculation of standard overhead rate and consider the implications of any inherent defects.
i. Check correct treatment of overhead spending capacity, and efficiency variances.

**Test of Net Realizable Value (NRV)**
Tests on NRV will be necessary where there are indications that the possible audit tests include:

i. Compare product costs of major products with current list selling prices less discounts.

ii. Evaluate shortfall of selling prices of finished goods ensure adequate provision has been made where necessary.

iii. Consider whether any further provision is required to NRV, any raw materials or own processed components which are unique to finished products where cost exceeds NRV.

iv. If anticipated price increases have been taken into account in determining NRV ensure that they are definite and that there are no known impediments to introducing them, such as government price control limitations (if any) or conceptual obligations.

v. In comparing selling prices and cost determined under a standard costing system remember that standard cost may not be the same as actual cost.
vi. Consider the tax implications of any significant, persistent and unjustifiable instances of negative or negligible price margins.

**Procedures to ensure that obsolete, redundant and unsaleable stocks have been identified and correctly treated in the books.**

i. Review client procedures for identifying, and providing obsolete, redundant and unsaleable stocks against the following criteria:
   a. Review made by or with the active participation of marketing technical and accounting staff.
   b. Complete line-by-line review for purposes of the physical count or year-end accounts, or continuous review in cycles of less than a year.
   c. Review acted upon by scrapping or disposing of stocks identified as obsolete, redundant and unsaleable.
   d. Results of review taken up in financial records by providing for items still physically on hand and by writing out of the books items physically disposed.

ii. Check for stocks of finished products that do not appear in current price lists or promotional literature.

iii. Compare quantities of finished products with unfilled orders.

iv. Compare quantities of finished products against past and projected sales performance.

v. Identify raw materials and components unique to obsolete as unsaleable products.

vi. Check that stocks or perishable goods are within their shelf life.

vii. Review quantity records for major items with no or little outward movement during previous year or with stocks equivalent to several year’s usage.

viii. Check that all items noted as unsaleable at time of physical count have been provided for.

ix. If the client provided for obsolete, redundant and unsaleable stocks or 25 percent of all items over one year old, check whether this formula is realistic and supported by previous experience.

x. Follow-up the outcome of provisions against these categories of stock made in the previous year to build up an assessment of the realism of management’s judgment. Examine quality control report prior to and after the year-end to see whether the year-end
stock and work-in-progress is likely to include items of doubtful quality.

**Analytical Review Procedures.**

In addition to evaluating controls and security arrangements, the stock, attending and observing the stock count to verify the existence of stocks, and assessing the acceptability of stock valuation, the auditor should undertake a review of the financial statements to gain an overall appreciation of the figures involved and to assess the materiality of stocks and work-in-progress in relation to the financial statements as a whole. Such procedures will include:

i. General scrutiny of the stock records, in order to:
   a. check on large of unusual items (loose tools, for instance, might be included in error).
   b. Ensure there are no material omissions.
   c. Reconcile stock movements since the beginning of the period with purchases, production and sales.

ii. Ratio analysis, considering:
   a. The gross profit ratio compared with that of previous year and those of other business operating in the market.
   b. The relationship between stocks and turnover, including consideration of current trading conditions and any changes in sales or stockholding policies.

iii. The relationship between actual and normal wastage to rejects deterioration.

iv. A review of other available information, and in particular:
   a. Operating and sales budgets
   b. Standard costing records ensuring that there are regularly updated, and that variances are correctly treated in the accounts.

v. Checking that disclosures in accounts comply with CAMA 1990 and SAS 4.

vi. Checking that bases and methods of stock accounting are consistent with previous year.

vii. A review of stocks and work-in-progress transferred between divisions or sites at above cost and ensure that unrealized profits are eliminated.
viii. Discussion with management. Note that it is considered in practice to obtain from the directors a written statement outlining not only any representations made by them during the course of the audit, but also detailing the method of ascertaining stock quantities and the bases of valuation. This would usually from a part of the letter of representation; through it may be a separate statement.

CHAPTER 13
AUDIT WORKING PAPERS

a. Definition:
Audit working papers are records of evidence gathered by the auditor before, during and after the audit. They are records of procedures applied in the performance of audit work.

b. Reasons for preparing working papers:
The main reasons for preparing audit working papers include the following:

1. The reporting partner needs to be able to satisfy himself that work delegated by him has been properly performed. The reporting partner can only do this by having available to him detailed working papers prepared by the audit staff who performed the work.
2. Working papers provide for-reference, details of problems encountered, together with evidence of work performed and conclusion.
3. The preparation of working papers encourages the auditor to adopt a methodological approach.
4. Working papers can be used in evidence against charges of enough care and skill had been exercised and that, in these circumstances, his conclusions were reasonable.
5. It provides a basis for training audit staff.

The International Auditing Guideline (ISG9) stresses that, “working papers should always be sufficiently complete and detailed to enable an experienced auditor to obtain an overall understanding of the audit”.

c. Contents of working papers:
It is usual for the audit working papers to be divided into:

1. A current file prepared for each annual audit and containing information relating primarily to the particular audit.

Current File Contains:
- A copy of the accounts, signed by the directors
- Index to all working papers
- Details of the audit plan
- Audit programme particulars and dates of work carried out and precise details of audit tests, their results and conclusion drawn.
- Schedules supporting each item in the balance sheet; showing make-up and how existence etc. has been verified, suitably cross referenced to documents arising from external verification.
- As above for all compliance with statutory disclosure requirements.
- Record of queries raised and the way in which they are resolved.
- Schedule of important statistics and working ratios together with explanations received of any significant variations (analytical review).
- Records or extracts of director’s and shareholders minutes, cross referenced where appropriate to working papers.
- Copy of management letter(s) and clients response
- Matters which though not of permanent importance, which will require attention during subsequent periods.

Permanent File Contains:
- Copy of the engagement letter, whether a statutory or non-statutory audit;
- Memorandum and Articles of Association Copies of minutes and other documents
- Short description of business and places of business
- List of accounting records and responsible officials and plan organization (constantly update).
- Statement showing a note of any accounting matters of importance and basis of accounting adopted;
- Client’s internal accounting including where appropriate, systems, notes flowcharts questionnaires.
- Criteria used to judge the Quality of Working Papers.

To support the audit opinion, the following criteria would be applied to measure the quality of the working papers:

1. Structure of Files:
A methodological and consistent structure is an essential requirement for the organization of each client’s working papers. The schedule appropriate to each section of the files should be indexed and cross-referenced in accordance with the standard method employed.

2. Presentation of Schedules Commonly Used:
   This should be examined to ensure consistency in layout (preprinted forms are designed to assist members of staff in this respect and should be used where appropriate).

3. Working Paper Discipline:
   Whatever the detailed content and purpose of a working paper, certain basic information must be shown.
   - This information includes:
   - The name of the client
   - The balance sheet date
   - The reference sheet date
   - The name (initials) of the person reviewing the working paper and;
   - The date of review.
   In addition, the following must be indicated:
   - The source of the information included in the working paper (e.g. figures from the nominal ledger from the payroll journal for a particular month, or member of the client’s staff) if this is not otherwise apparent;
   - The nature of the balance or amount dealt with the working paper, if this not otherwise apparent;
   - The scope of the audit tests, which recorded on the working paper;
   - A legend describing the audit tick marks used, or an explanation of the audit procedure carried out (if this not evident from the audit programmed itself).

4. Completeness:
   The schedules should be scrutinized to ensure that
   - All relevant and material facts and their sources are shown in respect of information and evidence obtained in the audit;
The nature, extent and timing of the audit procedures under taken by the members of staff are shown;
Summaries of evidence are shown and where these are readily apparent from the information, notes etc. the basic for arriving at the conclusion is set out clearly.

d. Retention or Non-Retention of Working Papers
In considering which records to handover, or retain on relinquishing his appointment, the outgoing Auditor should consider two fundamental points:
- Whether the various records belong to him or his client.
- If any fees are unpaid, whether a right of client exists over certain records.

(i) Ownership:
In order to determine whether or not documents and records belong to the certified accountant, it may be necessary to consider:
- The contract between the accountant and his client;
- The capacity in which the documents and records exists or are brought into being.

Clearly, if the records do not belong to the accountant the, he ahhs no right to retain them (save perhaps to exercise a right of lien regarding unpaid fees).

In Leicestershire Country & Michael Faraday & Partners Limited (1941) 2kb 205, the court of Appeal stated that, if an agent brings into existence certain documents whilst in the employment of his principals, they are the principal’s documents and the principal can claim that the agent should hand them over. Some areas of an accountant’s practice involve his acting as an agent for his client. Conversely, if the accountant is acting as a principal, then the records will belong to him.

Applying this principle to the points in the question and assuming that no specific contract exists between the accountant and his client, the position would be as follows:

(a) Books and Documents relating to:
1. The business
2. The individual owner
In both cases, the records clearly belong to the business and individual owners, respectively and not the accountant. They should therefore be returned to the former client or its nominee (e.g. the new accountant). The outgoing accountant should ensure that he obtains a suitable acknowledgement and discharge in relation to these records from the former client or its nominee.

(b) Working Papers Relating to:
   1. The audit
   2. Other work

Acting as an auditor, the Auditor is acting as a principal, and his working papers are his won. Similarly, his own properly but the end product of his engagement will belong to the client. For example, if the work is to prepare or write up a set of books for the clients, the completed books belong to the clients, but schedules, which he prepares for the purpose of writing up the books, will belong to him. It was established in Chantrey Martin & C.O.V. Martin (1953).

(c) Correspondence with:
   1. The Clients:
      Letter received by the accountant from his client are the accountant’s property and may not be returned by him. The same situation applies with regard to the accountant’s copies of his letters to his client. The accountant is clearly acting as a principal and not as an agent.
   2. The Inland Revenue
      In Chantrey Martin & C.O.V Martin (1953), it was held that correspondence between an accountant and the Inland Revenue was the property of the client. This is because the accountant is acting as agent for the client for the purpose of agreeing with the Inland Revenue on the client’s tax liability.

(d) Other third parties
Communications with third parties are the property of the accountant where the relationship is that of client and professional man and not that of principal and agent.

It may be noted that the accountant has been paid for work carried out for either the business or the owners or both. In this situation, he must consider whether he can retain any record which under the principles established above do not belong to him but which under he has right of lien for the unpaid fees, a lien is a right of a person to retain possession of the owner’s property until the owner pays what he owes to the person in possession.

It gives the possessor of the right to retain goods until a debt arising in connection with the goods is paid. Auditors are considered to have a particular lien over any books of accounts, files and papers which their client have delivered to them; and also over any documents, which have come into their possession in the course of their ordinary professional work.

In the case of Woodworth v Country 1975, Court of Appeal held that, whilst an accountant possesses no general right of lien over records. Which pass through his hand in the course of his hands in the course of his professional duties, he does posses a particular right of lien over certain records.

In order to establish a particular right of lien, the following circumstances must exist:

a. The documents retained must by property of the client who owns the money and not a third party, no matter how closely connected with the client.

b. The documents must have come into the possession of the accountant by proper means.

c. Work must have been done on the documents.

d. The fees for which the lien is exercised must be outstanding in respect of such work and not in respect of work other documents belonging to the same client.

Applying the above points to the records in question (i.e. those records which the accountant prima-facie, does not own):
a. Books and documents relating to:
   1. The business;
   2. The individual owner.
Provided work has been carried out on the above records for fees, which remain unpaid, then the accountant can retain these records. However, if the relating to work carried out on the business is not paid, the accountant cannot retain the documents relating to the individual owners because:
   - They are not property of the client owing the money, and
   - They are not documents on which work has been done for which the fee is due.
b. This principle is not relevant to working papers relating to audit or other work owned by the accountant/auditor.
c. Correspondence with:
   1. The Inland Revenue;
   2. Other third parties.

If the accountant acted as agent in relation to this correspondence, then the points mentioned in (a) above will apply.

The right of ownership in relation to client’s record: In considering which records to have over or retain, on relinquishing his appointment the outgoing accountant should consult three fundamental points:
   1. Whether the various records belong to him or to his client;
   2. If any fees are unpaid, whether a right of lien exists over certain records;
   3. In relation to records, which do belong to the accountant, whether he should hand it to persons other than his former client.

Standardization of Working Papers.
Most audit firm adopt a system of standard working papers which can be used in all audits.
Advantages
   - It brings about efficiency
   - Staff becomes familiar with them
   - Matters are not overlooked
- They help to instruct staff
- Work can be delegated to lower level staff
- Work can more easily be controlled and reviewed

Disadvantages
- Work becomes mechanical
- Client staff may becomes standard
- Initiative may be stifled/discouraged
- The exercise of necessary professional judgment is reduced.

CHAPTER 14

AUDIT REPORT

14.0 INTRODUCTION
Audit report is the means by which the auditor communicates the results of his work to the shareholders in particular, and to other users
in general. Often, it forms an integral part of the financial statements. The report, written by the audit firm, and signed by a partner of the firm, expresses an expert opinion on the credibility of the financial statements.

14.1 An Example of Audit Report.

JOFAD ROYAL NIGERIA LTD.
The Report of the Auditors
To the Members

We have audited the financial statements on pages 2 to 10 in accordance with approved auditing guidelines and standards. We obtained the information and explanations which we considered necessary for our audit.

RESPECTIVE RESPONSIBILITIES
In pursuance of the provisions of the law, the Directors have the responsibility to prepare the financial statements and present same to the auditors and we as auditors have the responsibility to examine and express our opinion on the financial statement.

BASIS OF OPINION
Proper books were kept, and adequate returns received from branches not visited. To the best of our knowledge, and according to the information and documents presented to us, the financial statements are in agreement with the books and records, and comply with the provisions and guidelines of the Companies and Allied Matters Act, 1990, and the Statement of Accounting Standards issued by NASB.

In our opinion, the financial statements give a true and fair view of the state of the company’s affairs at 31st December xxxx and its balance sheet as at that date.
J. Femi Adebisi & Co.
Certified National Accountants
Lokoja, Nigeria.
14.2 Details of Audit Report

1. **Identification of the Users**: The audit report first identified its intended recipients, the shareholders of Jofad Royal Nig. Ltd. Other users are left out. This clearly reminded the members of the public that the auditor is directly responsible to the shareholders, and not to any other parties that may decide to use the audit report. However, he does not absolve the auditor from blame and liability if his report is misleading and such third parties incur financial loss resultantly.

2. **Identification of the Subject Matter**: The subject of the audit is the company’s financial statement made up primarily of the annual restriction of the documents examined to the profit statement, balance sheet and funds statement should not be taken as a denial that other parts of the financial statement fall within the scope of the auditors report, and the auditor has the duty to ensure that the information therein are not inconsistent with the contents of the accounts.

3. **State the Auditors Opinion**: The end product of the audit process, the opinion function in the audit report is the auditor’s judgment on the credibility of the financial statements.

4. **Report on other Responsibilities and Rights**: These are whether proper books have been kept, and whether the information required by the auditor were obtained, and whether adequate returns were obtained from branches not visited.

5. **Other Reports**: The auditor is permitted to make reference in his report to any matter which, although does not imply qualification, will aid the user in having a better understanding of the report. In report on such unusual events, care is required in order not to give the misleading impression of negative report.

6. **Judgment in Audit Report**: The auditor report is not in any way a guarantee or certification, nor is it a statement of undisputed fact. Rather it should be construed as an expression of personal belief. The Companies Act 1990 stipulates this view, provided the auditor has carried out an adequate examination of all the evidence he regards necessary to the opinion he expresses. In the circumstances, he shall not be held
responsible for any other than an opinion. The implication is that the auditor can not be held negligent if he makes an honest error of judgment in a situation which there is a room for doubt.

7. **Date and the Audit Report:** Three dates are often given consideration in an audit report. These are:

- The date to which the audited financial statements were prepared; in the above case 31\textsuperscript{st} Dec., xxxx
- The date of signing the report, in this case 31\textsuperscript{st} January xxxx
- The date of the AGM of the company

The date on the audit report should be appended after all other information contained in the financial statement have been approved by the board of directors, and the auditor has considered all availed evidence, including receipt and review of directors’ report, the Chairman’s Statement, etc.

The implication of the above is that audit reports are dated before the AGM, after which the auditor appears to have discharged his obligation under the contract between him and the shareholders.

For sensitive audits, especially the audit of public companies, for the auditor to carry out a special review of post balance sheet events in order to obtain assurance on the following:

- That all material post balance sheet events, if any have been identified.
- That all such events are adjusted for and disclosed in the financial statement either directly or by circularization, as appropriate in the circumstances.
- That a review of all known risk area has been undertaken.
- That a review of minutes of meetings of shareholders, directors and management committees does not reveal any matter which is inconsistent with the view expressed in the audit report.
- That known external information from the media, development overseas, have adverse effect on the company’s affairs which the auditor has reported upon.

**14.3 Qualified Audit Reports**
In all the above cases, we have been talking of unqualified. Otherwise referred to as ‘clean reports’, which in the layman’s view represent a ‘clean bill of health’.

There are however circumstances where the auditor is unable to issue such a clean bill because he is not satisfied with the quality of the accounting information he audited. In the circumstance, he should express his adverse opinion; or our auditing parlance, qualify his audit report.

In qualifying his report, the auditor must express his dissatisfaction fully as he sees it, leaving nothing in doubt. He should further state the reasons leading to the qualification, and quantify the effect on the financial statement where applicable.

He will not be absolved from liabilities if he merely report his dissatisfaction to the directors of the company’ without conveying such to the shareholders in his report.

14.4 The Circumstances which may lead the Auditor to Qualify his Report, inter alia, are:

1. Failure to obtain all the information and explanations the auditor believes are necessary to his audit.
2. Failure to keep accurate and dependable accounting books and records, thus denying the auditor an adequate basis for the measurement of the accounting information being attested.
3. Dissatisfaction of the auditor with the company’s system of internal controls in relation to weaknesses which could largely allow fraud and effort to occur, thus leaving the auditor in uncertainty about the accuracy and dependability of the accounting data he was examining.
4. Dissatisfaction of the auditor with the suspicious attitude or action of the management in relation to legitimate inquiries on which the auditor has been put on certain suspicious and sensitive matters.
In the above four cases, the qualification was caused by the uncertainty the company has created for the auditor in relation to reaching his opinion.

There are some cases where although there is no element of uncertainty, the auditor merely disagrees with the directors on the issue of another, and on that basis qualifies his report.

**Reasons for disagreement**

1. Disagreement with the financial accounting concepts, bases and policies used by the company in the valuation and allocation of accounting data for the reasons that:
   - They are not suitable to the business of the company.
   - They have not been consistently applied. They are generally accepted by the accountancy profession.

2. Disagreement with the disclosure of the accounting information in relation to the best accounting practice or the minimum disclosure requirements of the CAMA 1990, or those contained in other regulatory edicts.

**14.5 Types of Qualification**

a. **Disclaimer:** The auditor may be faced with financial statements on which he is unable to form an opinion. In the circumstance, he should disclaim an opinion and give his reasons for so doing.

Such instances could be:
   - Lack of co-operation by the management or staff
   - Lack of adequate evidence on which to base his judgment.
   - Inherent uncertainty in relation to loopholes in the company’s system of controls.

b. **Opinion, Subject to:** In some circumstances, the auditor may be able to form a positive opinion, subject to a doubt or uncertainty not on the validity of the accounts as a whole, but on a given aspect, e.g. where he failed to verify goods said to be in transit, and the related documents are said to be seized by customs officials, leaving the auditor with no other than the verbal evidence of the directors. The matter leading to this type of
qualification is therefore usually not fundamental enough to cause a qualification of the entire financial statement.

c. **Except Opinion:** The auditor may find much of the accounting data adequately measured and reported upon, but may disagree on certain items which are not considered fundamental, and which do not give a true and fair view on the entire accounts excepting those item or the item he disagrees with as not having a true and fair view. Examples are departure from SAS provisions, inappropriate accounting policy, extent and manner of disclosures, etc.

d. **Outright Qualification:** Where the auditor is convinced beyond all reasonable doubts that the accounts do not give a true and fair view, he should qualify his report in no mincing words, putting the case as he sees it, with his reasons for and quantification of the qualification.

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**CHAPTER 15**

**INVESTIGATIONS**

a. **Meaning**
Investigation is an examination of accounts and records of a business concern with some special purpose in view. In most of the cases, the purpose of such an enquiry is to know as actually as possible the financial position of the concern so that an opinion can be formed and action taken accordingly. Thus, it is a sort of special audit with a particular object in view. It is actually conducted in addition to the regular audit of accounts and is, thus a scrutiny of accounts pertaining to several years whereas an audit relates only to a particular period, more specially a financial year. This is the major point of difference between the two. But it has to be remembered that the investigation of
accounts of a joint-stock company is not legally compulsory as is the case with audit.

Thus, there is another major point of difference between the two. An Auditor performs audit as a matter of routine at some regular interval but an investigator has to be more searching and inquisitive in his enquiry, even though there are no suspicious circumstances during the courses of his work. Nevertheless, the objects are different in each case.

b. Essentials for Investigation
An investigator should keep the following points in view during the course of investigation:
1. He should keep himself free from the influence of Directors and Managers of the business.
2. He should familiarize himself with all the important details about a business before the commencement of his work.
3. If necessary, he should seek the assistance of technical experts during the course of his enquiry.
4. He should confine to himself the purpose of investigation and keep details in regard thereto quite secret.

c. Scope and stages of Investigation
When an investigator is appointment by his client, he should obtain in writing all the necessary instructions from him so as to decide for himself the scope of work to be performed in pursuance of a special object. If any limitations are placed on his work, he should obtain them in writing so that he may exactly determine the scope and nature of his duties.

d. Objectives of Investigation
Investigation of account of a business will be advisable under the following circumstances:
1. When a person intends to purchase a business
2. When a new company wishes to purchase a running business or firm.

(ii) Investigation for preparation of prospectus for issues of shares
When preparing the report on the profits and losses for the preceding five years, it is usual for the accountant to make some adjustments to the originally published financial statements. Such adjustments may be made in respect of material facts which would have been taken into account in the original financial statements had they been known at the time of their preparation, material sources of revenue or expenditure which are expected not to recur and material changes in accounting Policies during the period.

The relevant aspects and items shown in the financial statements during the previous five years that may require adjustments include the following:

1. **Contract Prices**: Where material amounts of income were provisional in that they were derived from government or other contracts which were subject to cost investigations, or which for other reasons were known at the time of making up the accounts to be liable to subsequent adjustments, consideration should be given to the question as to whether adjustment is appropriate.

2. **Bad or Doubtful Debts**: Generally, adjustments should be not be made, in the light of subsequent events, to provisions which were considered to be reasonably necessary in respect of bad or doubtful debts having regard to information available when the accounts of any year were made up. Exceptional cases do arise, however, where the amount involved is very material and in such cases, it is necessary to consider whether adjustments should be made.

3. **Stocks and Work-in-Progress**: Where it is established that the amount included in the accounts at any particular year and should have been materially different, a reallocation should be made.

4. **Income**: Where in the period covered by the report, there were material changes in the nature of the business or the sources of income, or there have been exceptional receipts, the circumstances of each case will require consideration in deciding whether any adjustments should be made.

5. **Accounting Principles**: Where in the period covered by the report, there have been material changes in accounting principles applied, or the method of comparing profits or losses has in any
material respect not been in accordance with accepted accounting principles, the profits or losses should, if practicable, be adjusted so that they are computed in accordance with consistent and accepted principles, or if this cannot be done, the matter should be explained in the report.

3. When a person desires to enter into a partnership firm as a new partner.
4. When a person wishes to lend money to a business and wants to know its financial position.
5. When a person seeks avenues of investments.
   When a person wishes to make a valuation of shares of a limited company.
1. When the proprietor of a business suspects fraud and so on.
2. When it is suspected that the affairs of the company are not being properly managed (i.e. Statutory Investigation).
   We will now consider the duties of the Auditor for investigation under the following circumstances:

i. **When a Person Intends to Purchase a Business**
   checking that the accounts have been prepared on the basis of acceptable accounting policies and that these have been consistently applied throughout the period and in prior periods. The effects of any unusual accounting policies should be adjusted for where possible.
   Recording and considering the implications of any qualifications in auditors’ reports.

   Preparing a summary preferably in columnar format, of the accounts of the years under review to provide a basis for carrying out a variation analysis of the financial figures.

   Computing appropriate ratios from the accounts in order to establish and review trends. And identifying any material variations from year to which particular attention will be paid.

   Checking the latest set of accounts. This is particularly so where the gross profit has increased as compared with former years, as it is
impossible that, with a view to the sale of the business, manipulations may have been carried out with the object of inflating the profits of these periods. Hopefully, the latest set of accounts will be to a recent date. If not, a set of accounts should be prepared to a more recent date.

Other matters that the accountant should consider before commencing the detailed work include:

(a) The funds available to purchase the business
(b) The price the seller is asking for the business
(c) The extent to which the client intends to take an active part in running the business, and the capacity in which the client intends to continue to employ the present owner of the business.

In checking the latest set of accounts, the Auditor should:

- Check that the stocks, if any, have been properly valued. The accountant should look for slow moving and obsolete stock items.
- Check that proper ‘cut off’ has been established for sales and purchases.
- Check that sales and purchases are properly stated.
- Check accounts receivable, age analysis and verify that bad debts provisions are reasonable and thus that the amount included in accounts receivable is collectible.
- Check that accounts payable are completely and correctly stated at the end of the period.
- Obtain a valuation of the freehold property, if any, by a qualified valuer and check that the property is in the name of the company.
- This is necessary where the client intends to purchase the freehold property.
- Consider whether the value of other fixed assets shown in the balance sheet is reasonable.
- Check that the value of stock, debtors and creditors at the end of the period, are representative of their normal levels.
- Obtain details of bank overdraft facilities and terms of repayment of any loans.
• Obtain details of any charges, which may exist on the company’s assets and enquire as to the existence of any contingent liabilities.
• Consider whether the latest accounts are a fair reflection of the state of the business and review post balance sheet events to consider the possibility of any attempt at ‘window-dressing’.

Assuming that the Auditor has examined the accounts as far as he considers necessary and is of the opinion that they are correct, a considerable number of adjustments will, normally, have to be made to arrive at the profits upon which his report will be based. The object of the report is to afford the client information as to the achievement of the business in the past, from which he may form an opinion as to its probable earning capacity in the future. For this reason, it is necessary to adjust the past profits of the business to conform to the conditions that will obtain after the purchase. That is, to show what the net profits would have been had the conditions of management, finance, etc., been the same in the past years as those which will prevail after the purchase.

Other matters that should be considered during the investigation include:
(a) Whether labour relations are good
(b) Whether the present size of work force is reasonable.
(c) The skills and experience of the management and labour force
(d) The goodwill or otherwise of customers
(e) The number of products and diversity of customers base
(f) The size of market share
(g) The effect that the exit of the proprietor and key personnel may have on the business. If the proprietor is leaving the business, a restrictive covenant preventing him from setting up in competition and taking away customers should be considered.
(h) A profit and cash flow forecast should be obtained and carefully checked
(i) Outstanding contracts with customers and suppliers
(j) The transferability of existing licensing agreements to the client in the event of purchase.
(k) General trading conditions in the company’s market and areas for the future expansion.
(l) The remaining useful life of fixed assets and the cost of replacement.

Example:
You have been asked by your client to investigate a small engineering company, which he is interested in purchasing. The company employs about thirty staff and carried on business from its own freehold premises. About half of its turnover comprises the fabrication and assembly of cavity wall insulation equipment, which it supplies to a single customer. The reminders of the business comprise the manufacture of small components for local customers. The main items of plant are catches, milling machines, bending machines and similar equipment most of which is old but appears to be well maintained.

You are required to describe:
(a) How you would carry out the investigation and what matters you would particularly investigate.
(b) The form of your final report and recommendations you make and any qualifications you would make to the results of the work you have carried out.

Solution
a. The investigation will be carried out by executing the following work:
   • Establishment of contact with the auditors, if any, of the engineering company. This is important not only as a matter of professional courtesy but also to enlist their co-operation during the investigation.
   • Obtaining information about the environment within which relate to the political, social, economic and technological factors affecting the business of the enterprise. Such information is especially important as the client intends to hold long term investment in the business. The information to obtained includes:
   • Obtaining information specific to the company: such information will include the history of the enterprise, the nature of its business, its organizational structure, financial history, significant accounting policies and accounting systems.
• Conducting an analysis of the background and preliminary information obtained in order to determine those article areas that the investigation should address in “View of the clients purposes.
• Examining the financial statements of the enterprise with particular focus on the most recent accounts in order to ascertain the reliability of the financial information and to make appropriate adjustments in determining the future maintainable profits of the company.
• Considering other non-financial factors and the future prospect of the business.

The matters that will be particularly investigated include:
(a) In respect of the financial statements
   - The accounting basis: Check that the accounts are in accordance with normal policies, which are acceptable and have been consistently applied throughout the period and in prior periods. The effects of any unusual accounting policies should be adjusted for where possible.
   - Qualification of Prior Years Audit Reports: Record and consider the implications of any qualifications in the auditors’ reports.
   - The Trend of Business: Prepare a summary, preferably in columnar format, of the accounts of the years under review to provide a basis for carrying out the variation analysis to determine trends and investigate any material variations from years to year.
   - Stocks and work-in-progress: Check the proper valuation
   - Cut-off: Check that proper cut-off has been established for sales and purchase.
   - Sales and Purchases: Check that sales and purchases are properly stated. Identify the proportion of sales to the single customer during the years.
   - Accounts Receivable: Check accounts receivable age analysis and verify that the bad debts provision is reasonable and thus that the amount included in accounts receivable is collectible.
   - Accounts Payable: Check that account payable is completely and correctly stated at the end of each period.

Freehold Property: Obtain a valuation of the freehold property by a qualified value and check that the property is in the name of the company.
(a) Other Fixed Assets: Consider whether the value, remaining useful life, service ability and estimate replacement cost and time of other fixed assets shown in the balance sheet.

(b) Reasonableness of Amount: Check that the value of stock, debtor and creditor at the end of each period are representatives of their normal levels.

(c) Loans and overdrafts: Obtain details of overdraft facilities and terms of repayment of any loans. Obtain details of any charges, which may exist on the company’s assets and enquire as to the existence of any contingent liabilities.

Other matters to consider are:
(a) Whether labour relations are good
(b) Whether the present size of work force is reasonable
(c) The skills and weaknesses of the management and labour force.
(d) The size of market share.
(e) The effect that the exile of the current owners and key personnel may have on the business. If the proprietor is leaving the business, a restrictive undertaking, preventing him from setting up a competition and taking away customers, should be considered.

(a) Outstanding contracts with customers and suppliers.
(b) The transferability of existing licensing agreements to the client in the event of purchase.
(c) General trading conditions in the company’s market and areas for future expansion.
(d) Likely legislation, which may affect the business future of the company.

The report should include all material matters, which will enable the client to reach a decision. The accountant should leave the decision whether or not to purchase to the client.

The report should:
1. State the terms of reference of the engagement
2. State the scope of the carried out and the methodology used by the Auditors.
3. State any major facts, which were brought to light during the investigation.
4. Summarize the conclusions of the investigation, giving a number of different bases for valuing the business.
5. Include any recommendations and qualifications that may be necessary.

The report should be qualified if, inter alia, the Auditors have not obtained all the information they consider necessary for example, because of unduly restrictive time limits.

b. Recommendations
The recommendations may be made by the accountant in the following areas:
1. The range of prices within which the client can negotiate.
2. The need to seek for additional technical support on purchase of the business.
3. The need to recognize the company after purchase.
4. The need for a restrictive covenant with the existing owners of the company.
5. Determine any reasonable additional premium to be included in the valuation in view of any goodwill, and the share of ownership proposed to be purchased by the new partner.

(iii) AUDIT OF INVESTMENT IN BUSINESS
The major point to be considered by the investigator is to know exactly the nature of business in which he has to invest his money so that he may ascertain whether the investment will be profitable or not. He should keep the following points in view:
1. If the investment is proposed to be made in a private concern or in partnership firm, the investigator should go through the terms of investment to ensure whether they are favourable or not.
2. If he finds that some of the terms of investment are against his interest, he should make a report to that effect to his client.
3. If the investment is proposed to be made by way of purchase of shares or debentures in a joint-stock company, he should examine the Memorandum and Articles of Association with the
object of determining the rights and liabilities of various classes of shareholders.

4. He should thoroughly examine the Balance Sheets and profit and Loss Accounts of past years so as to be familiar with the earning capacity and financial position of the business in which the investment is proposed to be made.

5. He should try to determine the effective capital employed in the business and for this purpose, he should ascertain the correctness of the valuation of assets after deducting there from the existing liabilities.

6. Lastly, he should think of the proposed investment to be safe with the business and report to his client accordingly.

(iv) Investigation to determine credit worthiness

Special points to which attention should be paid when investigating a company for credit worthiness are:

a. A creditor who is asked to give extended credit will be mainly interested in the short-term cash flow prospect of the proposed debtor. Accordingly the special matters in the accounts of the proposed debtor company to which special attention should be paid during the investigation include the following:
   - The amount due from trade debtors within the period of the credit.
   - Account due from directors, employees, branches and subsidiaries or parent companies.

The nature and amount of stock and their methods of pricing. Amount of stock held on behalf of third parties. Stocks held on consignment and stocks pledged as collateral for other loans or advances.

a. On behalf of a bank for loan in contract to creditor, a bank from whom a loan is required will be interested depending on the period of the loan, in the medium of long term financial position of the company. Accordingly the special matters in the accounts of the proposed debtors company to which special attention should be paid the investigation include the following:
   - The valuation of real properties, plant, building, fixtures and fittings the maybe of depreciation and particulars of any recent valuations.
- The nominal, book and market values of investments. Details of investment pledged as security for loans and advances.
- Details of secured liabilities with amount outstanding and the date of repayment arrangements for meeting on amounts due to maturity and the particular asset charged.
- The future maintainable profits of the company.
- Nature and amount of all contingent liabilities.

The Auditors should confirm all these and submit their report.

(v) Investigation where fraud/irregularities is known or suspected to have taken place

Fraud is of two types. It may be defalcations involving misappropriations either of money or goods. It may be the manipulation of accounts without defalcations.

The conduct of investigations where fraud is suspected or known to be taken place vary much with the particular circumstances and accordingly, it is not possible to generalize. The fraudulent manipulation of accounts without defalcation usually takes the form of the inflation of assets, or the exclusion of liabilities. The purpose being to make the position of a business appear to be better that it really is or to enable dividends to be paid. Investigation of this type will involve the verification of the assets and liabilities and the verification of the assets and liabilities and the income and expenses for the relevant periods. The work involved is akin to the audit examination and is not considered any further. Defalcation involving the misappropriation of stock varies so much according to the nature of the goods and the trade carried on.

**General Approach**
The general procedure to be followed by the Auditor as set out below. He should:
(a) Obtain the terms of reference setting out the scope of the investigation.
(b) Obtain an understanding of the client’s business, organization, procedures and accounting systems.
(c) Determine the authority of those persons involved in the fraud. This will give him some indication of the opportunities which the fraudulent persons may have taken advantage of.
(d) Examine the records and books of accounts to which the officers have access and those that will be affected by the fraud and interview relevant persons to obtain necessary information.

(e) Report to findings to the client.

**Investigation when Merger or Acquisition is being contemplated upon.**
Whenever a merger of two or more companies is proposed, the intending entities may well call for investigation into the various concerns to enable take decisions. The form of investigation will be similar to that of acquisition of a company by another.

Apart from establishing the true financial positions of the companies, other items of interest will include:
- The market share
- Product acceptability
- Litigation (pending, if any)
- Source(s) of raw materials
- Power sharing
- Willingness of staff remaining under new management
- Market value of share (for quoted companies) etc.
CHAPTER 16
ASSURANCE SERVICES

Assurance services are independent professional services that improve the quality of information, or its context, for decision makers. The Assurance Services evolved from America and have since then gained global recognition with a lot of prominence among the developed economies.

This definition encompasses a number of important concepts. First, the definition highlights decision making. Making good decisions requires quality information, which can be financial or non-financial. The American Institute of Certified Public Accountants (AICPA) brought to the limelight, the need to develop standards to improve, regulate and control these services. Hence the Elliot Committee was inaugurate.

The Elliot Committee’s report presents a model for decision making and the role of information in decision-making activities. Information is critical in this decision model.

The Elliot Committee points out that three types of information enter into the problem definition stage of the decision model:

1. Environmental information
2. Process monitoring and diagnostic information, and
3. Outcome feedback information.

An assurance service engagement can help the decision maker search through this information in order to identify which pieces of information are relevant for the required decision. The practitioners should be able to make the best choice amidst several alternatives in the form of information available or provided to him.
The second concept relates to improving the quality of information or its context. Thus assurance service engagement can improve quality through increasing confidence in the information’s reliability and relevance. Context can be improved by the format in which information is presented. The auditor is expected to carry on his duties without interference and should express his opinion based on best practices.

The third important concept in the definition of assurance services is independence. As with the earlier discussions of financial statement auditor’s independence is the hallmark of the profession. However, with assurance services, the practitioner needs to be independent only with respect to the quality or context of the information. This means the practitioner must have his own mind in a particular assignment. He must be objective too.

The last concept is professional service, which encompasses the application of professional judgment. The practitioner applies professional judgment to the information that is the subject of the assurance service. In summary, assurance services can capture information, improve its quality, and enhance its usefulness for decision makers.

The Demand for Assurance Services

Economic, social, and regulatory trends are changing the context in which practitioners provide service. These trends include the explosion of information technology, increased competition for accountability of corporate managers, and aging of the population. For, information technologies continue to advance at a geometrical speed and, generally, at a lower cost. The new technologies change the way entities and people work, and they increase the volume of information and the speed at which this information is available to users. While these changes may potentially threaten the traditional audit, they offer an enormous opportunity for practitioners to provide additional services.

The generation of information will require assurance about its reliability, credibility, relevance, and timeliness. Another example is the aging of the population.

This increased number of older adults gives parishioners opportunities to provide additional services related to health care performance, personal financial planning, estate planning, pension plan audits, and fraud protection services. This is most prominent in the United State of
America, Canada and other advanced countries. Thus the need for assurance services can be traced to two sources. First, clients and others have asked auditors to provide services that rely on the auditor’s traditional competencies of independence, objectivity, and concern for the public interest. Second, in the face of fixed revenue growth from traditional audits, the profession has sought to identify new services that can be delivered to existing and new clients.

**Types of Assurance Services**

The various needs and nature of demands of assurance services had led to the identifiable class of such services. The AICPA, through the formation of the Assurance Services Executive Committee, helped to identify and develop services for firms to market to existing and new clients. The Special Committee on Assurance Services has proposed detailed plans for six assurance services that have significant market potential for practicing firms: In the work of William F. Messier, Jr. (2000) the following were identified and developed viz-a-viz:

- **Risk Assessment** – assurance that an entity’s profile of business risks is comprehensive and evaluation of whether the entity has appropriate systems in place to effectively manage those risks.

- **Business Performance Measurement** – assurance that an entity’s performance measurement system contains relevant and reliable measures for assessing the degree to which the entity’s goals and objectives are achieved or how its performance compares to competitors.

- **Information System Reliability** – assurance that an entity’s internal information systems provide reliable information for operating and financial decisions.

- **Electronic Commerce** – assurance that systems and tools used in electronic commerce provide appropriate data integrity, security, privacy and reliability.

- **Health Care Performance Measurement** – assurance about the effectiveness of health care services provided by HMOs, hospitals, doctors, and other providers.

- **Elder Care** – assurance that specified goals regarding the elderly are being met by various caregivers.

The Elliot Committee also identified seven other areas where assurance services might be appropriate: corporate policy compliance, internal
Web TrustSM Assurance
With the increase in the uses and reliance’s placed on internet services alongside the computer development which led to E-commerce, E-banking, E-lisrany etc, the need for control an regulation process were developed. This has since Electronic commerce involves individuals and organizations conducting business transactions, without paper documents, using computer and telecommunications networks. This includes transactions under Electronic Data Interchange (EDI), where formal contracts exist between the parties and business over the Internet (World Wide Web), where the parties do not have a preexisting contractual relationship. In recent years electronic commerce over the Internet has developed tremendously. However, this growth is not without threats and setbacks as adduced by consumer (such as credit card numbers). When they fall victim of Automated Teller Machine (ATM) trends. For example

The Risks of Electronic Commerce
Three broad risks are associated with electronic commerce:

1. Business practices
2. Business practices
3. Information protection

Because commerce over the Internet may involve transactions between parties who do not know each other, they are rather united by a common market. There the provider of goods and services are will to sell to any buyer on the agreed term. And here too there is a willing buyer or consumer ready to pay and enjoy what his/her money can buy how can a consumer know that the entity behind the Web page is. “real”? in other words, how can the consumer be sure that the entity follows good business practices and that consumers will not be defrauded similarly, how can the consumer have assurance that electronic transactions will not be changed, lost, duplicated, or processed incorrectly? All these
fears are entertained because the circuit can be broken or intercept or diverted Web TrustSM Principles.

**Business Practices Disclosure**
The entity discloses its business practices for electronic commerce transactions and executes transactions in accordance with its disclosed practices.

**Transaction Integrity**
The entity maintains effective controls to ensure that customer’s orders placed using electronic commerce are completed and billed as agreed.

**Information Protection**
The entity maintains effective controls to provide reasonable assurance that private customer information obtained as a result of electronic commerce is protected from uses not related to the entity’s business.

And how can the consumer be sure that private information will be protected? While setting up a Web page on the Internet is relatively easy, establishing strong security controls can be complex and costly. As a result of these risks, consumers have legitimate concerns about transaction integrity and confidentiality. An objective third party, such as a practitioner, can provide assurance to customers about these risks.

The Assurance Process for Web TrustSM In order to obtain the Web TrustSM seal of assurance, an entity must meet all the Web TrustSM Criteria and engage a CPA who is licensed by the AICPA to provide Web TrustSM service. Generally, this service will cover a period of three months or more. Once the seal is obtained, the entity can display it on its Web site provided the assurance examination is updated regularly and the entity informs the practitioner of any significant changes in its business policies, practices, processes, or controls. The entity’s Web TrustSM seal will be managed by a trusted third-party service organization (the “seal manager”). If the entity receives an unqualified
The practitioner notifies the seal manager that the seal can be displayed on the entity’s Web site and provides expiration.

The America experience is worth a case study and a platform to build upon or copy from. The urban migration in Africa and Nigeria in particular has made the study of Elder care.

**Elder Care**
The population in United States and Canada is aging, and many of these people have accumulated significant wealth. Additionally, individuals are living to ages where they require some form of assisted living. In the past these individuals relied on family members to provide some level of care. However, changing demographics show a more mobile younger generation. Many of these younger families have both spouses working outside the home, and they do no have time to care for elderly relatives. The CPA can bring another level of assurance of comfort to the elderly person and his or her family members. Elder Care Services build on provide a service that is in the public interest. More specifically, Elder Care Services is designed to assure family members that proper care is provided to elderly family members who no longer totally independent. The role of the practitioner is one of oversight. The practitioner acts in the place of the absent family members and relies on qualified specialists, employed by the client or the responsible family member, to provide the services outside the scope of the practitioner’s expertise. The practitioner’s role is to observe and report on how those service providers are meeting the needs of the client and the criteria for care established by the family members. If is likely that this service will be combined with traditional financial services, and the practitioner will establish strategic alliances with other professionals (such as elder law attorneys, geriatric care managers, and social workers or medical personnel). Based on research conducted by the AICPA, it appears that there is a demand for this type of services.

**Types of Elder Care Services**
Practitioners can offer three of Elder Care Services
  1. Consulting/Facilitating Services
  2. Direct Services
3. Assurance Services

Consulting/Facilitating Services
This type of services includes the practitioner consulting with the client or third part (the responsible individual) to establish the standards of care expected. This might include giving the third party a list of services that are available in the community. Consulting services might also include assisting the client or third party in selecting the care provider and level of care for each of care required.

Direct Services
Direct Services include practitioner services such as receiving, depositing and accounting for the individual’s income; paying bills and conducting routine financial transactions for the client; and supervising investments and accounting for the estate. These services might also include arranging for proper care, paying for it, and periodically ensuring that the care is being received at the appropriate level; arranging for transportation for the client; and supervising household items such as home maintenance and repairs.

Assurance Services
In this type of services the practitioner issues periodic reports about the quality of care provided to the elderly person. It is likely that Elder Care assurance services will be conducted as agreed-upon procedures in attestation engagements as described in this chapter. This type of assurance services may involve the practitioner visiting the elderly person and inspecting documentation such as logs, or other evidence, to support that the contracted services have been provided at the appropriate level of care.

The Assurance Process of Elder Care
The practitioner will likely prepare an agreed-upon procedures report. The engagement may require that the practitioner periodically report to family members less formally.
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