

# AUDITING

## PROFESSIONAL 1 EXAMINATION - APRIL 2019

### NOTES:

**Section A** - You are required to answer Questions 1, 2 and 3.

**Section B** - You are required to answer any **one** out of Questions 4 or 5. Should you provide answers to more than two questions in this section, you must draw a clearly distinguishable line through the answer(s) not to be marked. Otherwise, only the first two answers to hand for these four questions will be marked.

### TIME ALLOWED:

3 hours, plus 10 minutes to read the paper.

### INSTRUCTIONS:

During the reading time you may write notes on the examination paper but you may not commence writing in your answer book.

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

**Start your answer to each question on a new page.**

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question attempted.

**NB: PLEASE ENSURE TO ENCLOSE YOUR ANSWER SHEET TO QUESTION 3 IN THE ENVELOPE PROVIDED.**

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PROFESSIONAL 1 EXAMINATION - APRIL 2019

Time Allowed: 3 hours, plus 10 minutes to read the paper.

**Section A** - You are required to answer Questions 1, 2 and 3.

**Section B** - You are also required to answer **either** Question 4 or 5. Should you provide answers to both Questions 4 and 5, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for Question 4 or 5 will be marked.

## SECTION A - Questions 1, 2 and 3 are compulsory.

- 1.** You work as an audit senior for Murphy and Co. Accountants and Auditors. Delicious Cakes Ltd. (DC) is one of your portfolio of clients with a 31 January 2019 year-end.

You are at present planning the year-end audit of DC which specialises in the production of high-quality wedding cakes and pastries.

During preliminary audit work, you noted that the profitability of the company has declined and costs are increasing, while prices have been higher than competitors due to low volumes of output.

The company, in recent years, has relied on a bank overdraft facility to finance its activities. This area of concern for DC's management was raised at a meeting with you. During this meeting, a discussion took place which focused on actions that could be taken to improve the liquidity of the company. The management team informed you of a plan to expand facilities for producing wedding cakes, as this line had maintained its market share. The company has asked the bank for a loan to finance the expansion and also to maintain the present level of working capital.

To support its request for a loan, the company has prepared a cash flow forecast for the two years from the end of the reporting period. The internal audit department has reported on the forecast to the board of directors. However, the bank has said it would like a report from your practice, as the external auditors, to confirm the reasonableness of the forecast. Following this request, the company has asked you to examine the cash flow forecast and to report to the bank.

### REQUIREMENT:

- (a) Outline the level of assurance that should be included in your response to the bank's request. (4 marks)
- (b) Assess the procedures that should be adopted to examine the cash flow forecast. (9 marks)
- (c) Prepare a memo on ISA 300 – *Planning an Audit of Financial Statements* for a junior member of staff that includes a discussion on the following:
- (i) The key benefits of appropriate planning for the conduct of an audit of financial statements. (6 marks)
  - (ii) The key factors which should be considered when establishing the overall audit strategy. (5 marks)
  - (iii) The activities an auditor should undertake prior to accepting a client engagement. (3 marks)
  - (iv) The benefits to the auditor as a result of conducting appropriate client continuance procedures. (3 marks)

**[Total: 30 Marks]**

## 2.

- (a) You are an audit manager in Mc Reddi & Co., a firm of Certified Public Accountants. Recently, a junior member of staff almost disclosed some confidential information in regards to a client.

The potential threat was identified on time and averted. However, in light of this occurrence, the firm's partners have requested that you produce a briefing document for all staff, reminding them of their obligations of confidentiality with regards to the CPA Code of Ethics.

### REQUIREMENT:

Draft the required briefing document which should include a discussion of the following areas:

- (i) The activities a member should refrain from with regards to the confidentiality of a client in order to comply with the Code of Ethics?
- (ii) The circumstances where members may disclose confidential client or employer information.
- (iii) The key points for consideration by the auditor in deciding whether to disclose confidential information.

(15 marks)

- (b) You have been requested by the senior in charge to audit Strauss Fabricators Ltd.'s (Strauss) payroll, and have been provided with the following information:

Employees of Struass are paid on the basis of hours worked and quantities produced. The hours worked are recorded on clock cards and the quantities produced are confirmed by the supervisor.

Due to fluctuating work volumes, Struass still pays employees in cash at the end of each week for the previous week's work. Appointment of new employees is authorised by the managing director. The personnel department maintains employees' records and rates of pay. The cashier is separate from the wages department.

Previous years' audits have highlighted weakness in internal controls in the company's wages system. This has allowed an employee staff member in the payroll department to perpetrate a fraud by creating fictitious employees on the payroll and misappropriating wages. Some of your audit tests have been designed to detect whether this fraud is still taking place.

A 'starters and leavers' test is also carried out during each annual audit to ensure that employees are not paid before they commence employment or after they leave.

### REQUIREMENT:

- (i) Outline the principal controls that should exist in a payroll system and explain their purpose. (6 marks)
- (ii) Assuming you decide not to attend at the wages payout, recommend other techniques that should be used to verify the existence of employees. (5 marks)
- (iii) Set out how a starters and leavers test should be carried out by the auditor. (4 marks)

**[Total: 30 Marks]**

- 3. The following multiple-choice question contains eight sections, each of which is followed by a choice of answers. Each question carries equal marks. On the answer sheet provided, indicate for each question which of the options you think is the correct answer. Marks will not be awarded where you select more than one answer for any question.**

**REQUIREMENT:**

Record your answer to each section in the answer sheet provided.

1. The most reliable procedure to test the existence of a freehold building would be:
  - (a) Inquiry
  - (b) Observation
  - (c) Confirmation
  - (d) Inspection.
  
2. Inherent risk has two broad categories:
  - (a) Competitive tendering level risk, independence level risk.
  - (b) Entity level risk, independence level risk.
  - (c) Entity level risk, account balance and class of transaction level risk.
  - (d) Competitive tendering level risk, account balance and class of transaction level risk.
  
3. Due to recent storm damage, your client has lost all of its accounting records for the current year including backups. Which audit opinion is most likely to be issued?
  - (a) Disclaimer
  - (b) Adverse
  - (c) Unmodified
  - (d) Qualified (except for).
  
4. Which of the following is not a valid procedure for performing tests of controls?
  - (a) Enquiry of client staff
  - (b) Walk through tests
  - (c) Inspection of documents
  - (d) Observation of processes.
  
5. Which of the following is not a threat to objectivity?
  - (a) Independence
  - (b) Self-Review
  - (c) Advocacy
  - (d) Intimidation.
  
6. Auditors of a public limited company are appointed by which party?
  - (a) Audit committee
  - (b) Directors
  - (c) Shareholders
  - (d) Financial controller.

7. Which of the following related to the receivables could be tested using test data?
- (a) The arithmetical accuracy of the receivables ledger.
  - (b) The stratification of receivables according to age.
  - (c) Confirmation that any sales invoices issued resulting in a credit balance on a customer's account is flagged up for review.
  - (d) The calculation of the receivables collection period.
8. Which of the following statements relating to written representations, if any, is/are correct?
- (i) The purpose of obtaining written representations is to minimise unnecessary work where management can confirm the relevant facts.
  - (ii) It is inappropriate for the auditor to draft the written representations letter as it is a communication from the client to the auditor.
- (a) (i) only
  - (b) (ii) only
  - (c) Both (i) and (ii)
  - (d) Neither (i) nor (ii).

**[Total: 20 Marks]**

## SECTION B – Answer either Question 4 or Question 5

**4.**

- (a)** In the wake of major financial scandals, both nationally and internationally, regulators have attempted to address the issue of corporate governance of companies, particularly publicly owned companies.

**REQUIREMENT:**

You have been asked to produce a briefing note which discusses:

- (i) The concept of corporate governance. (3 marks)
  - (ii) External auditors' responsibility in relation to corporate governance. (3 marks)
  - (iii) The role and composition of an effective audit committee. (4 marks)
- (b)** At times, clients may query the need for an audit committee when they have a good working relationship with their external auditors. Justify the need for an audit committee in response to this reservation by clients. (4 marks)
- (c)** An area of common concern for the accounting regulatory authorities is that of the perceived expectation gap between the users of accounts and external auditors.

With reference to the roles and duties of auditors, discuss four main differences between the expectations of users of accounts and external auditors.

(6 marks)

**[Total: 20 Marks]**

- 5.** County Milk Ltd. (CLM) buys milk from local farmers, processes the milk and delivers it to retail outlets in the Munster area. You are currently auditing CLM's receivables system and note the following information:
- (i) The company employs 75 drivers and each is responsible for delivering milk to between 20 and 30 shops on a daily basis. Payments by customers are not normally accepted by the drivers. These are sent directly to the head office of the company.
  - (ii) The sales ledger is regularly reviewed by the office manager who prepares a list of accounts with 90-day balances or older for each driver. This list is used for the purpose of collection by the drivers. Each driver has a delivery book of accounts which is used for recording deliveries of milk and those receivables with 90-day balances.
  - (iii) Receivables normally amount to approximately €450,000. To date, the audit program used for the selection of receivables balances for direct confirmation stated: 'Select two accounts from each driver's customers, one to be chosen by opening each driver's delivery book at random and the other as the fourth item on the list of those balances that are 90-day or older accounts remaining unpaid'. Each page of the driver's delivery book deals with a single customer.

Having reviewed the receivables system, you conclude that statistical sampling techniques should be used to assist your audit work. On completion of your review and testing of the 2,000 receivables balances, your statistical sample of 100 accounts disclosed 10 errors. You conclude that there must be 200 accounts in the entire population which contain errors as you assume that the errors detected in the sample will be in exact proportion to the errors in the population.

**REQUIREMENT:**

- (a) Outline why the audit procedure used in the selection of receivables for audit confirmation would not produce a valid statistical sample. (4 marks)
- (b) Discuss the audit objectives in selecting a sample of 90-day accounts for direct confirmation and discuss whether the application of statistical sampling techniques would help in the attainment of the audit objectives. (8 marks)
- (c) Is it reasonable to assume that the errors detected in the sample of receivables balances tested are in exact proportion to the errors in the total population of receivables? Justify your answer. (4 marks)
- (d) Critically assess the reasonableness of the assumption that since statistical sampling techniques do not relieve auditors of their responsibilities in the exercise of professional judgement, they are of no benefit to the auditor. (4 marks)

**[Total: 20 Marks]**

**END OF PAPER**

## SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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PROFESSIONAL 1 EXAMINATION - APRIL 2019

### SOLUTION 1

**Note:** *The marks available for part (a) were redistributed to parts (b) and (c).  
Candidate's suggested solutions were scored on their responses to parts (b) to (c).*

#### Part A

Level of assurance you could include in your response to the bank's request.

The bank should be informed that the kind of report that you could give is a limited assurance or negative assurance report.

You would state in your report that nothing had come to your attention that would cause you to believe that the assumptions do not provide a reasonable basis for the cash forecast.

The report would go on to say that the forecast has been properly prepared on the basis of the assumptions.

The forecast is an assessment of cash flows in the future which is uncertain, therefore it is not possible to provide anything other than limited assurance.

#### Part B

Access the procedures that should be adopted to exam the cash flow forecast.

- Recalculate and cast the cash flow forecast to verify arithmetical accuracy.
- Review past forecasts with actual outcomes to establish the accuracy of the company forecasts in the past. If forecasts have been reasonable in the past, this would make it more likely that the current forecast is reliable.
- Confirm the assumptions that have been made in the preparation of the cash flow forecast. For example, you are aware that costs are rising so you would expect cost increases to be reflected in the cash forecasts.
- Review the sales department detailed budgets for the two years ahead and discuss with them the outlets that they will be targeting. This would help the auditor determine whether the cash derived from sales is soundly based.
- Review the production department's assessment of the non-current assets required to increase the production of white bread to the level required by the sales projections. Obtain an assessment of estimated cost of non-current assets, reviewing bids from suppliers, if available. This would provide evidence on material cash outflows.
- Agree the opening balance of the cash forecast to the closing balance of the cash book, to ensure the opening balance of the forecast is accurate.
- Consider the adequacy of the increased working capital that will be required as a result of the expansion. Increased working capital would result in cash outflows and it would be important to establish its adequacy.
- If relevant review the post year-end period to compare the actual performance against the forecast figures.
- Review board minutes for any other relevant issues which should be included within the forecast.

#### Part C

##### Memo:

To: New Trainee

From: L. Bowe, Audit Senior

Re: ISA 300 – Some Considerations

Date: 30 April 2019

*The following are relevant to certain aspects of ISA 300 – Planning an Audit of Financial Statements.*

##### Key benefits of Audit Planning:

- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor identify and resolve potential problems on a timely basis.
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.



- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by auditors of components and experts.

In establishing the overall audit strategy, the auditor shall consider the following key factors:

- Identify the characteristics of the engagement that define its scope;
- Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- Ascertain the nature, timing and extent of resources necessary to perform the engagement.

The auditor shall undertake the following activities prior to starting an initial audit:

- (a) Performing procedures required by ISA (Ireland) 220 regarding the acceptance of the client relationship and the specific audit engagement.
- (b) Communicate with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.

The benefits that can be derived by the auditor in performing the preliminary engagement:

Performing the preliminary engagement activities specified in ISA 300 at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement. Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which, for example:

- The auditor maintains the necessary independence and ability to perform the engagement.
- There are no issues with management's integrity that may affect the auditor's willingness to continue the engagement.
- There is no misunderstanding with the client as to the terms of the engagement.

**Liam Bowe**

## SOLUTION 2

### Briefing Note for all Staff:

*Recently a junior staff member almost inappropriately disclosed confidential information to a third party as a result I have drafted this briefing note on client confidentiality.*

**(a)** Confidential  
General rules

- (i)** The principle of confidentiality imposes an obligation on members to refrain from:
- (a) Disclosing outside the firm or employing organisation confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
  - (b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.

A member shall maintain confidentiality, including in a social environment.

A member shall also maintain confidentiality of information disclosed by a prospective client or employer.

A member shall also consider the need to maintain confidentiality of information within the firm or employing organisation.

A member shall take all reasonable steps to ensure that staff under the member's control and persons from whom advice and assistance is obtained respect the member's duty of confidentiality. The need to comply with the principle of confidentiality continues even after the end of relationships between a member and a client or employer. When a member changes employment or acquires a new client, the member is entitled to use prior experience. The member shall not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.

- (ii)** The following are circumstances where members are or may be required to disclose confidential information or when such disclosure may be appropriate:
- (a) Disclosure is permitted by law and is authorized by the client or the employer;
  - (b) Disclosure is required by law, for example:
    - (i) Production of documents or other provision of evidence in the course of legal proceedings; or
    - (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and
  - (c) There is a professional duty or right to disclose, when not prohibited by law:
    - (i) To comply with the quality assurance reviews of the Institute or other professional body;
    - (ii) To respond to an inquiry or investigation by the Institute or other regulatory body;
    - (iii) To protect the professional interests of a member in legal proceedings; or
    - (iv) To comply with technical standards and ethics requirements.
- (iii)** In deciding whether to disclose confidential information, members shall consider the following points:
- (a) Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the member;
  - (b) Whether all the relevant information is known and substantiated, to the extent it is practicable; when the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment shall be used in determining the type of disclosure to be made, if any; and
  - (c) The type of communication that is expected and to whom it is addressed; in particular, members shall be satisfied that the parties to whom the communication is addressed are appropriate recipients.

**(b)**

**(i)** Principle controls in a wages system and their purpose

- There should be a proper division of duties in the wages system- employees who calculate wages should not be responsible for making up the wage packages.
- There is proper control over custody of cash for wages and unclaimed wages.
- Wages are only paid to employees for work done, i.e. not in advance.
- Employees are paid at a rate authorised by management.
- There is appropriate authorised over employee appointment and dismissal.
- Deductions are correctly calculated and paid promptly to the relevant authorities, i.e. the Revenue Commissioners and pension companies.
- Payments are made to employees actually registered with the company.
- The transactions are correctly recorded in the books of accounts, including the allocation of the wages expense between sales, manufacturing, administration, etc.

The aim of these controls is to ensure that employees are paid at authorised rates for work done, that the transactions are recorded accurately in the accounting records, that the employees and other authorities are paid the correct sums and that the risk of fraud and error is minimised.

**(ii)** Techniques to check the existence of employees

- The signature of the employee signing for his or her wage can be checked to the record in the personnel department. The signature of the employee in the personnel records should have been obtained when the individual started employment in the company.
- The employee can be checked to the annual return made to the Revenue Commissioners, and there may be notifications from Revenue Commissioners of changes in the employee's tax code. If the employee has just joined the company (and had previously been employed by another organisation), there should be a notification from the former employer of the individual's tax code, gross pay and PAYE paid to date.
- The employee should have a national insurance number which may also be used to verify existence.
- The department manager could acknowledge a list of individuals employed in his department. This is difficult to obtain when a large number of staff are involved.

**(iii)** Starters and leavers test

The purpose of a starters and leavers test is to ensure that employees are neither paid before they start nor after they have left the company's employment.

To carry out this procedure, I will select two payrolls, say three months apart, and compare the names on the payroll. Where the name appears on both payrolls, the employee has been paid for the full three month period. Where the name appears on the first payroll and not the second, this is a 'leaver' and where the name appears on the second payroll and not on the first; this is a 'starter'. Starting and leaving dates should then be verified by examining the relevant personnel records.

I can then ensure that they have been paid for the correct period by checking the dates on the payroll and Revenue Commissioners official forms.

### **SOLUTION 3**

1. Answer D: Inspection
2. Answer C: Entity level risk
3. Answer A: Disclaimer, All accounting records having been lost due to storm damage means SAAE is not available. It is pervasive to the FS due to the extent of loss.
4. Answer B: Walk through tests, a walk through test is used to obtain an understanding of the system but does not test it
5. Answer A: Independence
6. Answer C: Shareholders
7. Answer C Confirming that any sales invoices issued resulting in a credit balance on a customer's account is flagged up for review, A, B and D would be carried out manually or using audit software
8. Answer D Neither (i) nor (ii)

## **SOLUTION 4**

**(a)**

### **Briefing note to all Audit trainees:**

**(i)** The term corporate governance refers to the means by which a company is managed in the interests of all stakeholders. It will include consideration of:

1. directors' responsibilities
2. composition of the board of directors
3. audit requirements (internal and external)

**(ii)** Corporate governance is the responsibility of the company's management and not its external auditors. However, it is the responsibility of the external auditors to form an opinion on the truth and fairness of the company's financial statements.

If a company has good standards of corporate governance and is therefore managed well in the interests of all stakeholders, the auditors are likely to conclude that the risk of material misstatement in the financial statements is reduced.

As a result of this they may well be able to reduce the extent of the audit procedures they carry out.

The external auditor may have to report on whether the company is compliant with Corporate Governance requirements.

**(iii)** The role of the audit committee is to provide a means of communication between the internal workings of the company and the external auditor.

It can also provide a channel of communication for employees who have concerns about the way the company is run.

The audit committee should be composed of non-executive directors and preferably include someone with relevant financial experience.

**Sarah Goode, Audit Senior**

**30 April 2019**

**(b)** A good relationship with external auditors is of immense help and support to a business in complying with regulations, ensuring optimum controls are in place and generally ensuring good corporate governance.

However, the existence of an audit committee can enhance the company's corporate governance profile in the following manner:

1. improving public confidence
2. providing further support to directors
3. strengthening the independence of the external auditor
4. improving internal procedures e.g. management accounting, & communication generally.

**(c)** The perceived differences are:

1. Users of accounts perceive that auditors are responsible for detecting fraud and in particular management fraud.

Auditors have their duties defined by statute and this fails to mention explicitly any duty to detect fraud. The fact that auditors have to form an opinion on the truth and fairness of the financial statements by law indicates that if truth and fairness is distorted by fraud then auditors are likely to have a duty to detect these to fulfil their statutory duty.

2. Users believe that auditors check and certify the financial health of a company thereby providing assurance that the company is a going concern, otherwise users are warned in the auditor's report.

Auditors on the other hand acknowledge some responsibility for this but not fully as they claim their judgements are made at the final audit and they cannot foresee the future.

This problem has been exacerbated by the collapse of a number of high profile companies.

3. As the auditor's report is addressed to shareholders most shareholders assumed that auditors owed them a duty of care and that legal redress can be sought in the event of negligence on the part of the auditor. Auditors are aware that generally that no such duty is owed to individual shareholders.
4. Some users assume that auditors certify the financial statements by checking every transaction. This is not part of the auditor's understanding as legally only an opinion is expressed on the accounts and in any case it is not practicable from a time and cost viewpoint to check all transactions and items in the financial statements.
5. Some users believe that auditors are not independent of the directors (perhaps based on certain alleged examples of allowing questionable or incorrect accounting policies to be used in financial reporting).

Auditors claim that independence is a state of mind and the issue cannot be assessed by the few examples of problems reported in the financial press.

6. Some users and institutions believe that auditors fail to comply with standards issued by the professional bodies. This they claim is the main cause of the confusion and gap in expectation. Auditors on the other hand claim they are complying with standards as their work is monitored.

## SOLUTION 5

- (a) A basic principle of statistical sampling is that each item in the population must have an equal chance of being selected. If this is not the case then there is a possibility that the sample selected will be biased in some way, and valid statistical results will not be obtainable.

The method of selection being used for County Milk Ltd does not allow random selection of items for two reasons:

- (i) each roundsman is likely to have a different number of customers on his round. Choosing one customer from each book from a 'random' page means that customers on the smaller rounds have a higher chance of being picked. Taking one item from each book also assumes that the population is homogeneous (ie, all items are the same). This may not be the case because each route is different and will have different drivers;
- (ii) taking the fourth item on each list of older debtors automatically precludes the picking of other debtors on that list; again the choice is not random.

The audit procedure will therefore not produce a valid statistical sample.

- (b) Audit objectives in circularising old debtors:

**Valuation** - provide evidence on any provision for bad debts (if circularisation request answered by liquidator or administrator) and also provide evidence as to the completeness of the balance. This ensures the value of the debtor is correctly stated in the financial statements.

**Existence** - provide evidence that the debtor balance actually exists and is therefore a bona fide debt

**Ownership** - provide evidence that the debt is due to County Milk Ltd

**Disclosure** - provide some evidence on the value to be included for debtors in the balance sheet and the amount of any bad debt provision - especially if material.

Statistical sampling techniques may help attain the audit objectives in (b) as noted below:

**Valuation** - evidence on the completeness of the debtor balance, and therefore the accuracy of the recording of the sales system can be gained by circularising some debtors. This audit objective would otherwise be met by depth testing a statistical sample of sales invoices;

- evidence on the bad debt provision can again come from the circularisation, although an after-date cash review is likely to provide the auditor with his main evidence.

**Existence ownership and disclosure** - statistical evidence will be of use here because the auditor has identified potentially risky debtor balances. If these debtors are shown to be in existence, owned by the company and correctly disclosed, then the auditor has some evidence that the less risky, less old debtor balance will also be correctly treated;

- stratification of the sample chosen will also assist the auditor because he can then concentrate on the larger balances for audit testing. Similarly increasing the confidence level will provide additional assurance that these balances are correctly stated.

The statistical technique in this situation will assist the auditor in meeting his audit objectives, as noted above, although it will suffer from additional non-sampling risk problems as follows:

- 7. debtors may fill the circularisation request form in incorrectly giving the auditor incorrect audit evidence;
- 8. the auditor could use an incorrect audit test, or an incorrect confidence level meaning that the wrong number of items are tested;
- 9. the auditor could also make mistakes in interpreting the results of his testing, especially regarding the number of errors found.

These factors will detract from the attainment of the audit objectives.

- (c) It is unlikely that the percentage of errors found in the sample testing will apply automatically to the whole population. Allowance must be made here for the level of precision, or movement away from this error percentage found in the sample when it is applied to the whole population. For example, a precision level of 2% would indicate that the error rate found would apply to the population, plus or minus 2%. The population error would therefore be in the range 8% to 12% for the sample error of 10% given in the question.

It is therefore possible that the error rate in the population is 10%, although this is unlikely and should not be relied upon. If the auditor wishes to be more precise regarding the population error rate, then the sample size of debtor balances tested must be increased. This will decrease the precision level to give a better estimate of the population error rate. To be 100% certain of the population error rate then all the items in the population must be tested.

In performing a statistical sample, the auditor accepts the (sampling) risk that his results may be different from those obtained from testing the whole population. As long as the maximum expected error does not exceed the tolerable error for this test, then the auditor can accept the results of the test that is the correct degree of assurance has been achieved.

**(d)** Statistical sampling techniques do not relieve the auditor of his responsibilities in the exercise of his professional judgement because:

- (i) the auditor must still determine the confidence and precision levels, and the tolerable error to use in the statistical sample; and
- (ii) in evaluating the results of the test, the auditor must still decide what constitutes an error and decide how this potentially affects the whole population,

Statistical sampling techniques do provide the following benefits to the auditor:

- (i) results of the tests can be determined precisely using statistical techniques;
- (ii) they decrease potential liability to clients and third parties by providing a precise audit methodology that can be defended in court;
- (iii) it assists in audit planning and testing by making the auditor identify populations for testing and determining the testing method.

Statistical techniques do therefore provide some benefit to the auditor and do not completely relieve him of his professional judgement.