

# LAGOS CITY POLYTECHNIC, IKEJA

## HIGHER NATIONAL DIPLOMA IN ACCOUNTANCY

### YEAR II

#### AUDIT PRACTICE AND ASSURANCE SERVICES

CODE: ACC 422

#### NATIONAL DIPLOMA IN ACCOUNTANCY

Course: AUDIT PRACTICE AND ASSURANCE SERVICES

CODE : ACC 422

CREDIT HOURS: 45 HOURS

**GOAL:** To give special attention to the application of auditing concepts, methodology and techniques used in audit judgment so as to enable the student handle and understand special audits and assurance services, and know the management of audit practice as well as the workings of Local and International factors that affect the practice of auditing.

#### GENERAL OBJECTIVES

On completion of this module, students should be able to:

- 1.0 Understand the development and operation of accounting standard and auditing guidelines.
- 2.0 Understand the process of auditing corporate distress
- 3.0 Understand the process of auditing public concerns.
- 4.0 Understand the management of audit practice and the and the concept of assurance services.
- 5.0 Understand the circumstances under which an auditor may become personally liable.
- 6.0 Understand the roles of ethics on provision of audit services.
- 7.0 Understand the process required for auditing special types of organizations.
- 8.0 Understand the introduction, functions, and operation of an internal audit department.
- 9.0 Understand the process of share transfer audits.

1.0 GENERAL OBJECTIVE: Understand the process of auditing corporate distress  
Week 1-2

- 1.1 Explain accounting standards and auditing guidelines
- 1.2 Trace the evolution and revolution of accounting standards and auditing guidelines.
- 1.3 Describe the various bodies that regulate accounting standards and auditing guidelines locally and internationally.
- 1.4 Explain the various factors militating against the harmonization of guidelines internationally such as lack of legal backings, cultural differences, etc
- 1.5 Explain current exposure drafts.

Assignment 1 to be submitted on May 27, 2015

2.0 GENERAL OBJECTIVE : Know the rights, duties and responsibilities of auditor.

Week 3-4

- 2.1 Differentiate between receivership, bankruptcy and liquidation
- 2.2 Explain the implications of insolvency for governance and going concern
- 2.3 Explain auditors' responsibility in relation to shareholders' information and participants' right.
- 2.4 State the duties and organization of the board of directors and the management
- 2.5 Explain the various systems of check and balances.
- 2.6 Test 1

3.0 GENERAL OBJECTIVE : Understand the process of auditing public concerns.  
Week 5-6

- 3.1 Explain the theory and practice of government accounting,
- 3.2 Explain the appointment, and functions of the Auditor-general of the Federation, State and Local Government
- 3.3 State the necessity of audit compliance with legislative and related authorities.
- 3.4 Explain the role of internal audit department in the public sector.
- 3.5 State the necessity of audit department in the public sector.
- 3.6 Explain the Value for money Audit.
- 3.7 Explain the role of Public Accounts Committee in audit process.
- 3.8 Explain the role of auditors in probe panels and investigation of fraud in the public sector.
- 3.9 Explain Board of Survey and their functions.
- 3.10 Explain types of reports.

Week 4.0 GENERAL OBJECTIVE : Understand the management of audit practice and the and the concept of assurance services

Week 7-8

- 4.1 Explain types of office and facilities to be maintained
- 4.2 State what partners' relationship should be.
- 4.3 Explain staff management procedure.
- 4.4 Explain the process of quality control.
- 4.5 Describe the training required by the audit staff.
- 4.6 Define the underlying concept of audit assurance engagement.
- 4.7 Explain the quality control practices and procedures.
- 4.8 Explain the rules and regulations concerning advertising and publicity, fees, tendering, engagement letters and consultation.
- 4.9 State performance and reporting standards.
- 4.10 Explain expectation gap as required of auditors.
- 4.11 State auditors' responsibilities for fraud searching, detection and prevention, omission, misstatements and other irregularities.
- 4.12 Explain negotiation skill required of an auditor for own office and on behalf of clients.

5.0 GENERAL OBJECTIVE: Understand the circumstances under which an auditor may become personally liable.

Week 9

- 5.1 Explain the principles of civil liability
- 5.2 Explain the various circumstances when an auditor may incur civil liability.
- 5.3 Explain criminal liability.
- 5.4 State the circumstances when an auditor may incur criminal liability.
- 5.5 Explain the auditor's liability to the third party.
- 5.6 Explain case laws.

Assignment 2 to be submitted in two weeks

6.0 GENERAL OBJECTIVE: Understand the Roles of Ethics on Provision of Audit Services

Week 10

- 6.1 Explain ethical standards.
- 6.2 Explain ethical code of conduct as it affects:
  - professional responsibility and independence, confidentiality, objectivity and conflict interest.
- 6.3 Explain the relationship between members concerning joint engagements and assurance services.

## 6.4 Test 2

7.0 GENERAL OBJECTIVE: Understand the process required for auditing special types of organizations

### Week 11-12

- 7.1 Identify the auditing problems peculiar to small businesses.
- 7.2 Describe solutions to mitigating auditing problems peculiar to small businesses.
- 7.3 Explain the types of accounts maintained by solicitors.
- 7.4 Explain the statutory and professional requirements to be maintained.
- 7.5 Explain the problems associated with auditing solicitors' accounts.
- 7.6 Proffer solutions to the problems associated with auditing solicitors' accounts.
- 7.7 State the problems peculiar to the auditing of the accounts of unincorporated bodies.
- 7.8 Proffer solutions to the problems associated with auditing of the accounts of unincorporated bodies.
- 7.9 Explain the process of auditing the accounts of unincorporated bodies.

8.0 GENERAL OBJECTIVE: Understand the introduction, functions, and operation of an internal audit department.

### Week 13

- 8.1 Define internal Audit.
- 8.2 Distinguish between internal audit and internal control systems.
- 8.3 state the functions of internal audit department.
- 8.4 Compare and contrast internal audit and statutory audit..
- 8.5 Describe how an internal audit department can be established..
- 8.6 Explain why internal auditors' independence is necessary.
- 8.7 Explain how the internal auditor's independence is maintained
- 8.8 Explain the special areas of internal audit such as: management audit, cost audit, detection of errors and frauds and ensuring laid down systems are maintained.
- 8.9 State the matters an internal auditor must include in his report.
- 8.10 Explain the role of the internal audit in an internal investigation.
- 8.11 Assignment 3

9.0 GENERAL OBJECTIVE: Understand the process of share transfer audits

### Week 14

- 9.1 Define internal the term share transfer
- 9.2 Differentiate between share transfer and share transmission
- 9.3 Explain the statutory requirements for share transfers
- 9.4 Explain how order (e.g through the memorandum of association etc) could be determined.
- 9.5 explain and Test for compliance with statutory and other requirements for the transfer of shares.
- 9.6 Explain the process of share transfer audit

# 1.0 CHAPTER ONE

## UNDERSTAND THE DEVELOPMENT AND OPERATION OF ACCOUNTING STANDARDS AND AUDITING GUIDELINES

At the end of the lecture, students are expected to understand the development and operation of accounting standards and auditing guidelines. Specifically, they should be able to:

- 1.1 Explain accounting standards and auditing guidelines
- 1.2 Trace the evolution and revolution of accounting standards and auditing guidelines.
- 1.3 Describe the various bodies that regulate accounting standards and auditing guidelines locally and internationally.
- 1.4 Explain the various factors militating against the harmonization of guidelines internationally such as lack of legal backings, cultural differences, etc.
- 1.5 Explain current exposure drafts.

## 1.1 THE DEVELOPMENT AND OPERATION OF ACCOUNTING STANDARDS AND AUDIT GUIDELINES

### **Introduction**

Financial statements are prepared to summarize the end-result of all the business activities by an enterprise during an accounting period in monetary terms. These business activities vary from one enterprise to other. To compare the financial statements of various reporting enterprises poses some difficulties because of the divergence in the methods and principles adopted by these enterprises in preparing their financial statements. In order to make these methods and principles uniform and comparable to the extent possible – standards are evolved in accounting. Similarly auditing standards are evolved to ensure uniformity the application of generally accepted auditing standards when performing auditing functions.

### **Accounting Standards**

Accounting Standards are the **statements of code of practice** of the regulatory accounting bodies. They are to be observed in the preparation and presentation of financial statements. In layman terms, accounting standards are the written documents issued by the expert institutes or other regulatory bodies to cover various aspects of measurement, treatment, presentation and disclosure of accounting transactions.

They are the frameworks for the preparation and presentation of financial statements. Also, they are guidelines that specify the accounting treatment for financial transactions. Essentially, standards help to ensure comparability, consistency and completeness of financial records.

These standards could be national like those developed by the Institute of Chartered Accountants of Nigeria (ICAN) or international like those developed by the International Accounting Standards Committee (IASC) International Financial Reporting Board. Differences between accounting standards come into reference when comparing financial statements prepared under different jurisdictions (e.g comparing financial statements prepared in Nigeria with those prepared in the U.S or Japan).

### **Auditing Standards**

Like the accounting standards, auditing standards are established procedures to be applied when engaged in audit functions. They are to be adapted and applied as appropriate in the audit of financial statements. According to the explanatory forward to the Nigerian Standards on Auditing (NSAs), Auditing Standards contain three main elements:

- (i) Basic principles;
- (ii) Essential procedures; and
- (iii) Related guidelines in form of further explanatory notes.

Within the framework, the basic principles and essential procedures need to be interpreted in relation to the explanatory and other materials which provide guidance to their application.

### **Auditing Guidelines**

It follows from the above that auditing guidelines provide detailed explanation on how to apply basic principles and procedures within a given standard. They are supplementary to audit guidelines.

For example,

Paragraph 4 of the Auditing Standard, 'The auditor's operational standard' states that: 'The auditor should obtain relevant and reliable audit evidence sufficient to enable him to draw reasonable conclusions. An Auditing Guideline was subsequently issued to give guidance on how that paragraph may be applied in relation to attendance at stocktaking. It is supplementary to and should be read in conjunction with the auditor's operational and reporting standards and related guidelines'

## **1.2 EVOLUTION AND REVOLUTION OF STANDARDS**

Evolution of accounting standards started with individual countries making pronouncements to guide financial reporting thus ensuring the reliability and relevance of financial information. In the United States of America, Generally Accepted Accounting Principles (GAAP) was maintained. In Great Britain, the Statement of Standard Accounting Practice (SSAP) held sway. In Nigeria, Statement of Accounting Standards (SAS) was in vogue. But in the last twenty years, the development of international accounting standards became evident in view of the growing influence of multinational companies and the globalization of world economy. European countries and third world countries harmonized their accounting standard to align with the pronouncements of the International Financial Standard Committee (IFSC) which later changed to International Financial Standard Board (IFSB). But the US would not align with the provisions of the International Accounting Standards as its Financial Accounting Standard Board did not recognize pronouncements outside GAAP. As the adoption of international accounting standards (IASs) became more widespread, and following the challenges of the world economic recession of the early 2000, international financial reporting standards (IFRSs) were developed. This caused the IFSB to be changed to the International Financial Reporting Council (IFRC). This Council has since 2001 been developing International Financial Reporting Standards (IFRS) which now seem to find favour with the US. Beginning from 2014, the US adopted the IFRS framework – already adopted by Nigeria since January 2012 for quoted companies.

### 1.3 THE VARIOUS BODIES THAT REGULATE ACCOUNTING STANDARDS AND AUDITING GUIDELINES

#### LOCALLY AND INTERNATIONALLY

#### **Accounting Standards and Guidelines**

The practice of Accountancy worldwide is governed by sets of rules and guidelines. These rules and guidelines are compiled into standards. There are two sets of standards governing the Accounting Practice in Nigeria. They are:

- a. International Standards:
  - (i) IAS: International Accounting Standards
  - (ii) ISA: International Standards on Auditing.

International accounting standards and guidelines are set by the International Federation of Accountants (IFAC) through one of its organs, the International Accounting Standards Board (IASB). This board was until 2001 addressed as the International Accounting Standards Committee (IASC) and was responsible for the issuance of international accounting standards (IAS) since 1974. As from 2002, the IASB commence issuance of International Financial Reporting Standards (IFRS).

As for auditing standards, another organ of IFAC, the International Auditing and Assurance Board (IAASB) is in charge. Professional associations in member countries of IFAC are expected to issue standards which comply with international auditing standards where such are not adopted wholesomely.

- b. Local Standards:  
Local standards include:
  - (i) SAS: Statement of Accounting Standards
  - (ii) NAS: Nigerian Auditing Standards.

Prior to 2002, accounting standards in Nigeria were issued by the Nigerian Accounting Standards Board (NASB) established in 1982. With the advent of the International Financial Reporting Standards (IFRS) and apparent change in accounting regulation from rule-based to principle-based, establishment of accounting standards became the responsibility of a new organ of government: the Financial Reporting Council of Nigeria.

With regard to auditing standards, the Institute of Chartered accountants of Nigeria used to issue auditing standards, being the only member of the International Federation of Accountants (IFAC). In 2013, however, IFAC admitted the Association of National Accountants of Nigeria (ANAN) into membership thus ending the special privilege enjoyed by ICAN.

Now, issuance of auditing standards is a function of the Financial Reporting Council of Nigeria (FRCN).

### 1.4 THE VARIOUS FACTORS MILITATING AGAINST THE HARMONIZATION OF GUIDELINES INTERNATIONALLY SUCH AS LACK OF LEGAL BACKINGS, CULTURAL DIFFERENCES, ETC



Attempts at harmonizing guidelines and standards internationally have always been lean on success rate. For example, the United States of America did not adopt International Accounting Standards issued by the International Accounting Standards committee. Countries also developed independent standards to comply with provisions of IASs or ISAs.

Many factors, including absence of legal provisions compelling global compliance, global cultural differences in culture, divergent educational systems, and varying levels of economic development contribute to this situation. Most stakeholders also argue that accounting standards and auditing standards based on rules are inflexible and may not address their legal, economic or social peculiarities thus making harmonization unattractive. For example, accounting standards in Nigeria must comply with the local legal framework, especially the Companies and Allied Matters Act (CAMA) 1990. In case of conflict, CAMA prevails. Also, the time framework for adopting such rule-based standards was definite. This might not align well with the business environment of some countries. With principle based standards, however, compliance among nations is improving and global harmonization may just a stone throw away.

## 1.5 CURRENT EXPOSURE DRAFTS

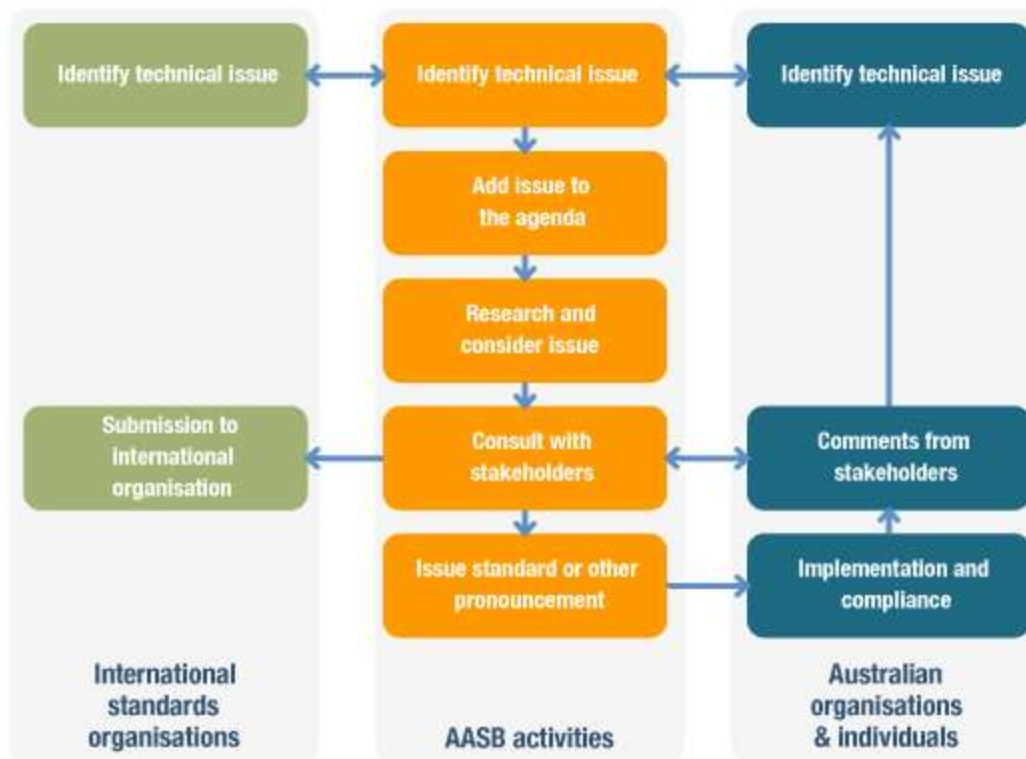
### 1.5.1 EXPOSURE DRAFT AND STANDARD - SETTING PROCESS

In Nigeria, accounting standards are set by The Nigerian Accounting Standards Board (NASB). Established in 1982, the Board is now referred to as the Financial Reporting Council (FRC). It takes the peculiar circumstances of Nigeria into consideration in the development or adoption of accounting standards. The following processes are involved:

- (i) Identification of technical issue;
- (ii) Constitution of technical committee of at least six experts;
- (iii) Development of working paper for the committee by the secretariat of the Board;
- (iv) Preparation and publication **of exposure drafts** (EDs) for comments within three months;
- (v) Collation and compilation of responses to the exposure draft;
- (vi) Conduct of a public hearing where necessary; and
- (vii) Issuance of a statement of accounting standard on the chosen technical topic.

Figure 1: The Australian Example of Standard - Setting Process.

### AASB Standard-Setting Process



The above is a simplified process of setting accounting standards. Establishment of auditing guidelines follows the same logic through the Nigerian Standard on Auditing (NSA) codified by the Institute of Chartered Accountants of Nigeria, being a member of the International Federation of Accountants (IFAC). This duty was delegated to the Nigerian Auditing Standards Committee (NASC) prior to the advent of the Financial Reporting Council.

New SAS is developed periodically to:

- a) Address issues not covered by existing Statutory Accounting Principles (SAP) guidance;
- b) Amend AN existing SAS; or
- c) Supersede existing SASs.

A major step in developing a new SAS as usual is the drafting of an Exposure Draft (ED). This contains the summary, conclusion, discussion and relevant literature sections. Public comments are solicited on the ED, and a public hearing organized where necessary before conversion to a SAS. The FRC may enlist the assistance of interested parties with requisite technical expertise as needed.

### 1.5.2 CURRENT EXPOSURE DRAFTS

These include the International Auditing and Assurance Standards Board (IAASB) Exposure Drafts (EDs) for:

- (i) Overall Explanatory Memorandum, The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement level, Including Engagement Quality Reviews
- (ii) Proposed International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial statements or Other Assurance or Related services Engagements (previously ISQC 1)
- (iii) Proposed International Standard on Quality management 2, Engagement Quality Reviews.
- (iv) International Standard on Auditing 220 (Revised), Quality Management for Audit of Financial statements – Issued February 8, 2019 with comments due July 1, 2019.
- (v) Proposed international standard on auditing 600 (revised): special considerations -- audits of group financial statements (including the work of component auditors) –issued on April 27, 2020 with comments ending on October 2, 2020.

EDs from the International Public Sector Accounting Standards Board (IPSASB):

- (i) Exposure Draft 70: [Revenue with Performance Obligations](#);
- (ii) Exposure Draft 71: [Revenue without Performance Obligations](#)
- (iii) Exposure Draft 72: [Transfer Expenses](#)

Comments on these will end by November 1, 2020

These three EDs released in February this year, pioneer new approaches for some of the most prevalent public sector transactions, including government transfers and grants for the delivery of key government services to citizens.

The International Public Sector Accounting Standards Board (IPSASB) extended the comment period for the [Exposure Drafts \(EDs\)](#) to **November 1, 2020**. The extension was in response to the additional challenges faced by stakeholders because of the COVID-19 pandemic, and was intended to provide stakeholders with additional time to undertake outreach and prepare their responses

## QUIZZES

1. Accounting Standards are the **statements of** ..... of the regulatory accounting bodies.
2. A New SAS is developed to .....an existing SAS
3. In Nigeria, SAS is developed by .....whereas, the International Accounting Standards Board (IASB) develops .....
4. One reason why international convergence of auditing standards is challenging is .....
5. Two processes in the development of an auditing standard are .....and.....

## REVISION QUESTIONS

1. Differentiate between accounting standards and auditing guidelines.
2. Explain the position of exposure drafts in the development of audit standards.
3. Indicate the bodies issuing local and international standards in Nigeria in relation to accounting and audit practices.
4. How many types of accounting standards are known to you? How would international exposure moderate the adoption of an accounting standard by a company and the utilization of audit standards by an external auditor?
5. Explain the roles of the following bodies in the development of accounting and auditing standards:
  - (i) ICAN;
  - (ii) IFAC;
  - (iii) FRCN;
  - (iv) CBN;
  - (v) NAICOM;
  - (vi) SEC;
  - (vii) FASB
6. (a) What are accounting standards and how do they differ from auditing guidelines.  
 (b) Using an appropriate chart, indicate how the Financial Reporting Council of Nigeria develops accounting standards.  
 (c ) indicate the body that establishes auditing standards and guidelines in:
  - (i) The United kingdom;
  - (ii) The United States of America; and
  - (iii) Nigeria.
7. (a) Iguana Juices Ltd. operates in Kenya and Sudan. In Sudan, the company operates solely as a private venture while in Kenya it receives over 85% of its funds from the United Nations Development Programme for Small Scale Enterprises (SSE).  
 You have just been employed as the Director of Internal Audit for the company. The company now faces the challenge of what accounting standards to adopt and what auditing guidelines should be followed.  
 In a brief memo to the managing Director in Lagos, far away from your own residence in Nairobi, show the:

- (i) main types of accounting standards available to accounting professionals in a country; effect of international operation on the accounting standards to be adopted by a company like Iguana Juices Ltd.
  - (ii) likely auditing standards you may wish to advocate following your findings that neither accounting nor auditing standards are well established in Kenya.
8. Explain two improvements to lease accounting arising from the replacement of IAS 17 by IFRS 16.
  9. Briefly explain the need for the revision of the following international standards:
    - (i) ISA 220
    - (ii) ISQM 1 and ISQM 2
    - (iii) ISA 600
  10. Explain the relevance of international convergence in the application of auditing standards.

## ASSIGNMENTS

1. With the aid of an appropriate diagram, explain how the Financial reporting Council of Nigerian sets auditing standards in Nigeria. Justify the need to change the setter of auditing standards in Nigeria from the Institute of chartered Accountants of Nigeria to the Financial Reporting Council of Nigeria.
2. Visit the Financial Reporting Council of Nigeria and detail the number of standards established by the Council to date, discriminating between:
  - (i) Auditing standards;
  - (ii) Accounting standards; and
  - (iii) Other standards.
3. Summarize the following:

### **EXPOSURE DRAFT, INTERNATIONAL STANDARD ON AUDITING 220 (REVISED), QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS**

#### **IAASB**

Feb 08, 2019 | Exposure Drafts and Consultation Papers

55 Pages

English

**All available Translations:** [French](#) [Spanish-Latin America](#)

[Don't see your language? Request permission to translate](#)

Comments due by: Jul 01, 2019

Proposed ISA 220 (Revised) will improve the management of quality at the engagement level for audits of financial statements. It contains enhanced and revised requirements and guidance to:

- Highlight the importance of the public interest role of audits, and improve the emphasis on the importance of the appropriate application of professional judgment and exercise of professional skepticism;
- Clarify the role and responsibilities of the engagement partner, particularly the required involvement of the engagement partner throughout the audit, and retain

the emphasis on the engagement partner's responsibility for managing and achieving quality at the engagement level;

- Modernize ISA 220 for an evolving environment, including changes in audit delivery models and the use of technology; and
- Clarify the relationship between ISA 220 and the International Standards on Quality Control/Management, including additional clarification of the engagement partner's and engagement team's interaction with the firm, and the engagement team's ability to depend on the firm's quality management policies or procedures.

This memorandum should be read in conjunction with the overall explanatory memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*.

Respondents are asked to respond separately to each of the exposure drafts and the overall explanatory memorandum. We request that comment letters do not include tables as they are incompatible with the software we use to help analyze respondents' comments.

#### **Exposure Drafts**

- Overall Explanatory Memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*
- Proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (previously ISQC 1)
- Proposed International Standard on Quality Management 2, *Engagement Quality Reviews*
- Want to learn more? Visit our Quality Management homepage

<https://www.iaasb.org/publications-resources/exposure-draft-international-standard-auditing-220-revised-quality-0>

Retrieved on July 22, 2020

#### **4. Read the following and explain how the duties of an auditor are enhanced by the revision.**

#### **EXPOSURE DRAFT, INTERNATIONAL STANDARD ON QUALITY MANAGEMENT 2, ENGAGEMENT QUALITY REVIEWS**

**IAASB**

Feb 08, 2019 | Exposure Drafts and Consultation Papers

33 Pages

English

**All available Translations:** [French](#) [Spanish-Latin America](#) [Spanish-Latin America](#)

[Don't see your language? Request permission to translate](#)

Comments due by: Jul 01, 2019

To ensure that engagement quality reviews continue to be robust and effectively support high-quality audits and other engagements, the IAASB has proposed various enhancements to engagement quality reviews. This includes a new proposed standard on engagement quality reviews that includes enhancements regarding:

- The eligibility criteria to perform the engagement quality review; and
- The engagement quality reviewer's performance and documentation.

The requirements addressing the selection of engagements for review have also been strengthened and are included in [Exposure Draft, ISQM 1, \*Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements\*](#).

This memorandum should be read in conjunction with the overall explanatory memorandum, [The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews](#).

Respondents are asked to respond separately to each of the exposure drafts and the overall explanatory memorandum. We request that comment letters do not include tables as they are incompatible with the software we use to help analyze respondents' comments

<https://www.iaasb.org/publications-resources/exposure-draft-international-standard-quality-management-2-engagement-0>

5. Read the following and justify the rationale for revising ISA 600 being NSA 25 in Nigeria.

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 600 (REVISED):  
SPECIAL CONSIDERATIONS -- AUDITS OF GROUP FINANCIAL STATEMENTS  
(INCLUDING THE WORK OF COMPONENT AUDITORS)**

**IAASB**

Apr 27, 2020 | Exposure Drafts and Consultation Papers

English

All available Translations: [French](#) [Russian](#)

[Don't see your language? Request permission to translate](#)

Comments due by: Oct 02, 2020

**SUBMIT COMMENT**

To ensure that International Standards on Auditing (ISAs) continue to provide a foundation for high-quality global audits, the IAASB Exposure Draft, ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, proposes more robust requirements and enhanced guidance that:

- Clarifies the scope and applicability of the standard.
- Emphasizes the importance of exercising professional skepticism throughout the group audit.
- Clarifies and reinforces that all ISAs need to be applied in a group audit through establishing stronger linkages to the other ISAs, in particular to proposed ISA 220 (Revised), ISA 315 (Revised 2019) and ISA 330.
- Focus the group engagement team's attention on identifying and assessing the risks of material misstatement of the group financial statements and emphasizes the importance of designing and performing procedures that are appropriate to respond to those assessed risks. When component auditors are involved, the proposed standard highlights the importance of the group engagement team's involvement in the component auditor's work.
- Reinforces the need for robust communication and interactions between the group engagement team, group engagement partner and component auditors.
- Includes new guidance on testing common controls and controls related to centralized activities.
- Includes enhanced guidance on how to address restrictions on access to people and information.
- Enhances special considerations in other areas of a group audit, including materiality and documentation.

Comments are requested by October 2, 2020

<https://www.iaasb.org/publications/proposed-international-standard-auditing-600-revised-special-considerations-audits-group-financial>

Retrieved on July 22, 2020



## 2.0 CHAPTER TWO

### UNDERSTAND THE PROCESS OF AUDITING CORPORATE DISTRESS

At the end of the lecture, students are expected understand the Process of Auditing Corporate Distress. Specifically, they should be able to:

2.0 The Process of Auditing Corporate Distress.

2.1 Differentiate between receivership, receiver manager, bankruptcy and liquidation

2.2 Explain the implications of insolvency for governance and going concern

2.3 Explain auditor's responsibility in relation to shareholders' information and participants' right.

2.4 State the duties and organization of the board of directors and the management

2.5 Explain the various systems of checks and balances.

## The Process of Auditing Corporate Distress

### 2.0 Introduction: Corporate Distress

Corporate distress implies companies in financial troubles: those who have incurred losses for less or more than three years, promising customers without being able to fulfill the attendant financial obligations. These also are companies experiencing corporate decline, pausing from previous successful financial performance into economic uncertainties regarding going concern. Expectedly most companies in this position find it difficult to attract additional financing to revive their businesses and may as well be constrained by inability to compete effectively in the market sphere where they operate.

#### 2.1 Differences between receivership, receivers-manager bankruptcy and liquidation Receiverships

This is the process by which a receiver is appointed to receive properties belonging to a company. Such an appointee has the legal right to 'receive' property of a chargee belonging to the company concerned. Also, the appointee may be given the power to manage the assets under his control. In such case, he is referred to as receiver/manager. Conditions for the appointment and operation of a receiver/manager is set out under sections 387 – 400 of (CAMA, 1990). A receiver may be appointed by a person to recover sums being owed as the holder of a charge- as in debenture- over assets. Such appointment may be according to the terms of the instrument creating the charge.

#### Bankruptcy

This may be viewed as a legal proceeding through which an insolvent debtor is declared bankrupt. This often involves individual traders or persons who are unable to meet their financial obligations in the settlement of creditors. Note that an insolvent debtor does not automatically become bankrupt: he must commit an 'Act of Bankruptcy' to be so declared. The "Act" includes defaults on the part of the debtor sufficient to be deemed evidence of insolvency.

Bankruptcy could be legal or voluntary. It is voluntary when the petition is brought by the debtor. On the other hand, legal bankruptcy arises when one or more creditors petition the court to have a debtor judged insolvent. In either case, the purpose is to have an orderly and equitable settlement of the obligations of the debtor.

Acts of Bankruptcy include commission of any of the following by the debtor;

- (i) Conveyance or assignment of personal property to a trustee for the benefit of the creditors generally;
- (ii) Making a fraudulent conveyance, gift, delivery, or transfer of personal property or any part thereof;
- (iii) Making any conveyance or transfer of own property or any part thereof, or creating any charge thereon which would be void as a fraudulent preference when he is adjudged bankrupt;
- (iv) Departing or making oneself absent from Nigeria, or departing from personal dwelling house or place of business, or by beginning to keep house with the intention of defeating or delaying creditors;
- (v) Permitting execution to be levied on him and allowing the goods to be sold or held by the court bailiff for more than 21 days;

- (vi) Filing a declaration of inability to pay debts, or by filing a bankruptcy petition against self;
- (vii) Failing to comply with a bankruptcy notice duly served upon him; and
- (viii) Giving notice to any creditor regarding suspension, or intention to suspend payment of due debts.

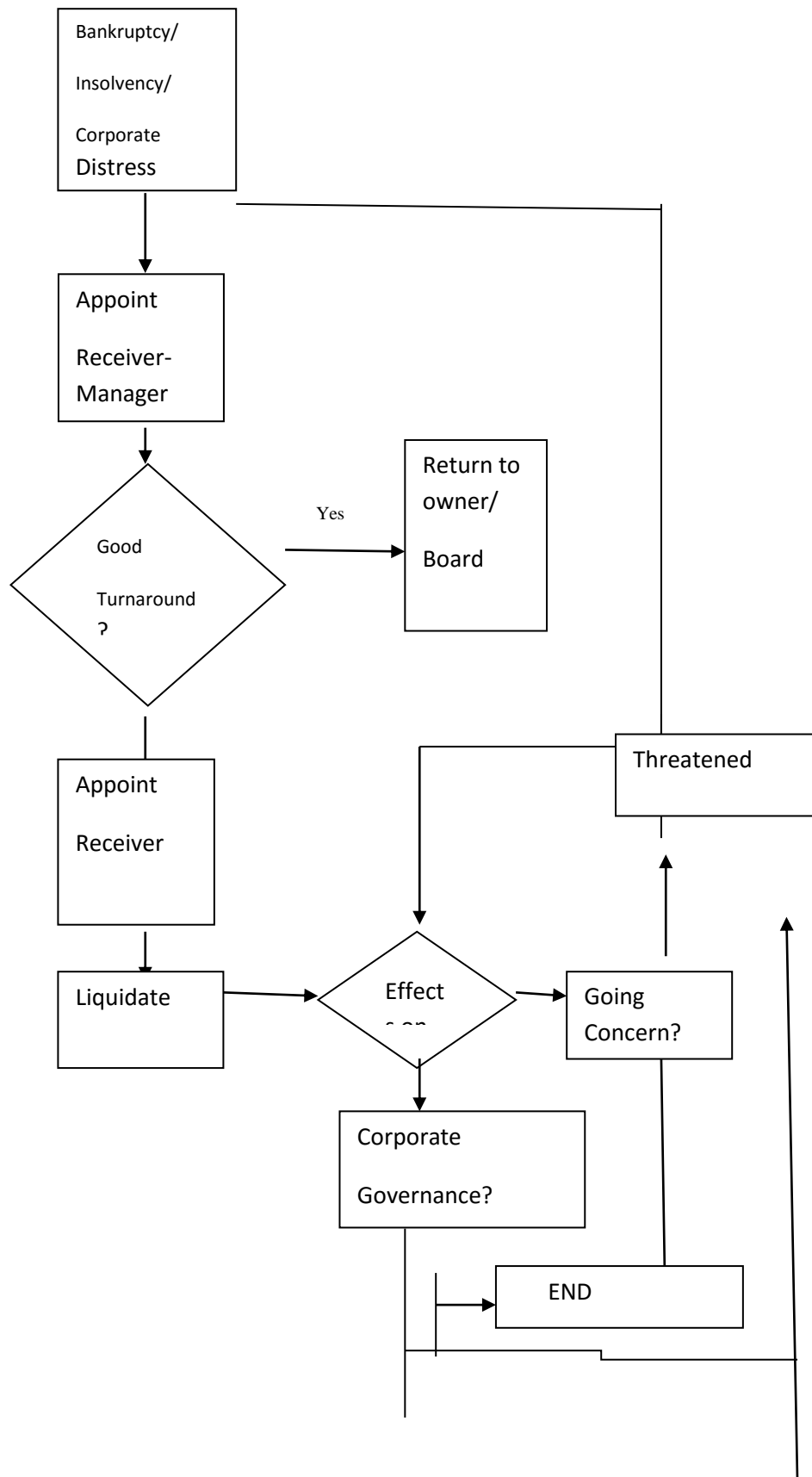
#### Liquidation

This is the process of dismantling a business, paying off debts in order of priority, and distributing the remaining assets in cash to the owners. This is called 'winding - up process.'

CAMA provisions in section 401 through 536 deals with this.

The process involves the realization of assets and distributing same with a view to terminating the affairs of the company taking the creditors into consideration.

By which business corporations are directed and controlled.' (OECD, 1999)



Corporate Distress: Effect on going concern and corporate governance.

Figure 2.1

## 2.2 Implications of Insolvency for Corporate Governance

### 2.2.1 Corporate Governance

This refers to action, manner and system of governing a corporate entity. It is ‘the system by which business corporations are directed and controlled.’(OECD)

The Organization for Economic Co-operation and Development (OECD) further illustrates the working of corporate governance structure to include:

- (i) Specification of the distribution of rights and responsibilities among different participants in the corporation;
- (ii) Spelling out of the rules and procedures for making decisions on corporate affairs; and
- (iii) Providing the structure through which the company objectives are set and the strategy for attaining the goals; and
- (iv) Monitoring performance.

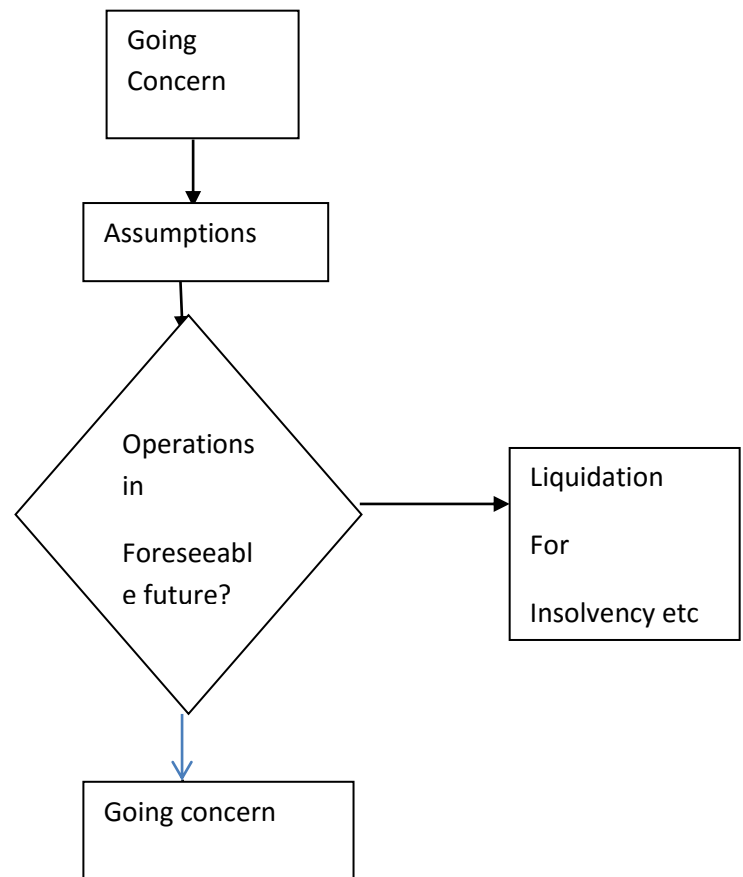
### Implications of Corporate distress on Corporate Governance

Once there is corporate insolvency, the position of those charged with corporate governance becomes threatened. When a company is on the verge of collapse, the effectiveness and accountability of board of directors become meaningless. Hence, rules, regulations and guidelines should be carefully and religiously implemented to prevent insolvency which often, brings about litigations and change of the entire board of directors. Early this year 2015, for example, the Securities and Exchange Commission (SEC) announced the suspension of the board of directors of BGL, a dominant player in the stock broking business and financial intermediary. The board was later replaced by an interim board to manage the affairs of the company for six months. The action followed board squabbles and inability to meet obligations of some aggrieved clients. The suspension may lead to a total halt of the original board if liquidation sets in.

### Insolvency and Going Concern Threats

Going concern is a fundamental accounting concept. SAS 1 defines it as ‘an assumption that the business unit will operate in perpetuity: that is, the business is not expected to be liquidated in the foreseeable future.’

NSA 1 further explains that under this assumption. The entity is viewed as being in business for the foreseeable future and without the plan or need to liquidate, cease trading or seek protection from creditors in accordance with laws or regulations. Consequently, assets and liabilities are recorded on the basis that it is possible to realize assets and discharge obligations in the ordinary course of business.



Going Concern Assumption  
Figure 2.2

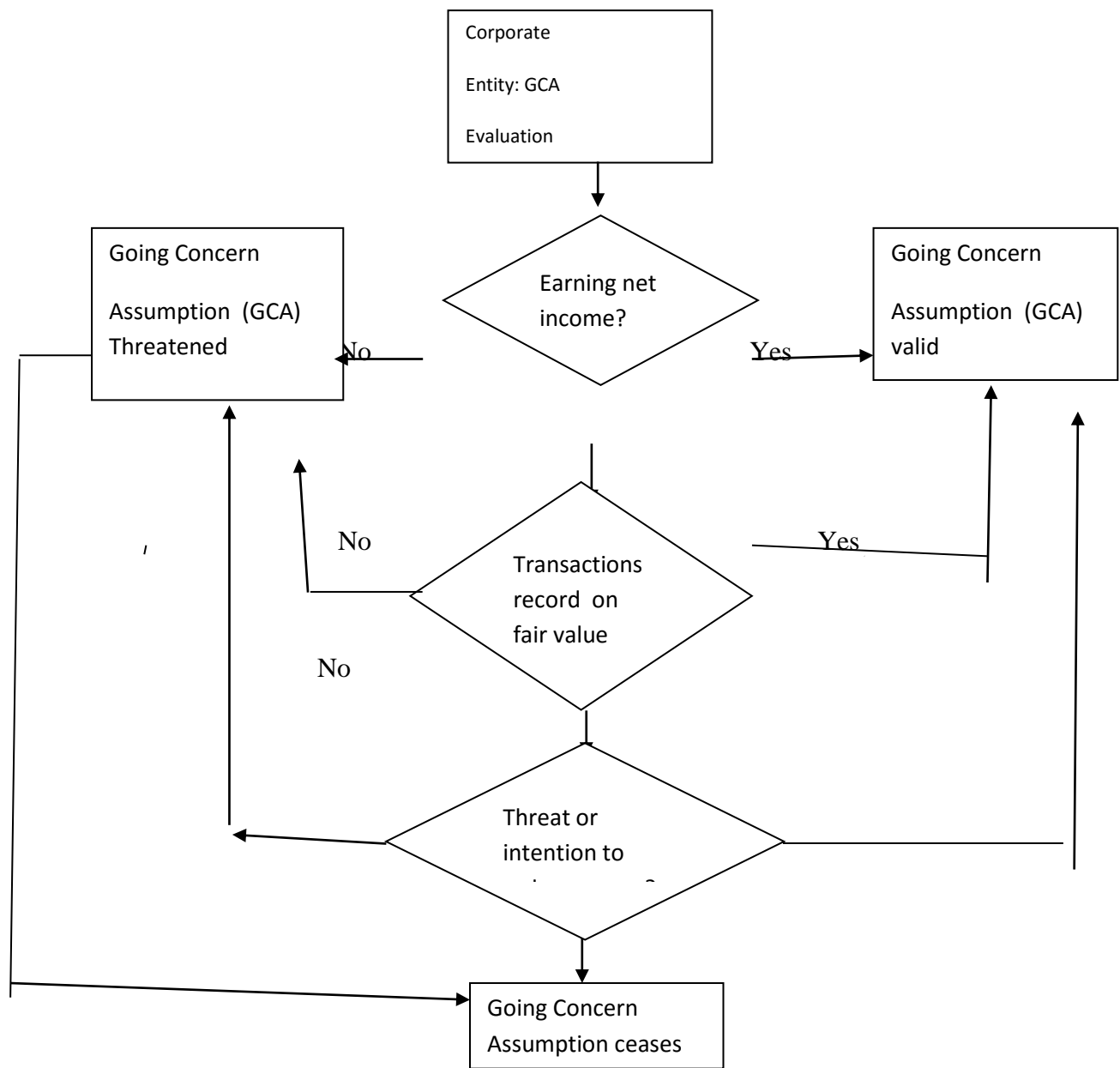
The implication of this is that the directors of a company will consider the company as a going concern if it is capable of:

- (i) Earning a reasonable net income;
- (ii) Financial transactions are recorded on fair value which supports settlement of obligations as they fall due; and
- (iii) There is no threat or intention to curtail significantly the scope of operation in the foreseeable future.

If the directors of a company doubt the appropriateness of the going concern principle, then such information should be given in the financial statement. The appropriateness or otherwise of the going concern status must also be a subject of audit opinion.

Where insolvency persists in a company, both the directors and the auditors should embark on remedial actions. If the actions fail, the option of winding up the company should be considered thus implying that the entity is no longer a going concern.

Implications of corporate distress and test of corporate distress by directors may be represented as shown in figure 2.3.



Test of corporate distress by directors  
Figure 2.3

From the above, it is evident that corporate distress is a threat to ‘going concern’ assumption and may lead to cessation of the assumption.

## 2.3 RESPONSIBILITY OF THE AUDITOR REGARDING INFORMATION TO SHAREHOLDERS AND THE RIGHT OF PARTICIPANTS.

The auditor's responsibility is to consider:

- (i) The appropriateness of management's use of going concern assumption in the preparation of the financial statements;
- (ii) Whether there are material uncertainties about the entity's ability to continue as a going concern which ought to be disclosed in the financial statements;
- (iii) Planning the audit to obtain an understanding of the entity regarding possible events, conditions or related business risks with the potential of casting significant doubt on continued adoption of the going concern assumption;
- (iv) Being alert to audit evidence of events or conditions and related business risks that could cast significant doubt on the ability of the entity to continue as a going concern when performing audit procedures within the engagement;
- (v) When events or conditions are identified which may cast significant doubt on the ability of the company to continue as a going concern, to :
  - (a) Review management's plan for future actions based on its going concern assessment;
  - (b) Gather sufficient and appropriate audit evidence to confirm or dispel the existence of material uncertainty events by carrying out other audit procedures deemed necessary;
  - (c) Seek written representations from management relating to plans for future action aimed at restoring confidence in the going concern assumption;
- (vi) If based on the evidence gathered, and in his judgment, a material uncertainty exists related to events or conditions which alone or in aggregate, may cast significant doubt on the ability of the entity to continue as a going concern.

A material uncertainty event exists when the magnitude of its potential impact is such that in the opinion of the auditor, clear disclosure of the nature and implications of the uncertainty is necessary for the representation of the financial statements not to be misleading.

## 2.4 THE DUTIES AND ORGANIZATION OF THE BOARD OF DIRECTORS AND THE MANAGEMENT

### 2.4.1 Duties – ensuring global best practice

Organization:

The board should be well organized to promote effectiveness of the entity i.e its ability to meet its desired goals and objectives.

Board is concerned with setting strategic direction as well as internal control measures

The Board should provide the structure through which the company objectives are set as well as the strategy for attaining the goals. Measures of performance should also be developed by the board with appropriate mechanism for comparing achievements with stated objectives while observed deviations from plan should be investigated. Corrective actions should always be instituted as well to prevent repeated poor performances.

Management – implementation of all directives by the Board. Compliance with global best practices is also important. External laws and regulations such as the Companies and Allied Matters Act, Investment and Securities Act must be complied with. Relevant international standards such as the International Accounting Standards (IAS),



International Financial Reporting Standards (IFRS) and the International Monetary Fund (IMF) must also be strictly implemented where necessary.

## 2.5 THE VARIOUS SYSTEMS OF CHECKS AND BALANCES.

The internal control system is made up of internal audit and internal checks. These are essential to ensure compliance extant rules and regulation to facilitate the achievement of corporate goals. Some of the checks and balances required to increase the effectiveness of corporate governance in preventing corporate distress include:

(i) Financial literacy of audit committee

Rahmat et al., (2012) established significant negative relationship between financial distress and the financial literacy of audit committee as well as the quality of external audit. The implication of the study is that quality external audit coupled with an effective audit committee, improves corporate financial performance.

(ii) Minimization of disagreement over reporting matters

This, especially for financially distressed companies, is a strong factor in audit switching (Schwartz and Menon, 1985). S&M established that failing firms have a greater tendency to switch auditors than do healthier firms- though audit qualifications and management changes were found to be of no significant statistical importance.

Whether insolvency is being prolonged or not the effect is same on the probabilities of a change in corporate value. For example, directors may wish to distribute higher dividends thus 'saving' money from creditors. Costs of financial distress may also feature in higher costs of capital as short term loans become expensive and difficult to secure. (Wikipedia, 2012)

(iii) Balanced relationship between audit fees to avoid impairment of audit independence

Using the DeAngelo (1981) auditor independence model, Blay and Geiger (2012) found that concerns over the relationship between auditor fees and the possible impairment of auditor independence, as reflected in going concern modification decisions, are supported by empirical study of highly distressed firms in more recent years. They examined audit service fees and non-audit service fees and the auditor's going concern reporting decisions using post-SOX period of 2004-2006 and stringent control sample of distressed firms. Firms paying higher subsequent fees were found to be less likely to receive current going-concern modifications from sitting auditors. Furthermore, the magnitude of NAS fees received by the auditor in the current year is negatively related to the issuance of going concern report modification.

All distressed banks in America, for example were audited by the Big Four:

PricewaterhouseCoopers(PwC), Deloitte, KPMG and Ernest Young. They equally audit about 99% of FTSE 100 companies (Sikka, 2012). At the peak of the financial crisis, they gave the usual clean reports companies that shortly went insolvent: Northern Rock, Abbey national, Alliance and Leicester, Bradford & Bingley, HBOS, Lloyds TSB and Royal Bank of Scotland (RBS). Others were Bear Stearns and Lehman Brothers. Following enquiry by the House of Lords' economic affairs committee auditors were accused of 'dereliction of duty,' 'complacency,' and basking in a culture of 'box ticking' instead of giving meaningful auditing services.

(iv) Best practice in the appointment of auditors

Resolutions are seldom accompanied by any information on the composition of the audit team, time spent on the job, audit and consultancy contracts, information obtained from directors, list of faults found with corporate accounts, regulatory action taken against auditors or anything else that may shed light on the quality of audit work or conflict of interest. Thus weak accountability measures mean little social value contribution by the auditors.

## QUIZZES

1. Corporate distress implies companies in financial ..... those which have incurred losses for less or more than ..... years, promising customers and other stakeholders without being able to fulfill the attendant financial .....
2. One NSA relevant to corporate distress is NSA .....on.....
3. Corporate distress may lead to .....or a halt of .....assumption/
4. Only an .....sound board could present .....and enhance unhindered going concern assumption.
5. To avoid corporate distress, entity must pay attention to .....details of operational performance.

## REVISION QUESTIONS

1. (a) What is corporate distress?  
(b) Explain the essence of financial literacy among the audit committee members as a basis for preventing corporate distress.
2. Indicate how the organization of the board of directors may prevent corporate distress.
3. Briefly state the position of the following in relation to corporate distress;
  - (i) Going concern;
  - (ii) Board of Directors;
  - (iii) Chaos Theory.
4. Briefly distinguish between:
  - (i) Bankruptcy and insolvency;
  - (ii) Receiver in bankruptcy and Receiver Manager;
  - (iii) Insolvency/bankruptcy and liquidation.
5. (a) What is chaos theory?  
(b) Explain the relevance of chaos theory in the audit of Kujore Plc with substantial market share and source of raw materials in Borno State of Nigeria.  
(c ) In May 2015, the Securities and Exchange Commission (SEC) announced the suspension of the Board of Directors of BGL Plc, a dominant player in the capital market. Briefly explain how this event will affect your audit process for the year 2015 as the External Auditor of the company.

## ASSIGNMENTS

1. Explain the significance of the Nigerian Standard on Auditing 23, 'Going Concern' on the responsibilities of the following in relation to going concern challenges;
  - (i) The Board of Directors; and
  - (ii) The External Auditors of the company.
2. Explain how greater care in the procedure and best practice in the appointment of external auditors and actual performance of external auditing may stem incidents of global financial crisis.
3. (a) Briefly comment on the role of Atedo Peterside's report on corporate governance in Nigeria in strengthening going concern assumption.  
(b) Examine the role of Audit Committees in Corporate Distress amelioration in Nigeria..
4. From the following article, explain:
  - (i) Two advantages of receiver-managers;
  - (ii) The possible outcome of appointing a receiver-manager for Poloni and Company Limited; and
  - (iii) Investigate and report on the actual outcome.

### [N139m debt: Receiver manager takes over Italian company](#)

Published on October 22, 2015 by [pmnews](#) · [No Comments](#)

Akin Kuponiyi

<http://www.pmnewsnigeria.com/2015/10/22/n139m-debt-receiver-manager-takes-over-italian-company/>

A Federal high court sitting in Lagos, western Nigeria, has granted leave to a Lagos lawyer, Barrister Temilolu Adamolekun appointed by Guaranty Trust Bank Plc as receiver manager to take over an Italian company.

The firm, Poloni and Company Limited situated at 58/60, Ajose Street Mende village, Maryland, Lagos, was taken over due to the inability of the company to pay a debt of N139,061,280.27.

The order of the court was sequel to an affidavit sworn to by a legal practitioner Mr Gbenga Akinde-Peters in support of motion ex-parte filed before the court by the law firm of Temilolu Adamolekun, the deponent averred that in October, 2014, Guaranty Trust Bank Plc granted loan in the sum of N124 million to Poloni and Company Limited to augment its working capital.

The loan was secured by personal guarantee and indemnity signed by Mr Domenico Poloni who is the alter ego of Poloni company, and a duly registered deed of legal mortgage wherein it

pledged all the piece of land situted at Mende village, off Ikorodu road of Lagos State covered by a deed of transfer between Michael Adebajo Akinola and Poloni company limited.

The company has failed to liquidate the facility which has continued to attarct interest in line with terms and conditions in the agreement executed before granting the loan and as at 13 May, 2015, the company's indebtedness stood at N139,061,280.27.

Despite several letters of demand the company has failed to liquidate its indebtedness to the bank.

Consequently, the bank appointed Mr Temilolu Adamolekun as Receiver/Manager over the property and assets mortgaged in favour of the bank by the company.

Guaranty Trust Bank Plc then urged the court not only to restrain the company and its directors and agents from obstructing the receiver manager from performing his duty but to also grant the receiver manager leave to take over the company pending the hearing and final determination of the motion on notice.

The presiding Judge, Saliu Saidu acceded to the request of the bank.

The company has since been taken over by the Receiver/Manager.

<http://www.pmnewsnigeria.com/2015/10/22/n139m-debt-receiver-manager-takes-over-italian-company/>

Retrieved on October 27, 2015.

5. Read the following story and explain why Aliko Dangote had to resign from the board. Describe the strengyh of the going concern assumption in the company following an analytical review of the financial statement of the company from year 2015 financial year to 2019.

### **Dangote resigns from Dangote Flour Mills. Here's why.**

South African Tiger Brand's failing business venture with Dangote Flour Mills seems to be at an end as name-on-the door founder and Africa's richest man Aliko Dangote, along with three other people [resigned](#) today from the board of Dangote Flour Mills. Olakunle Alake, Asue Ighodalo, Aliko Dangote and Arnold Ekpe all resigned today after Tiger Brands announced that it was reducing funding to the Nigeria-based Dangote Flour Mills.

Tiger Brands bought shares worth [\\$150 million dollars](#) in Dangote Flour Mills in 2012, gaining a 63.35% stake in the company, making it the majority shareholder. The majority shareholders also accrued debts of about a \$100 million from the sale. When asked, why he sold the majority stake, Dangote said the decision was in line with their [plans to diversify](#). However, it is likely that this was not the case. Dangote Flour Mills was actually in crisis; and Tiger Brands was its savior.

However, despite this attempt to save the business, Dangote Flour Mills revenue still fell in the first half of 2013, with a loss of about \$26.8 million. Tiger Brands responded by indicating a readiness to increase its [stake in DFM to 70%](#) but the plan did not see the light of the day.

While Tiger Brands recorded profits in South Africa, DFM was holding it back. [DFM was being affected](#) by falling oil prices, the devaluation of the Naira and the subsequent increase in the price of imported wheat. Things came to a head when TBS recorded losses because of DFM. TBS told investors in May 2015 they would have to raise money from DFM by selling shares, but it seems they retired the initial plan. DFM was termed 'a big liability' by an [analyst in Cape Town](#). TBS revenues rose, when they decided to reduce financing DFM in Nigeria, which would have a great impact on DFM (its majority shareholder cutting its losses) and is likely why Dangote and co. resigned.

This announcement is a big hit for Dangote, but considering that TBS and DFM were at odds, it was perhaps a smart, yet difficult choice.

<http://venturesafrica.com/dangote-resigns-from-dangote-flour-mills-heres-why/>

Retrieved on November 17, 2015

### 3.0 CHAPTER THREE

## UNDERSTAND THE PROCESS OF AUDITING PUBLIC CONCERNS

At the end of the lecture, students are expected understand the process of auditing public concerns. Specifically, they should be able to:

- 3.1 Explain the theory and practice of government accounting,
- 3.2 Explain the appointment, and functions of the Auditor-General of the Federation, State and Local Government
- 3.3 State the necessity of audit compliance with legislative and related authorities.
- 3.4 Explain the role of internal audit department in the public sector.
- 3.5 State the necessity of audit department in the public sector.
- 3.6 Explain the Value for Money Audit.
- 3.7 Explain the role of Public Accounts Committee in audit process.
- 3.8 Explain the role of auditors in probe panels and investigation of fraud in the public sector.
- 3.9 Explain Board of Survey and their functions.
- 3.10 Explain types of reports.

## 3.1 THE THEORY AND PRACTICE OF GOVERNMENT ACCOUNTING

### GOVERNMENT ACCOUNTING

Government accounting encompasses the processes of analyzing, recording, classifying, summarizing and communicating all transactions involving the receipt and disposition of government funds and property, and interpreting the results thereof.

Such report enables the people to have a clearer view on how the government spends the funds from the taxes being paid. Government Accounting System (GAS) aims at:

- (1) Simplify government accounting;
- (2) Conforming to international accounting standards; and
- (3) Generate periodic and relevant financial reports for monitoring performance

**Governmental accounting** is an [umbrella term](#) which refers to the various [accounting systems](#) used by various [public sector](#) entities

### Public vs. Private Accounting

There is an important difference between [private sector accounting](#) and governmental accounting. The main reasons for this difference are the environment of the accounting system. In the government environment, public sector entities have differing goals, as opposed to the private sector entities' one main goal of gaining profit. Also, in government accounting, the entity has the responsibility of [fiscal accountability](#) which is demonstration of compliance in the use of resources in a budgetary context. In the private sector, the budget is a tool in [financial planning](#) and it isn't mandatory to comply with it.

Government accounting refers to the field of accounting that specifically finds application in the public sector or government. A special field of accounting exists because: - The objectives to which accounting reports to differ significantly from that for which generally accepted accounting practice has been developed for in the private (business) sector; & - The usage of the results of accounting processes of government differs significantly from the use thereof in the private sector.

An exception exists on the above-mentioned differences in the case of public utility businesses (for example Electricity Services) that may be intended to produce a net income or profit, but a



significant debate exists over whether there should be such an exception. Nationalisation includes, amongst others, the argument that entities should be either private or public, and that the objectives of public entities should differ significantly from that of private entities. In other words, is the generation and reticulation of electricity with the objective to generate a profit in the public interest or not? And if it is the best way, shouldn't it then be completely private instead of having access to public funds and monopolies?

The unique objectives of government accounting do not preclude the use of the [double entry accounting system](#). There can, however, be other significant differences with private sector accounting practices, especially those that are intended to arrive at a net income result. The objectives for which government entities apply accountancy can be organized in two main categories: - The accounting of activities for accountability purposes. In other words, the representatives of the public, and officials appointed by them, must be accountable to the public for powers and tasks delegated. The public, who have no other choice but to delegate, are in a position that differs significantly from that of shareholders and therefore need financial information, to be supplied by accounting systems, that is applicable and relevant to them and their purposes. - Decision-making purposes. The relevant role-players, especially officials and representatives, need financial information that is accounted, organized and presented for the objectives of their decision-making. These objectives bear, in many instances, no relation to net income results but are rather about service delivery and efficiency. The taxpayer, a very significant group, simply wants to pay as little as possible taxes for the essential services for which money is being coerced by law.

Governmental accounting standards are currently being dominated by the accounting standards (internationally sometimes referred to as IFRS) originally designed for the private sector. The so-called Generally Recognised Accounting Practices (GRAP) that are being enforced in the public sector of countries such as South Africa, one of the front-runners in this regard is based on the Generally Accepted Accounting Practices originally developed for the private sector. The above and common sense raises the question of whether this is the best solution. It is of course cheaper and it is alleged that the history of separate development of accounting practices for government has not been successful. Even at the onset of the current fiscal crisis in Europe and other parts of the world it was argued authoritatively that the sometimes inapplicable accounting practices of the private sector being used, have contributed to the origination of, and belated reaction to, the fiscal crisis.<sup>(1)</sup>

## Governmental Accounting

Public sector accounting refers to the field of accounting that specifically finds application in the public sector or government. A special field of accounting exists because: - The objectives to which accounting reports to differ significantly from that for which generally accepted accounting practice has been developed for in the private (business) sector; and - The usage of the results of accounting processes of government differs significantly from the use thereof in the private sector.

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accounting practices, especially those that are intended to arrive at a net income result. The objectives for which government entities apply accountancy can be organized in two main categories: - The accounting of activities for accountability purposes. In other words, the representatives of the public, and officials appointed by them, must be accountable to the public for powers and tasks delegated. The public, who have no other choice but to delegate, are in a position that differs significantly from that of shareholders and therefore need financial information, to be supplied by accounting systems, that is applicable and relevant to them and their purposes. - Decision-making purposes. The relevant role-players, especially officials and representatives, need financial information that is accounted, organized and presented for the objectives of their decision-making. These objectives bear, in many instances, no relation to net income results but are rather about service delivery and efficiency. The taxpayer, a very significant group, simply wants to pay as little as possible taxes for the essential services for which money is being coerced by law.

The governmental accounting system sometimes uses the historic system of [fund accounting](#). A set of separate, self-balancing accounts are responsible for managing resources that are assigned to specific purposes based on [regulations](#) and [limitations](#).

The governmental accounting system has a different focus for measuring accounting than private sector accounting. Rather than measuring the flow of [economic resources](#), governmental accounting measures the flow of [financial resources](#). Instead of recognizing [revenue](#) when they are earned and [expenses](#) when they are incurred, revenue is recognized when there is money available to liquidate [liabilities](#) within the current accounting period, and expenses are recognized when there is a drain on current resources.

Governmental financial statements must be accompanied by required supplementary information (RSI). The RSI is a comparison of the actual expenses compared to the original budget created at the beginning of the [fiscal year](#) for the Government's General Fund and all major Special Revenue Funds.

## GOVERNMENT ACCOUNTING SYSTEMS

There are four systems of government accounting:

### 1. Federal Government Accounting (at the National level)

It is used by the different departments, bureaus, offices, and the field offices and operating units of agencies controlled by the FGN.

### 2. State Government Accounting

This is used by the different departments, bureaus, offices, and the field offices and operating units of agencies controlled by state governments.

### 3. Local Government Accounting

This is used by local governments, local government development areas, cities and municipalities.

### 4. Commercial Accounting

This system is popularly used by the private sector but applied by government owned and/or controlled companies operating as commercial ventures.

## ACCOUNTING THEORY

The term could apply to all forms of accounting, although most often it is used with reference to financial accounting -- financial by corporate entities to owners of equity and other investors.

Accounting theory chiefly revolves around two documents: the balance sheet and the income statement. The balance sheet measures the state of an entity at a particular moment in time. Balance sheets are designed to embody the equation

$$\text{Assets} = \text{Liabilities} + \text{Equity}.$$

The income statement, also sometimes called the "profit and loss" statement, abbreviated as the P&L, is a document designed to show the change in the company's condition through a given period -- month, quarter, or year. Revenue accounts may include sales, interest, rental income and service fees. Expense accounts may include cost of goods sold, salaries/wages, rent paid utilities and office administration expenses.

### THEORY:

Three important concepts upon which it is based are:

- (i) fund accounting;
- (ii) accrual accounting; and
- (iii) budgetary accounting.

### Fund Accounting

A fund is an account in which money is deposited for a definite purpose. It means segregation of cash for some specified purpose or purposes (James, 1950).

Fund Accounting is a system of [accounting](#) used primarily by non-profit or [government organizations](#). Under this concept, it is more important to [keep](#) a [record](#) of how [money](#) is spent, rather than how it is earned, unlike [corporations](#). The [accounting records take the form](#) of a [collection](#) of [funds](#), each [fund](#) having a distinct purpose, ranging from [operating expenses](#) to [funding](#) the various [activities](#) of the organization (Wikipedia, 2013)

Furthermore, fund accounting is a system emphasizing [accountability](#) rather than [profitability](#), used by [non-profit organizations](#) and governments. In this system, a *fund* is a self-balancing set of [accounts](#), segregated for specific purposes in accordance with laws and regulations or special restrictions and limitations.<sup>[1]</sup>

## Financial reporting

State and local governments report the results of their annual operations in a [comprehensive annual financial report](#) (CAFR), the equivalent of a business's financial statements. A CAFR includes a single set of government-wide statements, for the government entity as a whole, and individual fund statements. The [Governmental Accounting Standards Board](#) establishes standards for CAFR preparation.<sup>[6]</sup>

Governments do not use the terms *profit* and *loss* to describe the net results of their operations. The difference between revenues and expenditures during a year is either a *surplus* or a *deficit*. Since making a profit is not the purpose of a government, a significant surplus generally means a choice between tax cuts or spending increases. A significant deficit will result in spending cuts or borrowing. Ideally, surpluses and deficits should be small

## Accrual Accounting

An accounting method that measures the performance and position of a company by recognizing economic events regardless of when cash transactions occur. The general idea is that economic events are recognized by matching revenues to expenses (the matching principle) at the time in which the transaction occurs rather than when payment is made (or received). This method allows the current cash inflows/outflows to be combined with future expected cash inflows/outflows to give a more accurate picture of a company's current financial condition

Accrual accounting is considered to be the standard accounting practice for most companies, with the exception of very small operations. This method provides a more accurate picture of the company's current condition, but its relative complexity makes it more expensive to implement. This is the opposite of cash accounting, which recognizes transactions only when there is an exchange of cash.

The need for this method arose out of the increasing complexity of business transactions and a desire for more accurate financial information. Selling on credit and projects that provide revenue streams over a long period of time affect the company's financial condition at the point of the transaction. Therefore, it makes sense that such events should also be reflected on the financial statements during

the same reporting period that these transactions occur.

For example, when a company sells a TV to a customer who uses a credit card, cash and accrual methods will view the event differently. The revenue generated by the sale of the TV will only be recognized by the cash method when the money is received by the company. If the TV is purchased on credit, this revenue might not be recognized until next month or next year.

Accrual accounting, however, says that the cash method isn't accurate because it is likely, if not certain, that the company will receive the cash at some point in the future because the sale has been made. Therefore, the accrual accounting method instead recognizes the TV sale at the point at which the customer takes ownership of the TV. Even though cash isn't yet in the bank, the sale is booked to an account known in accounting lingo as "accounts receivable," increasing the seller's revenue.

Budgetary accounting.

The process in [Government Accounting](#) of [recording](#) budgetary [amounts](#) in the [accounts](#) of a [fund](#). Recording these [balances](#) has a dual [effect](#). [First](#), the control of this budgetary function is made known. In addition, there is [recognition](#) given to the [legal](#) pillars of the [budget](#). The need for this recording is consistent with the responsibility of [fund accounting](#). It is primarily concerned with [performance](#) in [terms](#) of authority to act and the action itself. The recording of both the budget and the [actual transactions](#) helps to fix responsibility

The [cash basis](#) and the [accrual basis](#) are the two primary methods of tracking income and expenses in accounting.

Both can be used in a range of situations from the accounts of a whole country,<sup>[1]</sup> a large corporation, a small business or an individual. In many cases regulatory bodies may require individuals, businesses or corporations use one method or the other. When this is not the case, the choice of which to use is an important decision as both have advantages and disadvantages

### **'Modified Accrual Accounting'**

An accounting method commonly used by government agencies that combines accrual-basis accounting with cash-basis accounting. Modified accrual accounting recognizes revenues when they become available and measurable and, with a few exceptions, recognizes expenditures when liabilities are incurred. This system divides available funds into separate entities within the organization to ensure that the money is being spent where it was intended.

The Government Accounting Standards Board, which is recognized as the official source of generally accepted accounting principles (GAAP) for state and local governments, establishes modified accrual accounting standards. To distinguish government accounting from business accounting, modified accrual

accounting uses some different terminology than other accounting methods. For example, it uses the terms "excess" or "deficiency" instead of "net income", and "expenditures" instead of "expenses". The idea that government agencies need a different type of accounting system is accepted because the purpose of government organizations is significantly different from the purpose of both for-profit businesses as well as not-for-profit non-governmental organizations.

### 3.2 THE APPOINTMENT AND FUNCTIONS OF THE AUDITOR-GENERAL OF THE FEDERATION, STATE AND LOCAL GOVERNMENT

#### THE APPOINTMENT OF THE AUDITOR-GENERAL OF THE FEDERATION

The appointment of the Auditor-general is provided for in section 86 of the 1999 Constitution of the Federal Government of Nigeria. This states that the appointment is by the President following recommendation by the Federal Civil Service Commission and subject to the approval of the National Assembly.

#### THE FUNCTIONS OF THE AUDITOR-GENERAL OF THE FEDERATION (AGF)

The function of the Auditor – General of the federation is to audit and report upon the public accounts of the Federation and of all offices and courts of the federation. This is contained in section 85 of the Constitution which also mandates the AG to submit his reports to each house of the National Assembly within 90 days of receiving financial statements from the Accountant-general.

It is also the function of the AG to provide lists of auditors qualified to be appointed by government statutory corporations, commissions, agencies, including all persons and bodies established by an Act of the National Assembly. Such bodies are to elect their external auditors from the list.

Moreover, the AG is to provide guidelines ,on the level of fees to be paid external auditors. He is also required to comment on the annual accounts and auditor's reports thereon.

The AG also has power to conduct periodic checks on all statutory corporations, commissions, authorities, agencies, including all persons and bodies established by the Act of the National Assembly.

### 3. 3. THE NECESSITY OF AUDIT COMPLIANCE WITH LEGISLATIVE AND RELATED AUTHORITIES

Essentially, legislative authorities include the National Assemblies while related authorities include the Executive, the Judiciary as well as guidelines derived from Financial regulations and official circulars. Compliance with the legislative and related authorities will enable the Auditor –General:

- (i) To determine whether government accounts have been satisfactorily and faithfully kept via Financial Audit.
- (ii) To ensure that funds are expended as appropriated by the National Assembly via Appropriation Audit.
- (iii) To ensure that laid down controls and procedures are observed in tendering, contracts, and storekeeping with a view to preventing waste, pilferage and extravagance – via Financial Control Audit.
- (iv) To ascertain the level of the economy, efficiency, and effectiveness derived from government projects and programmes – via Value for Money Audit.

### 3.4 THE ROLE OF INTERNAL AUDIT DEPARTMENT IN THE PUBLIC SECTOR

This is well explained in chapter 17 of the Financial Regulations 2009. Its main role is to provide the management control function by measuring and evaluating the effectiveness of internal Control System in public offices.

### 3.5 THE NECESSITY OF AUDIT DEPARTMENT IN THE PUBLIC SECTOR

It is necessary to establish internal audit department in the public sector to complement the control functions of Accounting Officers by providing complete and continuous audit of all the accounts and records of revenue and expenditure, assets, allocated and unallocated stores where necessary (s.1701(ii)). This is not to relegate normal departmental checks and controls. Audit departments in the public sector also encourage issuance of special reports where necessary thus addressing financial irregularities on time or strengthening weaknesses in the accounting procedure.

### 3.6 Explain the Value for Money Audit.

#### **Value for Money Audit (VFMA)**

<http://www.businessdictionary.com/definition/value-for-money-audit.html>

This is an independent audit of a not-for-profit organization such as government agency or unit, charity, trust, etc., to assess the effectiveness and efficiency of its utilization of funds. It is employed where the standard commercial performance index of profitability could not be used. It may also be called value for money analysis.

*Vfma, hence, is an investigation into whether or not the use of resources is economic, efficient and effective. It seeks to identify ways in which the return for*

*resources employed could be maximized and to recommends such ways to those charged with management.*

- To identify and recommend ways in which the return for resources employed may be maximized.

Read more: <http://www.businessdictionary.com/definition/value-for-money-audit.html#ixzz2WKOmsBJY>

### 3.7 THE ROLE OF PUBLIC ACCOUNTS COMMITTEE IN AUDIT PROCESS.

The role of Public Accounts Committee in Audit Process

The role of the Public Accounts Committee in the public sector is like that of the Audit Committee in the private or commercial sector.

The committee reports to the National Assembly and the President on matters referred to it (s7 (a)). It also reports on its activities to the president for each preceding year, not later than six months after the end of the year (s7(b)).

It follows, therefore that the PAC ensures due compliance with statutory provisions with regard to preparation and attestation of financial statements in the public sector. This helps to promote accountability in the public sector and minimize fraud. Furthermore, since PAC comments on reports of the Auditor-General, it serves as a control against abuse of ethical norms such as independence and objectivity in the public sector.

In Nigeria, the enabling Act for PAC was enacted on April 3, 1987. It was established essentially to examine the audited accounts of all offices and courts of the Federation and the Auditor-General's report thereon as well as other detailed matters.



### 3.8 THE ROLE OF AUDITORS IN PROBE PANELS AND INVESTIGATION OF FRAUD IN THE PUBLIC SECTOR

This may be explained using the audit cycle as shown below.

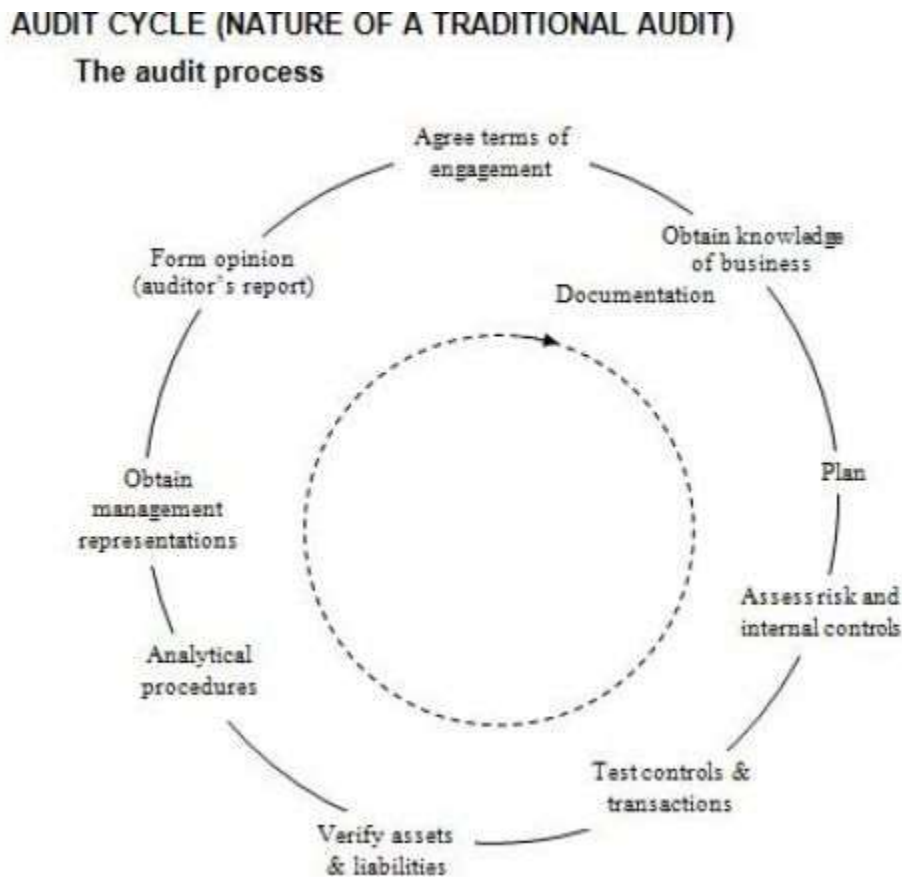


Figure 3.1: The Audit Cycle

Consequently, the role of auditors in probe panels and investigation of fraud in the public sector include:

- (i) Using his professional expertise to gather evidence about the entity being investigation and its environment.
- (ii) Testing the evidence collected using auditing procedures which may be substantive, transactional or analytical.
- (iii) Obtaining management representation as well as ensuring that the draft report is discussed with relevant officers of the entity being investigated.
- (iv) Writing the report in the desired format. This is essential where a foerformat is presented, thus making the report acceptable to the client.

### 3.9 BOARD OF SURVEY AND THEIR FUNCTIONS

#### Board of Survey

A board of survey refers to a team of officials duly appointed to conduct a survey of the assets of a vote by undertaking a physical inspection of the assets, stores (inventories), cash, bank balances and books of accounts for a given vote.

#### Functions of Board of Survey

The general objective of the board of survey is surveying the assets, stores, cash, bank balances and books of accounts of every vote for the preceding financial year. specific objectives for board of survey include;

- a) To ascertain the assets portfolio of Government and hence plan for the future replacement (new acquisitions) or upgrading of existing assets through identifying unserviceable assets, surplus to requirements, underutilized or uneconomic to maintain assets and planning for disposal (boarding off).
- b) To ensure accountability and transparency in assets management and establish a proper linkage between planning budgeting and budget execution cycle especially in the area of future replacement and maintenance budgets.
- c) Ensure bank statements and inventory closing stocks are reconciled with the cashbooks & stock ledgers respectively and, any reconciling items identified together with proper opening balances carried forward.
- d) Monitor through inspections and ensure compliance with previous year's implementation of recommendations and highlight any gaps in use of government property which may hinder efficient service delivery.
- e) To inform reporting by preparation of financial information to be included in financial statements.
- f) Ensure completeness of assets in the register for proper accountability & transparency

The Board of Survey: Contrasting with the Public Accounts Committee.

The Public Accounts Committee (PAC) and the Board of Survey (BOS) are two elements in the auditing process of the public sector. Together these two elements enhance the integrity of the financial system in the public sector.

While PAC acts as a check on the Auditor – General of the Federation, BOS serves as a check on the utilization of assets by government agencies. In the auditing process of the Nigerian University Commission (NUC) for example, BOS will verify all assets including cash as at the end of the financial year –December 31 or at the beginning of a new year. This will form a part of the financial report submitted by the Accountant – General of the Federation to the Auditor – General of the Federation. This role is different from that of PAC which is a committee of the National Assembly which verifies audit reports on NUC as submitted to it by the Auditor – General of the Federation.

### 3.10 TYPES OF REPORTS

Types of reports produced by the Auditor- general could be classied into:

- (i) Routine; and
- (ii) Non-routine reports.

#### ROUTINE REPORTS

Routine reports are the statutory reports as:

- (i) Financial Audit Report  
This is structured to report on whether government accounts have been satisfactorily and faithfully kept.
- (ii) Appropriation  
This is designed to report on whether funds are expended as appropriated by the National Assembly or not.
- (iii) Financial Control Audit Report the objective of this is to report on the extent to which laid down controls and procedures are observed in tendering, contracts, and storekeeping with a view to preventing waste, pilferage and extravagance.
- (iv) Value for Money Audit Report  
This is meant to ascertain and report on the level of the economy, efficiency, and effectiveness derived from government projects and programmes.

#### NON-ROUTINE REPORTS

These include reports on:

- (i) Investigations which may arise in the course of the year; and
- (ii) Other reports resulting from spot checks.

Read more: <http://www.businessdictionary.com/definition/value-for-money-audit.html#ixzz2WK0msBJY>

#### INTERNATIONAL DIMENSION

The Auditor – General of the Federation is also a member of the International Organization of Supreme Audit Institutions (INTOSAILS). This body is made up of all the Auditors – General of nations of the world and is responsible for auditing activities of international organizations like the United Nations, the World Bank Group, the International Monetary Fund (IMF), etc. consequently, the AGF may be a member of a team auditing a certain international organization and so, may be responsible for the outcome – the resultant audit report.

#### QUIZZES

1. INTOSAILS mean.....
2. The Auditor – General of the Federation (AGF) is appointed by .....subject to the confirmation of .....
3. Two benefits of compliance with statutory and other regulatory provisions in governmental accounting are.....
4. Two accounting concepts more prominent in the process of auditing ublic concerns are .....
5. It is important to have accountants in investigative panels to .....

## REVISION QUESTIONS

1. (a) What is ‘Value for Money Audit’?  
(b) Briefly explain how the Board of Survey promotes integrity in the management of public concerns.
2. Briefly explain the procedure for appointing the Auditor-General of the Federal Republic of Nigeria.
3. (a) What is INTOSAILS?  
(b) State the role of INTOSAILS in the process of auditing the following organizations for the year ended December 31, 2018:
  - (i) Cadbury Nigeria Plc.;
  - (ii) University of Jos;
  - (iii) American Embassy, Abuja;
  - (iv) International Monetary Fund (IMF); and
  - (v) Nigerian - American University, Abuja

## ASSIGNMENTS

1. Briefly distinguish between government accounting and commercial accounting.
2. Visit the Federal Cash Office in your location. Describe the process of verifying government assets in fiscal years.
3. Explain the appoint of the AGF
4. What are the functions of the AGF in Covid-19 era?
5. Find a copy of the Public Accounts Committee for Lagos state and the Federal Republic of Nigeria. Summarize each one.

## 4.0 CHAPTER FOUR

### UNDERSTAND THE MANAGEMENT OF AUDIT PRACTICE AND ASSURANCE SERVICES

At the end of the lecture, students are expected understand the Management of Audit Practice and Assurance Services. Specifically, they should be able to:

- 4.1 Explain types of office and facilities to be maintained.
- 4.2 State what partner relationship should be.
- 4.3 Explain staff management procedure
- 4.4 Explain the process of quality control.
- 4.5 Describe the training required by the audit staff.
- 4.6 Define the underlying concept of assurance engagement.
- 4.7 Explain quality control practices and procedure
- 4.8 Explain the rules and regulations concerning advertising and publicity, fees tendering engagement letters and consultation.
- 4.9 State performance and reporting standards.
- 4.10 Explain expectation gap as required of auditor
- 4.11 State auditors responsibilities for fraud searching, detection and prevention, omissions, misstatement and other regulations.
- 4.12 Explain negotiation skill required of an auditor for own office and on behalf of client.

## 4.0 The Management of Audit Practice and the Concept of Assurance Services

### Management of Audit Practice

Like any other business, audit practice must be managed efficiently and effectively to ensure commercial viability and the attainment of corporate goals. This is more relevant as inefficient audit firms fade out or face colossal liabilities.

#### 4.1 Types of offices and facilities to be maintained.

Typically, audit firms are classified into three:

(i) Small.

These include sole proprietors and partnership with two or three partners. This type accounts for the most popular mode of audit practice, due perhaps, to the ease with which such firms could be established and the flexibility of operation.

(ii) Medium.

These are firms bigger than the small firms but not in the class of the 'Big Four.' Firms in this category may have international affiliation.

(iii) Big

The big firms are often referred to as the 'Big Four'. They are the big international audit firms with global outreach. They are big fee income from practice spread across many countries of the world. These firms include KPMG, Deloitte, Pricewaterhouse Coopers and Ernest Yong.

Audit firms may also be classified according to the services rendered. In this regard, we have the traditional audit office and forensic audit office.

(i) Traditional audit offices are concerned with established audit services and assurance services, including taxation, management consultancy, insolvency etc.

(ii) Forensic audit office is involved the audit relating to litigation. The focus of this type is the establishment of legal liabilities arising from court cases or injunctions. This office may be a section of a medium large or audit practice.

Whatever the form of an audit practice, it remains an unincorporated entity. Ownership is therefore either sole proprietorship or partnership. Nonetheless, an audit firm must be well arranged. Responsibilities must be well defined while reporting procedures are clearly spelt out. Also facilities must be maintained to facilitate good professional practice.

### Facilities to be maintained

It is important to provide good physical office environment to enhance efficiency. Adequate space must be provided for the staff. Materials and equipment provided must also conform to the prevailing technological advancement. The followings are some of the facilities essential in an audit office:

(i) Well ventilated or air-conditioned office;

- (ii) Desktops for each staff and laptops for audit seniors and above;
- (iii) Local Area Network (LAN) to aid intranet connectivity;
- (iv) Wide Area Network (WAN) to facilitate internet connectivity;
- (v) Calculators where necessary;
- (vi) Printers;
- (vii) Well equipped library for storing relevant books, accounting standards, Acts of establishment and other legislation, manuals of accounting packages etc;
- (viii) Relevant printing stationery such as bank confirmation letters, circularization letters, audit programmes, letters of consent etc.

The location of the office is also important because a poorly located office and a badly designed office may impair the image of the firm.

#### 4.2 Partner relationship.

Partnership in audit practice should be regulated by a written statement usually called a 'Deed of Agreement.' This should detail the rights and privileges of each partner.

The relationship should be such that will foster growth and evolution of opportunities from manifest challenges. It must also help to improve service delivery to clients. Such relationship is also expected to mitigate risks - both business and litigation risks.

Engagements must be executed professionally and in compliance with appropriate legislations and standards.

#### 4.3 Staff Management Procedure

Staff management is a key area in professional practice. This involves creating managers out of staffers. A manager, by definition is someone who performs his duties through others. His traditional functions include planning, organizing, leading and controlling. A manager is a staff who has progressed beyond mere focus on control and authority to the establishment of credibility, commitment building and team leadership. Every office must aspire to instill skills in their employees to make them best in making use of available resources optimally.

The usual procedure in audit practice is to appoint a Staff Partner. Such partner will be responsible for:

- (i) Employing the appropriate staffers via human resource planning, recruitment and selection;
- (ii) Annual performance evaluation;
- (iii) General staff welfare;
- (iv) Training and development which should focus more on employability rather than job security;
- (v) Preparation of routine schedule of work on weekly basis; and
- (vi) General administration matters for smooth and efficient operational performance.

#### 4.4 The process of quality control

Quality control is the implementation of policies and procedures to ensure that audit work is of a consistently high quality. It is a process of 'hot review' of audit process to ensure high quality work and resulting output. It is a systematic rather than piecemeal approach which proceeds methodologically to resolve issues of quality and problems in turns. Also, it is a continuous process.

Quality control issues relate more to poor management of the audit process or the institution itself.

Quality assurance establishes that:

- (a) Needed controls are in place;
- (b) Controls are being properly implemented;
- (c) Potential ways of strengthening or otherwise improving controls are identified.

Institutions are encouraged to establish policies, procedures and systems that promote actions leading to high quality while discouraging or preventing actions which may impede quality.

Development and implementation of quality control should be with respect to all phases of the audit process such as:

- (i) Selecting matters for audit;
- (ii) Deciding the timing of the audit;
- (iii) Planning the audit;
- (iv) Executing the audit;
- (v) Reporting the audit results; and
- (vi) Following-up and evaluating the audit findings, conclusions and recommendations.

Nature of organizations with high quality work

Organizations with high quality work exhibit qualities such as:

- (i) Establishment of clear understanding based on education, training and experience of what is required to achieve set goals;
- (ii) Unrelented commitment to quality throughout the organization; and
- (iii) Development of quality control culture as a long-term process.

Issues relating to quality control are covered in a release by the International Audit and Assurance Standards Board (IAASB), a standing committee of IFAC, in February 2004. Termed "International Standard on Quality Control," the document provides for the quality requirement of audit engagements.

The Nigerian Standard on Quality Control (NSQC) 1 complies with the international standard. It was issued in 2006.

To ensure compliance, ICAN has established a monitoring mechanism through nits Professional practice Monitoring Committee (PPMC).

#### 4.5 Training required by the audit staff



The training required of audit staff is essentially to increase their capabilities, make the work more interesting and increase the self esteem of the employees. Training should assist staffers to acquire related skills, knowledge and behavior. They should also be developed to improve their ability to meet changes in job requirements and customers' expectations. Audit staff in contemporary society must be articulate, computer literate and exposed to a number of accounting packages.

#### 4.6 The Underlying Concepts of Assurance Engagement

The assurance practice is that aspect of professional practice dealing with the management of the various processes deployed to accomplish audit tasks and assignments. It is the management of 'Audit Practice' and distinct from management of 'Audit Office.' While firms employ non accountants to manage some aspects of their office, 'Audit Practice' needs to be managed by real professionals.

According to the International standard on Auditing (ISA) No 100 (on Assurance engagement), Assurance Engagement is "one in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria." It gives an independent opinion on the true and fair nature of the financial statement being reported upon.

Underlying Concepts of Assurance Practice.

- (i) The triage concept – three people are involved:
  - (a) The practitioner i.e the Professional Accountant;
  - (b) The intended user; and
  - (c) The responsible party (the person(s) who prepared the subject matter).
- (ii) A subject matter which may vary considerably but is likely to fall into one of the following three categories:
  - (a) Data (for instance, financial statement or business plans or projections);
  - (b) Systems or processes (which may be internal control systems or computer systems); and
  - (c) Behavior (including social and environmental performance or corporate governance).
- (iii) Suitable criteria – to assist the assurance provider to judge whether the information is reliable and credible or not. The accounting standards and legal provisions, for example, may be suitable criteria in assurance services relating to financial statements. Other assurances may need reliance on Code of Governance or Code of Practice.
- (iv) Sufficient Appropriate Evidence – required in supporting the assurance opinion. This requires the practitioner to substantiate the opinion drawn in order to elicit the confidence of the user in accepting the information as reliable. Consequently, the practitioner must obtain evidence to confirm that the criteria have been met.
- (v) A written report in appropriate form – provided to the intended users in a written form, containing certain specified information. The import of this is to add to the

assurance that the user is being given. It ‘ensures that key information is being given and that the assurance given is clear and unequivocal.’ (ICAEW, 2012)<sup>1</sup>

<sup>1</sup> The Institute of Chartered Accountants, ‘Concepts of and need for assurance,’ [financial.kaplan.co.uk/Documents/ICAEW/Concept\\_assurance.pdf](http://financial.kaplan.co.uk/Documents/ICAEW/Concept_assurance.pdf) retrieved on June 24, 2012

#### 4.7.1 Quality Control Practices in Auditing Firms

Pursuit of the highest standard of control should be a major objective of every professional accounting office. The philosophy of high quality control must flow through the entire firm rather than in respect of particular engagements. Such standard must accord with pronouncements from the International Federation of Accountants (IFAC) which makes such rules through the International Audit and Assurance Standards Board (IAASB). Pronouncements by the Institute of Chartered accountants of Nigeria (ICAN) on quality control must also be followed. This assignment is often performed by the Nigerian Auditing Standard Committee.

Practices in Nigeria, hence, must follow the Nigeria Standards on Quality Control (NSQCs) which often fully comply with the International Standards on Quality Control (ISQCs).

#### 4.7.2 Quality Control Procedure for Auditing Firms

With respect to an audit firm, this must comply with the standard as set out in paragraph 1.3 of the ISQC as follows:

- (i) Establishment of a system of quality control designed to provide reasonable assurance of compliance with professional standards and legal requirements;
- (ii) Ensuring that following from (i) above, reports issued by the firm or engagement partners are appropriate in the circumstances they were issued;
- (iii) An internal culture that considers quality as priority is inspired by leaders and maintained by the firm.

#### 4.7.3 Quality Control Practices in Auditing Assignments

Apart from quality control at the audit firm level, as detailed in ISQC and NSQCs, individual assurance engagements must also be subjected to good quality control. The implication of this is that individual audit assignment must be executed following standard quality control measures. These are usually patterned to follow pronouncements by IFAC which issues International Standards on Auditing (ISA). ISA number 220, for example, deals with ‘Quality Control for Audit Work.’ ICAN also issues Auditing Standards or Guidelines in conformity with the international standard in this case. Should there be disagreement between the two, ICAN’s standard prevails – since it takes the peculiar nature of the country into cognizance.

The responsibility for each audit task lies with the Engagement Partner who supervises the engagement team. Together, they should implement quality control measure suitable to the engagement being undertaken.

The following sections are covered by the Quality Control Standards:

- (i) Leadership Responsibilities – lying with the engagement partner;
- (ii) Ethical Requirements – dealing with compliance with ethical requirements by the audit team. Compliance with the Professional Conduct of Members of ICAN is essential in this regard;
- (iii) Acceptance/continuance of client relationship and specific audit engagements – quality control standard in respect of accepting and continuing with the audit engagement should be met. Receipt of information which would have precluded the firm from accepting the assignment in the first instance must be communicated to the firm on time for speedy resolution;
- (iv) Assignment of engagement team – based on qualification and experience as a unit fit for specific assignment;
- (v) Engagement performance – dealing with actions necessary for the execution of the engagement such as direction, supervision, review, consultation, differences in opinion and quality control; and
- (vi) Monitoring.

#### 4.7.4 Quality Control Procedures in Auditing Assignments

This may be an elaborate consideration of factors discussed in (v) and (vi) above.

- (i) The engagement partner informs members of the engagement team of their responsibilities, nature of the client's business, risk related issues, possible problems and how to tackle them;
- (ii) Appointment of an audit senior within the team to supervise the audit work;
- (iii) As the work progresses, it is subjected to constant review regarding conformity with engagement procedures, appropriateness and sufficiency of evidence obtained;
- (iv) Consultation with appropriate personnel in difficult cases as well as proper documentation of such cases;
- (v) Where differences of opinion arises, resolution should be according to the policy of the firm;
- (vi) Appointment of a reviewer by the engagement partner with whom significant matters could be discussed and finalized prior to the issuance of audit report;
- (vii) Reference to the work of the firm's quality control system monitoring team on the engagement to determine if their findings have any significant impact on the assignment being executed.

#### Qualities of good Review

Quality control review is the concluding part of the engagement performance stage of an assurance service. Essentially, the review should include:

- (i) An evaluation of the significant judgments made by the engagement team e.g materiality and significant risk; and
- (ii) An evaluation of the conclusions reached in forming the auditor's report. This may include re-examination of conclusions on difficult or controversial issues or matters generating differences in opinion.

4.8 Rules and regulations concerning advertising and publicity, fees, tendering engagement letters and consultation. See ICAN Pack pp 198-204.

These are contained in the ICAN Code.

4.9 Performance and Reporting Standards. See ICAN Pack pp 204- 205.

4.10 Expectation Gap as required of Auditor.

The 'expectation gap' is the difference between what users of financial statements, the general public perceive an audit to be and what the audit profession claims is expected of them in conducting an audit.' (Ojo, 2006). Ojo further opined that probable lack of clarity between users of financial information and the reporting auditors on the proper definition of the role and definition of an audit contribute significantly to the gap.

Ojo, M (2006), 'Eliminating the Audit Expectations Gap: Myth or Reality? Munich Personal rePEc Archive, February, [http://mpa.ub.uni-muenchen.de/232/MPRA.Paper.No. 232.posted](http://mpa.ub.uni-muenchen.de/232/MPRA.Paper.No.232.posted) November 2007/00:53 retrieved on June 24, 2012

The expectation gap is the gap between the auditors' actual standard of performance and the various public expectations of auditors' performance (as opposed to their required standard of performance). Many members of the public expect that:

- auditors should accept prime responsibility for the financial statements,
- auditors 'certify' financial statements,
- a 'clean' opinion guarantees the accuracy of financial statements,
- auditors perform a 100% check,
- auditors should give early warning about the possibility of business failure, and
- auditors are supposed to detect fraud (See *Wisconsin Law Journal* article entitled, "Why Didn't Our Auditors Find the Fraud?").

Such public expectations of auditors, which go beyond the actual standard of performance by auditors, have led to the term 'expectation gap'.

([http://wiki.answers.com/Q/What\\_is\\_an\\_audit\\_expectation\\_gap](http://wiki.answers.com/Q/What_is_an_audit_expectation_gap))

Simply put, expectation gap is the difference between the statutory role of an auditor and the role generally expected of him by the investing public.

According to ISA 200:

*'While the auditor is responsible for forming and expressing an opinion on these financial statements, the responsibility for preparing and presenting the financial statements in accordance with the applicable financial reporting framework is that of the management of the entity with oversight from those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.'*

The auditor does not have primary responsibility as regards prevention and detection of fraud though these may be incidental to his duties. That responsibility belongs to the management and the board of directors. This may explain why when the Cadbury Nigeria Plc assurance issue arose in 2006, the auditing firm was not the prime focus. Key managers were sacked while the board was dissolved. Nonetheless the auditors, Akintola Williams, had to resign of their own volition.

4.11 Auditors responsibilities for fraud searching, detection and prevention, omissions, misstatement and other regulations. See ICAN Pack pp 206- 209.

4.12 Negotiation skill required of an auditor for own office and on behalf of client.  
See ICAN Pack pp 209- 212.

### QUIZZES

1. Partnership in audit practice should be regulated by a written statement usually called a '.....of Agreement.'
2. The responsibility belongs to the management and the board of directors to detect ..... as such responsibility is merely ..... to auditing.
3. Quality control review is the concluding part of the engagement performance stage of an .....service.
4. Two 'Big Four' accounting firms are .....and .....
5. Every office of an accounting firm must aspire to instill ..... in their employees to make them best in making use of available resources optimally

### PRACTICE QUESTIONS

1. Distinguish between 'Audit Practice' and 'Assurance Services.'
2. Explain the role of an 'Engagement Partner' in an audit process. Show how thw role differs from that of the 'Staff Partner' and how the two role complement each other in the attainment of an excellent office and credible professional performance.
3. What do you understand by 'expectation gap' in audit? Indicate how you would narrow the gap in your professional practice.
4. (i) Explain the differences between ISA 3 and ISQC 1.  
(ii) Justify similarities between the two, if any.
5. Discuss how the dexterity in negotiation may assist in the practice of accountancy.

## ASSIGNMENTS

1. Explain 'audit gap' and show how it may be minimized in Nigeria.
2. Read through the following documents:
  - (i) ICAN Code of Conduct Part 2; and
  - (ii) ICAN Pack on Assurance pages 198-212

Write on:

- (a) Rules and regulations concerning advertising and publicity, fees, tendering engagement letters and consultation.
- (b) Auditors' responsibilities for fraud searching, detection and prevention, omissions, misstatement and other regulations.
- (c) Performance and Reporting Standards.
- (d) Negotiation skill required of an auditor for own office and on behalf of client.

## **5.0 CHAPTER FIVE**

### **UNDERSTAND THE CIRCUMSTANCES UNDER WHICH AN AUDITOR MAY BECOME PERSONALLY LIABLE**

At the end of the lecture, students are expected understand circumstances under which an auditor may become personally liable. Specifically, they should be able to:

- 5.1 Explain the principles of civil liability
- 5.2 Explain the various circumstances when an auditor may incur civil liability.
- 5.3 Explain criminal liability.
- 5.4 State the circumstances when an auditor may incur criminal liability.
- 5.5 Explain the auditor's liability to the third party.
- 5.6 Explain case laws.

## 5.0 THE CIRCUMSTANCES UNDER WHICH AN AUDITOR MAY BECOME PERSONALLY LIABLE

In the practice of Auditing, it is important to appreciate that the professional may become personally liable for injuries suffered by the client or the third party. Such knowledge will promote professional competence and due care as well as exercise of professional skepticism in the performance of professional assignments thus preventing or minimizing possible occurrence of personal liability. Two common forms of liability which an auditor may suffer are civil and criminal liabilities which were treated in ACC 213 and ACC 223 during our days in the ND. Whichever, form, it must be noted that some guiding principles apply.

### 5.1 THE PRINCIPLES OF CIVIL LIABILITY

Civil liability is the potential responsibility for payment of damages or other [court-enforcement](#) in a lawsuit. It means being responsible for actions and practices that are not criminal but could damage others.

Common law involves civil liabilities such as:

- (a) breach of contract and the tort of misfeasance against a client; and
- (b) liability to third parties

Misfeasance, being an aspect of civil liability, is the improper performance of some lawful act.

It follows from the above that principles of civil liability includes the following:

- (i) Privity as in contract where only parties to the contract could sue in case of a breach or negligent performance;
- (ii) Damages must be established and proved to have arisen from non-performance or negligent performance;
- (iii) A third party may sue for damages if it is proved that it is foreseeable that he would rely on the outcome of the professional performance; and
- (iv) Regulators often sue as third parties in case of non-compliance or negligent performance.

Section 368 of Companies and Allied Matters Act CAP C20 LFN (CAMA) 2004 sets the principle for civil liability of an auditor in line with the principles stated above.

### 5.2 THE VARIOUS CIRCUMSTANCES WHEN AN AUDITOR MAY INCUR CIVIL LIABILITY

Circumstances under which an auditor may incur liability include:

- (i) **Contract**  
Where negligent performance of a fiduciary duty gives rise to loss by the aggrieved party – the client or a shareholder who is allowed to sue the auditor after duly informing the directors of his intention to sue the auditor following the failure of the directors to sue. This is in accordance with the statutory provisions of CAMA 1990 CAP C20 LFN 2004 section 368.



(ii) Tort

Where third parties are allowed to sue the auditor where they suffer loss from breach of due care by the auditor.

Consequently, circumstances under which an auditor may incur civil liability relate to breach of contract in which only a party to the contract may sue or misfeasance under tort which empowers injured third parties to sue the auditor when he breaks the care principle.

An extract of section 368 is provided below:

### 368. Liability of auditors for negligence

- (1) A company's auditor shall in the performance of his duties, exercise all such care, diligence and skill as is reasonably necessary in each particular circumstance.
- (2) Where a company suffers loss or damage as a result of the failure of its auditor to discharge the fiduciary duty imposed on him by subsection (1) of this section, the auditor shall be liable for negligence and the directors may institute an action for negligence against him in the court.
- (3) If the directors fail to institute an action against the auditor under subsection (2) of this section, any member may do so after the expiration of 30 days' notice to the company of his intention to institute such action.

## 5.3 CRIMINAL LIABILITY

Criminal liability arises mainly from relation between the auditor and the state whereas civil results from the relationship between the auditor and the specific organization. Consequently, criminal liability arises from national or local legislation. In Nigeria for example, criminal liability arises from provisions of the:

- (i) Companies and Allied Matters Act (CAMA) 1990 CAP C20 LFN 2004 section 643;
- (ii) Penal Code; and
- (iii) Economic and Financial Crime Commission.

Underlying principles for criminal liability therefore include:

- (a) Willful intention to commit the crime;
- (b) Knowingly or recklessly causing a professional report to be issued;
- (c) Including misleading, false or deceptive materials in professional statements; and
- (d) Prosecution by the state rather than the business entity with the auditor had the contract.

Section 643 of CAMA 1990 is recaptured below:

643. (1) Where a penalty is not elsewhere prescribed in this Act and subject to the provisions of subsection (2) of this section, if any person in any return, report, certificate, balance sheet, or other document 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, he shall be guilty of an offence and liable-

- (a) On conviction in the High Court to imprisonment for a term of two years: or
- (b) On conviction in a lower court, to a fine of 1,000 or to imprisonment for a term of four months, or to both such fine and imprisonment.
- (2) Nothing in this section shall affect the provisions of any enactment imposing penalties in respect of perjury in force in Nigeria.

#### 5.4 the circumstances when an auditor may incur criminal liability.

From the principles and statutory provisions laid above, it is clear that an auditor may incur criminal liability in the following circumstances:

- (i) when he willfully commits a crime while performing his professional duties;
- (ii) when he knowingly or recklessly approves issuance of a professional report that is misleading or fraudulent.

The fact remains that the auditor will incur criminal liability where he acts with a guilty conscience. A good example is that of Scott London in 2013 who knew that it was ethically forbidden for a professional to share sensitive information about clients with third parties, yet went ahead to share sensitive information with a friend who subsequently used the information to derive financial gains.

### 5.5 THE AUDITOR'S LIABILITY TO THE THIRD PARTY

The auditor also has liability to third parties under common law.

Third parties cannot sue for breach of contract because of lack of privity but can sue in a tort action for ordinary negligence, gross negligence, or fraud.

The burden of proof in such case is upon the third party – plaintiff to prove the element of duty of care, breach of that duty, damages suffered, and a causal connection between the auditor's actions and the plaintiff's losses.

Furthermore, the auditor may be liable to a third party if he ought to foresee that the third party would rely on his report to make informed decision. This derives from the principle of foreseeability established in the case of Caparo.

### 5.6 EXPLAIN CASE LAWS

Case laws are established from rulings of Courts of competent jurisdiction. In common law, cases are the most prominent sources of law or even legal reformation. For example, in the law of contract, a third party may be precluded from seeking redress. This has however, changed based on some decided cases which established new principles and novel standards. An example of this is the principle of foreseeability.

Case laws have also changed the defense mechanism for auditors. Now, auditors may be guilty of misfeasance but be extricated if it is proved that the client was contributory to the negligence or fraud. In the case of Moore Stephen, for example, the auditor was extricated because it was proved that the beneficiary of the fraud was the company itself!

The Landmark Decision in *Donoghue v. Stevenson*: the Principle of Negligence and the Duty of Care

The celebrated case of ***Donoghue v. Stevenson*** [1932] All ER Rep 1; [1932] AC 562; House of Lords provides a logical and legal premise upon which third parties can rely. In this English case, the court awarded damages against the manufacturer of a ginger beer bottle (not against the vendor) which content contained a decomposed snail taken by a lady. Although there was no privity of contract between the manufacturer and the lady, the court held that the defendant did owe the plaintiff or any other unknown person who happens to consume the ginger beer a duty of care and had breached that duty.

In relation to auditor's liability to third parties, it used to be the case that in the absence of a contract, unless fraud is alleged, an auditor was not liable to damages in favor of third parties; the presence of negligence or otherwise being immaterial. See ***Chandler v. Crane Christmas & Co.*** [1951] 2 KB 164; [1951] 1 All ER 426, where the Court of Appeal held that auditors who had negligently prepared a set of draft accounts on which investors had relied without any contractual relationship were not liable.

The tide changed, flowing from the sound reasoning in ***Donoghue v. Stevenson***, and probably the important dissenting judgment of Denning LJ who had argued for a duty of care for negligent statements in the ***Chandler case***, the House of Lords in the latter case of ***Hedley Byrne & Co Ltd. v. Heller & Partners*** [1963] 2 All ER 575 held in favor of auditor's liability to third parties.

### **The Circumstances of Each Case is Important in Determining Liability**

Having stated the above qualifications, it must be pointed out here that the determination of an auditor's liability cannot be done with mathematical exactitude. Perhaps, Lord Hodson was making the same point in the case of ***Hedley Byrne & Co Ltd v. Heller & Partners Ltd*** [1964] AC 465 when he said at p. 514:

*"I do not think it is possible to catalogue the special features which must be found to exist before the duty of care will arise in a given case."*

Similarly, Lord Devlin said, at pp. 529-530:

*"I do not think it possible to formulate with exactitude all the conditions under which the law will in a specific case imply a voluntary undertaking any more than it is possible to formulate those in which the law will imply a contract."*

These positions their Lordships seem agreeable.

### **Recent Limitations to the Scope of Auditor's Liability to Third Parties**

Interestingly however, in the recent case of **Caparo Industries Plc v. Dickman & Others** [1990] 2 AC 605, the courts have tended to move towards a more exact conclusion.

The decisions in both the lower courts and the House of Lords in this case were that auditors are not liable to shareholders who based investment decisions on accounts prepared for stewardship purposes. The case in effect limited the scope of auditors' liability to third parties.

Therefore, the provision of information by auditors of a company was not intended to help shareholders, or any third party for that matter, make decisions as to future investment in the company, but as contemplated by statutes were meant to enable shareholders exercise their class rights in general meetings.

Lord Bridge, in analysing the particular facts of the case based upon principle of proximity, said, inter alia, that there could not be a duty owed in respect of "liability in an indeterminate amount for an indeterminate time to an indeterminate class" (**Ultramares Corp v Touche**, [1931] 174 N.E. 441 at 441 per Cardozo C.J. New York Court of Appeals).

Applying those principles, the defendants owed no duty of care to potential investors in the company who might acquire shares in the company on the basis of the audited accounts. Where any loss is suffered by a company or member of the particular company as a result of the proven negligence of the auditor, the right of action given to such company or member is reasonably sufficient. To avoid the clumsy situation where auditors would become easy scapegoats in the hands of strangers, this current position of the law may have found it more convenient to see third parties as being on a frolic of their own.

### **How Can an Auditor Defend Himself Against Liabilities Upon Litigation?**

To be sure, if every auditor had been complying strictly to standards and regulations, ensuring quality control, avoiding too much reliance on client's and third parties' representation, obtaining legal advice to help make letters of engagements clearer or draft disclaimer statements and taking indemnity insurance, there would have been little need for the question above. But of course, "to err is human", they say, and to raise defences, legal (if I may add).

The law is sometimes like the "Nigerian God" we often come across in the obituaries: it gives and takes. The following are possible defences that an auditor may rely on upon a potential or real suit:

- (1). Absence of duty of care where there is no fiduciary relationship.
- (2). That auditing standards and best practices of the profession have been complied with and applied in the preparation of audit. E.g. GAAS (Generally Accepted Auditing Standards).
- (3). Show as much as you can that the alleged negligence had nothing to do with the ascertainable loss suffered. Once you are able to show a lack of causal connection, there can be no liability on this basis.
- (4). The auditor can point accusing fingers at the client, citing contributory negligence. Once you can show that such negligence by the company affected your own professional judgment, your negligence becomes extinguished.

## QUIZZES

1. In practice, an auditor may be sued by the client or .....
2. The major principle upon which liability of civil nature hangs is .....
3. Civil liabilities are distinct from criminal liabilities in that .....
4. In cases laws, developments are brought to issues on liability as shown in the case of ..... which abandoned the rule in .....
5. One advantage of studying the liability of auditors is to .....

## REVISION QUESTIONS

1. Compare and contrast the principles of civil and criminal liabilities.
2. The Auditor is expected to apply the highest degree of care and skill in the conduct of his assignment if liability, especially to a third party is to be avoided.
  - (a) Examine this statement with reference to decided cases.
  - (b) State two measure which an external auditor may adopt to minimize third party liabilities.
3. (a) Briefly explain the principle of foreseeability in external auditing.
  - (b) You have just been called by one of your clients, Gudugba Plc to conduct a special audit on Jefinic Plc., a company being targeted for acquisition. The company, Jefinic Plc., has been incurring losses for past five years. Because it operates in a different environment, your client is of the opinion that acquisition will enable its entrance into that market easier, thus expanding its operational base and improving its ROI by at least 20% in the medium term.  
You are required to:
    - (i) Explain two ways through which the decision in Caparo V Dickman may apply to your task.
    - (ii) Indicate how you may curtail possible liability arising from the assignment.

## ASSIGNMENTS

1. Summarize the following cases:
  - (i) Ultramares Corp;
  - (ii) Moore Stephen
  - (iii) Caparo
  - (iv) Re: London Cotton Mill
  - (v) Scott London
  - (vi) PwC v Tycon
2. Draw out three significant lessons on liability to the statutory auditor.

## 6.0 CHAPTER SIX

### UNDERSTANDING THE ROLES OF ETHICS IN THE PROVISION OF AUDITOR SERVICES

At the end of the lecture, students are expected to Understanding the roles of Ethics in the provision of Auditor Services. Specifically, they should be able to:

- 6.1 Explain ethical standards
- 6.2 Explain ethical code of conduct as it affect:
  - Professional responsibility and independence;
  - Confidentiality;
  - Objectivity; and
  - Conflict of interest.
- 6.3 Explain the relationship between members concerning joint engagement and other assurance services.

## 6.1 Definition

Ethics are [Principles](#) that when followed, [promote values](#) such as [trust](#), good [behavior](#), fairness, and/or kindness.

There is not one [consistent](#) set of standards that all professions must follow, but each profession has the [right](#) to [develop](#) the standards that are meaningful for their members.

Ethical standards are not always easily enforceable, as they are frequently vaguely defined and somewhat [open](#) to interpretation ("The auditor must be independent, " or "Treat every assignment with diligence and skill"). Others can be more specific, such as "Do not [share](#) the client's private [information](#) with anyone outside of the company.

**Ethics**, also known as **moral philosophy**, is a branch of [philosophy](#) that involves systematizing, defending, and recommending concepts of right and wrong behavior.

<http://www.businessdictionary.com/definition/ethical-standards.html>

The Microsoft Encarta dictionary defines ethics as code of morality - a system of moral principles governing the appropriate conduct for a person or group.

Read more: <http://www.businessdictionary.com/definition/ethical-standards.html#ixzz1zIIWLGv>

A more professional attempt on ethics is presented below:

### Professional Ethics in Auditing

Professional ethics refers to the professionally accepted standards of personal and business behavior, values and guiding principles.

It encompasses the personal, organizational and corporate standards of behavior expected of professionals.

Professionals and those working in acknowledged professions, exercise specialist knowledge, and skill.

How the use of this knowledge should be governed when providing a service to the public can be considered a moral issue and is termed professional ethics.

Professionals are capable of making judgments, applying their skills and reaching informed decisions in situations that the general public cannot because they have not received the relevant training.



Codes of professional ethics are often established by professional organizations to help guide members in performing their job functions according to sound and consistent ethical principles.

## **Objectives of Professional Ethics**

Professional accountants play an important role in building up the economic wellbeing of their community and country with their attitude, behavior, and unique services.

They have common objectives whether they work in capacities of external auditors, internal auditors, financial experts, tax experts, and management accountants.

Their common objectives are to perform their duties and responsibilities and to attain the highest levels of performance by the ethical requirements generally to meet the public interest and maintain the reputation of the accounting profession.

Personal self-interest must not prevail over these duties. The IFAC and ICAN Codes of Ethics help accountants to meet these obligations by setting out ethical guidance to be followed.

To achieve these objectives, they have to establish credibility, professionalism, quality of service and confidence. Acting in the public interest involves having regard to the legitimate interests of:

- (i) Clients;
- (ii) Government;
- (iii) financial institutions;
- (iv) employees, investors;
- (v) the business and financial community; and
- (vi) others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce.

In summary, then, the key reason accountants need to have an ethical code is that people rely on them and their expertise. It is important to note that this reliance extends beyond clients to the profession, other members of the profession and the society at large.

Accountants deal with a range of issues on behalf of clients. They often have access to confidential and sensitive information. Knowledge of such information must not be abused or disclosed to unauthorized people.

Also, auditors claim to give an independent view, hence, it is important that they are independent.

Compliance with a shared set of ethical guidelines gives protection to accountants as well, as they cannot be accused of behaving differently from other accountants. It may also extricate them from disciplinary measures by the Institute.

Adapted from:

<https://www.iedunote.com/professional-ethics-in-auditing>

Retrieved on July 16, 2020

### **6.2.1 ETHICAL CODE OF CONDUCT AS IT AFFECTS PROFESSIONAL RESPONSIBILITY AND INDEPENDENCE**

As taught in ACC 213 and recaptured above, an auditor is professionally responsible to his client, his colleagues, the profession and the society at large. Ethical codes are specified in standards mandated by the various accountancy bodies in compliance with the principles established by the International federation of Accountants (IFAC). In Nigeria, ethical code of conduct is contained in the Institute's 'Professional Code of Conduct and Guide for Members'. The code is principle based as it anchors on the five principles established by IFAC. The basic principles are:

- (i) Integrity;
- (ii) Objectivity;
- (iii) Professional Competence and Due Care;
- (iv) Confidentiality; and
- (v) Professional Behavior'

The main thrust of ethical standards and considerations is the upholding of professionalism and good practice. Auditors in Nigeria are saddled with the responsibility of examining the financial statements of organizations for the purpose of ascertaining their truth and fairness. In the process it is the responsibility of a Chartered Accountant to conduct himself in a manner considered appropriate by the Institute to the profession in general and to other members of the Institute in particular. The auditing profession in Nigeria is regulated by a combination of legal, regulatory and professional documents as detailed below:

- (i) The Companies and Allied Matters Act (CAMA) 1990 serves as the supreme regulator. The Act was substantially revised in 2018;
- (ii) The Nigerian Standards on Auditing (NSAs);
- (iii) The Statement of Accounting Standards (SAS) as well as the International Financial Reporting Standards (IFRS);
- (iv) The Investment and Securities Act (ISA) 2007 in case of listed companies;
- (v) Banks and Other Financial Institutions' Act (BOFIA) in case of a banking entity, or the Nigerian Insurance Act (NIA) for insurance businesses, or the Pensions' Reform Act in relation to pensions administration; and
- (vi) Rules of Professional Conduct released by ICAN and ANAN for their members in compliance with the pronouncements of the International federation of Accountants (IFAC) on same.

The ICAN rules for example, provide in part two for accountants in public practice – statutory auditors. For effectiveness, however, an accountant in public practice must be conversant with provisions in parts 1, 2 and 4 dealing with the principles, the framework for

applying the principles and penalties for non-compliance. Ethical codes on professional performance and independence therefore require that an auditor should:

- (i) Comply with the fundamental principles;
- (ii) Identify threats to compliance with the principles which may include:
  - Self-interest threats;
  - Self-review threats;
  - Advocacy threats;
  - The family threats; or
  - Intimidation threats.
- (iii) consider quantitative and qualitative factors in the evaluation of threats to his professional responsibility (integrity, competence and due care as well as professional behavior) and independence;
- (iv) adopt as appropriate safeguards as illustrated in chapters of part 3 giving more elaborate explanations on how the fundamental principles could be applied .

Specifically, responsibilities of the auditor are indicated below in relation to the profession colleagues, and the society.

### Auditor's responsibility to the profession

In the performance of his professional duties, an auditor has a number of responsibilities to the profession. These include:

- (i) Technical competence;
- (ii) Compliance with extant rules and regulations;
- (iii) Diligence in the performance of his duties;
- (iv) Participation in continuous professional training programmes;
- (v) Practicing 'No direct advertisement['
- (vi) Compliance with quality review of members or a professional body;
- (vii) Responding to an inquiry or investigation by a member body or regulatory body; and
- (viii) Compliance with ethical code of conduct.

Rule 3.1.1 of ICAN Code provides that 'A Chartered Accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the

good reputation of the profession and as a result would be incompatible with the rendering of professional services.'

Non-compliance may be counted as misconduct, defined in the Code as 'any act or default likely to bring discredit to a member, the Institute or the accountancy profession.'

### Auditor's responsibility to colleagues

An auditor's responsibilities to his colleagues include, but not limited to:

- (i) Maintenance of high ethical standard;
- (ii) When working for a client introduced by a sitting colleague, not accepting any offer other than the assignment from his colleague from the client;
- (iii) Compliance with rules relating to changes in professional appointment.

Non-compliance with the above may lead the auditor to being charged for professional misconduct defined in the Code as 'any act or default likely to bring discredit to a member, the Institute or the accountancy profession.'

### Auditor's responsibility to the society

The main responsibility of an auditor to the society is the expression of an opinion on whether financial statements and associated notes as prepared by the directors or those charged with governance have been prepared in accordance with an appropriate financial reporting framework. This opinion is more relevant in contemporary financial reporting environment which seeks to address information deemed more relevant to users. To achieve the above, the auditor has to be mindful of the following responsibilities towards the society:

- (i) Maintenance of high ethical standard;
- (ii) Maintenance of confidentiality of information obtained during the audit process subject only to some recognized exceptions;
- (iii) Not impeding the arrest of a client who commits an offence requiring arrest;
- (iv) Disclosing information in public interest to the police especially, where litigations arise.

It should be noted that audit opinion affects clients and many other members of the society in many ways, especially in relation to making economic decisions. Also, judgment of the auditor in the performance of his duties may further affect the society, resulting into investigations which may be costly.

According to rule 1.1.2 of the ICAN code of conduct,

'A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a Chartered Accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest Chartered Accountants should observe and comply with the ethical requirements of this Code.'

It follows, hence that a responsibility of an auditor is to act in public interest as a protective shield of the society against the nuances of corporate managers. Compliance with the Code ensures this.

### 6.2.1.2 Ethical code of conduct as it affects Independence

The main thrust of ethical standards in auditing is to ensure and uphold the auditor's independence. Independence implies an absence of relationship. It means unrelated, disconnected, isolated, remote and insular. It also implies freedom from control, influence, support and aid of others. It connotes that the auditor is free from the exercise of powers thus making him free, unhindered, emancipated and disassociated from dominance or influence of third parties..

The implication of the ethical codes on the auditor is to encourage the auditor to express opinions without the overbearing influence of the entity being audited and its directors. The Code recognizes two forms of independence:

- (i) Independence of mind; and
- (ii) Independence in appearance.

#### Independence of mind

this, according to rule 13.2.1 is 'The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.'

#### Independence in appearance

This, according to rule 13.2.2 relates to 'The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.'

Codes relating to independence are also principle-based, hence, the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior must be applied. The application of the concept depends on the nature of the engagement, whether it is a financial statement audit (assurance service) or an assertion – based assurance engagement as explained in chapters 12 and 13 of the Code.

Rule 13.2.3 of chapter 13 recognizes the potential danger in misinterpreting ‘independence’ out of context. It therefore clarifies that ‘The use of the word “independence” on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.’

Consequently, applying the conceptual framework requires firms and members of assurance teams to:

- (i) Identify threats to independence;
- (ii) evaluate threats to independence; and
- (iii) apply appropriate safeguards in addressing threats to independence.

Auditors are not expected to only fulfill the provisions of a set of specific rules, which may be arbitrary, but to fully apply the conceptual framework which is more related to public interest.

Rule 13.3.1 provides that ‘Members of assurance teams, firms and network firms are required to apply the conceptual framework contained in part 1 (Fundamental Principles) to the particular circumstances under consideration. In addition to identifying relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether or not relationships between individuals outside of the assurance team and the assurance client create threats to independence.’

Notable ethical codes on independence are listed below. It must be noted however, that these are no binding rules as auditors are expected to apply the Fundamental Principles in identifying, evaluating and resolving ethical challenges. Some of these are;

- (i) Undue dependence on a client. To address this Institute of Chartered Accountants of Nigeria has established that fees from connected clients should not exceed 25% (ICAN 1998).
- (ii) Limitation of family or personal relationship. This calls for the avoidance of professional relationship where there is personal relationship.
- (iii) Avoidance of beneficial interest in clients’ business. This may include acquisition of shares or other investments. Partners, their spouses, and minor children are precluded from holding shares in client companies. Where an audit staff has a beneficial interest, he should not be engaged in the audit of such company. Where the articles of a company requires that the auditor must have some share qualification, then the minimum requirement should be held.
- (iv) Avoidance of loan relationship. The practice or those closely related to the firm should not obtain or advance loans to clients. Furthermore, an audit firm should not

- guarantee a client for the purpose of a loan and vice versa. Overdue fees constitute loans and hence, must be discouraged.
- (v) Provision of other service. Though allowable, in some circumstances, this must be taken with care.

### 6.2.2 Ethical code of conduct as it affects confidentiality

Ethically, the auditor must exhibit good conduct towards management of confidential information. This is well addressed in the Code of Conduct of ICAN. Confidentiality is one of the fundamental ethical principles. Rule 1.2.0(d) of chapter 1 on Fundamental Principles provides that 'A Chartered Accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the Chartered Accountant or third parties.'

It is required that information which is confidential to a client or employer acquired in the course of auditing should not be disclosed by a member unless the consent of the client is obtained, or legal right or duty to disclose arises. Even where legal right to disclose arises, the client must be informed before disclosure. Regarding acceptance of audit engagements, the prospective auditor must observe the principle of confidentiality on information provided by the current auditor except as otherwise guided by the ICAN Code. Paragraph 4.4.2 of the ICAN Code provides as follows:

'The prospective Auditor should ordinarily treat in confidence any information provided by the existing Auditor. However, it may be essential to the fulfillment of a prospective Auditor's obligations that he should disclose such information. It may, for example, be unavoidable for the prospective Auditor to disclose to officers or employees of the client matters brought to his attention by the predecessor firm, which needs to be properly investigated. Such disclosure should be no wider than is necessary.'



Confidential information must not be used for improper purposes – e.g to acquire shares in the company or use it to personal or related third party advantage.

### 6.3 Ethical code of conduct as it affects objectivity and conflict of interest.

Ethical code of conduct as it affects objectivity and conflict of interest must also be evolved using the Fundamental Principles and the associated safeguards. According to statement 1.2.0(b) ‘Objectivity is the state of mind, which has regard to all considerations relevant to the task in hand but no other consideration. A Chartered Accountant should not allow bias, conflict of interest or undue influence to override his professional or business judgments.’

Statement 1.2.2 further provides some guidelines on objectivity as follows:

- (a) The principle of objectivity imposes an obligation on Chartered Accountants to be fair, intellectually honest and free of conflicts of interest. Regardless of service or capacity, Chartered Accountants should protect the integrity of their professional services, and maintain objectivity in their judgment.
- (b) In selecting the situations and practices to be specifically dealt with in ethics requirements relating to objectivity, adequate consideration should be given to the following factors:-
  - (i) Chartered Accountants are exposed to situations, which involve the possibility of **pressures** being exerted on them. These pressures may impair their objectivity.
  - (ii) Relationships should be avoided which allow prejudice, bias or influences of others to **override** objectivity
  - (iii) Chartered Accountants have an obligation to ensure that personnel engaged on professional services **adhere** to the principle of objectivity.
  - (iv) Chartered Accountants should neither accept nor offer **gifts or entertainment**, which might reasonably be believed to have a significant and improper influence on their professional judgment or those with whom they deal. What constitutes an excessive gift or offer of entertainment varies from situation to situation but Chartered Accountants should avoid circumstances, which would bring their professional standing into disrepute.

To avoid conflict of interest and promote objectivity, Statement No. 8 of ICAN Code precludes appointment of members where:

- (i) A member firm had acted as auditor to the insolvent company;
- (ii) A partner or employee of a member firm had been a director of the insolvent company;

- (iii) A partner had been Receiver of any asset or undertaking of the company (in the case of liquidator). But the liquidation is a members' voluntary winding-up, the restrictions are vacated.

Also, code No. 4 on Changes in Professional Appointment requires that the incoming auditor should seek information from the outgoing auditor regarding his nomination and appointment – even where the previous auditor was a sole practitioner and deceased. If consent is refused, the client should be informed and the appointment should not be taken.

### **6.3 Ethical code of conduct as it affects conflict of interest.**

Last semester in ACC 412 lesson 13, it was noted that generally great difficulty exists in defining conflicts but that it could be defined as a serious disagreement between two or more beliefs, ideas or interests. It makes, co-existence seems impossible. It was also stated that since it deals with moral value, dichotomy may exist between personal and professional ethics. Therefore, whenever conflicts arise resolution must be achieved. This is because conflict may impair objectivity, a key principle in professional ethics to which all Chartered Accountants subscribe. In professional engagements, conflict of interest is the most discussed as it may combine with other undesirable factors such as bias, undue interference to override professional judgment.

Ethically, conflict of interest may be a threat to adherence to some fundamental principles of ethics such as objectivity, confidentiality and competence/due care. Therefore, it must be reduced to levels of insignificance if not totally eliminated. Manifestation of conflict of interest is common in either the threat of self-interest or self-review and has adequate guidance for mitigation. Such guidance may be legislative, regulatory or professional. Guidance may also derive from the engaging party. Statement (chapter) five of the ICAN Code deals well with the issue of conflict of interest and is reproduced below:

#### **5.0.0 CONFLICT OF INTEREST**

5.1.1 A Chartered Accountant in public practice should take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may give rise to threats to compliance with the fundamental principles. For example, a threat to objectivity may be created when a Chartered Accountant in public practice competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client. A threat to objectivity or confidentiality may also be created when a Chartered Accountant in public practice performs services for clients whose interests are in conflict or the clients are in dispute with each other in relation to the matter or transaction in question.

5.1.2 A Chartered Accountant in public practice should evaluate the significance of any threats. Evaluation includes considering, before accepting or continuing a client relationship or specific engagement, whether the Chartered Accountant in public practice has any business interests, or relationships with the client or a third party that could give rise to threats. If threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

5.1.3 The following additional safeguards should also be considered:

- (a) The use of separate engagement teams.
- (b) Procedures to prevent access to information (e.g. strict physical separation of such teams, confidential and secure data filing).
- (c) Clear guidelines for members of the engagement team on issues of security and confidentiality.
- (d) The use of confidentiality agreements signed by employees and partners of the firm.
- (e) Regular review of the application of safeguards by a senior individual not involved with relevant client engagements.

5.1.4 Where a conflict of interest poses a threat to one or more of the fundamental principles, including objectivity, confidentiality or professional behaviour that cannot be eliminated or reduced to an acceptable level through the application of safeguards, the Chartered Accountant in public practice should conclude that it is not appropriate to accept a specific engagement or that resignation from one or more conflicting engagements is required.

5.1.5 Where a Chartered Accountant in public practice has requested consent from a client to act for another party (which may or may not be an existing client) in respect of a matter where the respective interests are in conflict and that consent has been with-held by the client, then they must not continue to act for one of the parties in the matter giving rise to the conflict of interest.

Another Code worthy of note is Statement 8 on marketing which explains how the exercise may create self-interest and provides guidelines for safeguard. It is also reproduced below for emphasis and completeness.

#### 8.0.0 MARKETING PROFESSIONAL SERVICES.

8.1.0 When a Chartered Accountant in public practice solicits new work through advertising or other forms of marketing, there may be potential threats to compliance with the fundamental principles. For example, a self-interest threat to compliance with the principle of professional behaviour is created if services, achievements or products are marketed in a way that is inconsistent with the principle.

8.1.1 A Chartered Accountant in public practice should not bring the profession into disrepute when marketing professional services. The Chartered Accountant in public practice should be honest and truthful and should not:

- (a) make exaggerated claims for services offered, qualifications possessed or experience gained; or
- (b) make disparaging references to unsubstantiated comparisons to the work of another Chartered Accountant.

If the Chartered Accountant in public practice is in doubt whether a proposed form of advertising or marketing is appropriate, the Chartered Accountant in public practice should consult through the Registrar/Chief Executive of the Institute of Chartered Accountants of Nigeria.'

It should also be noted that unresolved conflict of interest calls for non-acceptance of an engagement or its determination. Statements three and sixteen also deal more explicitly on the subject matter.

## 6.5 Ethical code of conduct as it affects relationship between members concerning joint engagement and other assurance services.

A joint engagement is an audit or assurance assignment carried out by more than one audit firms simultaneously for the same financial statements. This could arise from the desire of directors of a company to have multiple or complementary assurance services regarding their financial statements. It may also be desirable where operations are complex and large with an audit firm being unlikely to effectively perform within the stipulated time. In some cases, joint engagement may be compelled by regulation.

In the circumstance, the following ethical codes are relevant:

- i. Communication with others;
- ii. Joint liability as only a single set of financial statements are signed by the joint auditors;
- iii. Being sure that clients do not change auditors due to conflict of viewpoints.

In relation to communication with others, for example, Statement 4 of the ICAN Code dealing with professional appointments provide in paragraph 4.4 as follows:

**'Joint Auditor**

A member whose firm is nominated as a Joint Auditor should communicate with all existing Auditors and be guided by similar principles to those set out in relation to nomination as an auditor. Where it is proposed that a joint audit appointment becomes a sole appointment, the surviving auditor should communicate formally with the outgoing joint auditor.'

It is important that some provisions in NSA 25 – Special Considerations: Audit of Group Financial Statements and NSA 3 on Quality Control also contain guidance on joint audit. Most of the guidelines on joint audits apply to non-assurance services as well.

The main points to note in this lesson are as follows:

- (i) Ethical considerations by professional accountancy bodies are now principle- based rather than rule-based. Conceptual framework is provided for the application of the principles.
- (ii) Five fundamental principles now drive ethical codes of conduct for members - integrity, objectivity, competence and due care, confidentiality and professional behavior.
- (iii) Threats to the fundamental principles being complied with have also been identified in five categories listed as self-interest, self-review, advocacy, familiarity and intimidation.

- (iv) Consequently, an array of well explained safeguards has been provided by the professional bodies to complement directives from statutes and other external regulatory frameworks.
- (v) Most client organizations also establish guidelines as safeguards to enhance compliance with the principles.
- (vi) A professional accountant is expected to adapt the examples provided as situations demand, evolving pragmatic safeguards where necessary instead of considering the examples given in the Code as all-inclusive.

## QUIZZES

1. Ethics is a code of.....values.
2. Professional ethics (PE) refers to the professionally accepted .....of personal and business behavior, values and guiding .....
3. PE encompasses the personal.....and corporate standards of behavior expected of professionals.
4. Ethically, conflicts of interest must be eliminated or reduced to a level of.....
5. The disclaimer in the Nigerian Standards on Auditing (NSA) 25 on joint audit is that .....

## REVISION QUESTIONS

1. (a) What is professional ethics?  
(b) Explain the framework for ethical conduct in the performance of auditing and assurance services in Nigeria.
2. (a) What is the essence of ethics in auditing?  
(b) You are the Chairman of Mercian Bank Plc. The Managing Director appointed on July 1, 2018 has just been found to be the grand child of the principal partner of the firm auditing your company.  
(i) State two likely impacts of such relationship on the audit engagement.  
(ii) Explain two possible safeguards to address the situation.
3. With reference to the Nigerian Standards on Auditing (NSA) 25 discuss the rationale for the exemption clause on joint audits.
4. (a) Explain the concept of objectivity,  
(b) Describe three responsibilities ethically imposed on an external auditor through the concept of objectivity,  
(c) Identify three safeguards that could possibly ameliorate ethical issues relating to objectivity.
5. (a) Explain the relevance of congeniality in assurance services.  
(b) Indicate three circumstances where the adherence to the concept may be impracticable in an assurance engagement.

## ASSIGNMENTS

1. In a tabular format, present an analytical description of the categories of frameworks from which professional ethics are developed in Nigeria
2. According to statement 3.1.1 , ‘A Chartered Accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the rendering of professional services.’ Arising from this statement, you are required to:
  - (a) explain how the public practice of a Chartered Accountant could impair:
    - (i) Integrity;
    - (ii) Objectivity; or
    - (iii) The good reputation of Accountancy Profession.
  - (b) Identify three safeguards available to such practitioner within:
    - (i) The client organization;
    - (ii) The Technical Guidance;
    - (iii) The companies and Allied Matters Act (CAMA) 2018; and
    - (iv) The ICAN Code of Conduct for Members.
3. Download the ICAN Code of Conduct for Members.
  - (a) Summarize statements 3, 8 and 17.
  - (b) Distinguish between assurance and non-assurance services.
  - (c) Cite five examples of who ethical standards may differ between assurance and non-assurance services.
4. Visit an accounting firm. Find out how the partners maintain ethical balance between:
  - (i) The firm;
  - (ii) The engagement team; and
  - (iii) The client.
5. With reference to the ICAN Code, discuss the relevance of independence in the practice of professional accountancy beyond the era of covid-19 pandemic.

## **7.0 CHAPTER SEVEN**

### **UNDERSTAND THE PROCESS REQUIRED FOR AUDITING SPECIAL TYPES OF ORGANIZATIONS**

At the end of the lecture, students are expected to understand the process required for auditing special types of organizations. Specifically, they should be able to:

- 7.1 Identify the auditing problems peculiar to small businesses.
- 7.2 Describe solutions to mitigating auditing problems peculiar to small businesses.
- 7.3 Explain the types of accounts maintained by solicitors.
- 7.4 Explain the statutory and professional requirements to be maintained.
- 7.5 Explain the problems associated with auditing solicitors' accounts.
- 7.6 Proffer solutions to the problems associated with auditing solicitors' accounts.
- 7.7 State the problems peculiar to the auditing of the accounts of unincorporated bodies.
- 7.8 Proffer solutions to the problems associated with auditing of the accounts of unincorporated Bodies
- 7.9 Explain the process of auditing the accounts of unincorporated bodies.

**7.0 GENERAL OBJECTIVE:** Understand the process required for auditing Special Types of Organizations (STOs)



Auditors design detailed audit procedures to obtain sufficient appropriate audit evidence. Procedures can include inspection, observation, confirmation, recalculation, re-performance, and analytical procedures, often in some combination. These procedures must also be observed in the case of small organizations as many of them often get listed in the Stock Exchange. To compound the auditing paradox is the fact that many of these firms are handled by smaller audit firms – mainly sole proprietors. Need for caution arises from the fact that many newly listed companies fold up few days after listing. In China, for example, Hontex International was suspended from the Hong Kong Stock Exchange in March 2010, 64 days after listing. Such an experience cast aspersions on the ability of auditors to foresee failure before corporate listing. For effective performance, hence, it is important for the auditor to discern the nature of small businesses, their peculiar auditing problems and the ways of mitigating the audit problems.

### Small Businesses (Entities)

According to the Nigerian Auditing Practice Statement (NAPS) 1, a small entity is one in which:

- (a) There is a concentration of ownership and management in a small number of individuals- often a single individual:
- (b) One or more of the following are also evident:
  - (i) Few sources of income;
  - (ii) Unsophisticated record-keeping; or
  - (iii) Limited internal controls together with the potential for
  - (iv) Management override of controls.

It follows, hence that for audit purposes, small businesses are those that are characterized by:

- (i) a concentration of decision making;
- (ii) less complex operations;
- (iii) a lack of formal systems and processes;
- (iv) limited segregation of incompatible responsibilities;
- (v) Increased potential for management override of controls.
- (vi) Limited accounting knowledge of personnel.

### Auditing Problems Peculiar to Small Businesses

From the characteristics of small businesses indicated above, some peculiar audit problems arise. These, when compared to the audit of large enterprises, include:

- (i) Unsophisticated documentation;
- (ii) Less complexity in the performance of the audit thus requiring fewer hands;
- (iii) Weak internal control;
- (iv) Management override of control.

The two most significant audit issues that arise in the audit of small businesses are:

- (i) the auditor may also provide other services to the client in addition to performing the audit; although this can aid the auditor by providing better knowledge of the client's business, it can also threaten the auditor's independence.
- (ii) the controls in the small business are likely to be nonexistent or weak; this can potentially create a situation where the audit cannot be carried out in conformity with generally accepted auditing standards; this is likely to be the case where there is inadequate documentation of transactions or where the auditor has concerns about the integrity of management

## 7.2 Describe solutions to mitigating auditing problems peculiar to small businesses.

The audit of small businesses is often less complex because they generate fewer and generally simpler transactions. Nonetheless, to mitigate auditing problems peculiar to them, the auditor must consider the following possible solutions:

- (i) Alertness to concerns about independence, especially where he also provides other services to the client.
- (ii) Having a fair understanding of the client's business.
- (ii) Having a fair understanding of the client's business.
- (iii) . Ensuring that the client understands the scope of the audit and the concept of materiality
- (iv) Gaining an understanding of the system in uses especially where the client deploys EDP in his accounting and finance functions. Usually, standardized software will be in use, thus facilitating quick understanding.
- (v) Making judgment about the extent of control that is maintained by the owner/manager.
- (vi) Assessing internal control risk as maximum and performing substantive audit.
- (vii) Evaluating whether evidence obtained is sufficient to support an audit opinion
- (viii) Place little reliance on an interim audit as most audit work will be down at or after year end. In nthe circumstance, controls will seldom on interim audit.

## 7.3 TYPES OF ACCOUNTS MAINTAINED BY SOLICITORS

The type of accounts maintained by solicitors derives from their fiduciary relationship with their clients. The logic is to separate clients' accounts – and by implication, money- from those of the

practitioners. The following books are required to be maintained to record transactions on behalf of the clients and office operation:

- (i) Cash book – (2 columns: clients' bank A/c and Office A/c);
- (ii) Bill delivered book;
- (iii) Petty cash book or disbursement book;
- (iv) Clients' ledger A/c – (2 columns – Clients a/c and Office A/c); and
- (v) Private ledger – account not included in clients' ledger.

#### 7.4 THE STATUTORY AND PROFESSIONAL REQUIREMENTS TO BE MAINTAINED.

Statutory requirements to be maintained by solicitors include:

- (i) Safe keeping of deeds of agreement in case of partnership;
- (ii) Keeping of account books;
- (iii) Safeguard of client's property;
- (iv) Upon termination of representation, protection of client's interest, including surrender of papers and properties to which he is entitled;
- (v) Ethically, financial records must be maintained. These include bank account, retainer agreement, etc.

Professionally, the following requirements are necessary:

- (i) Keeping sufficient accounting records to prepare and audit financial statements;
- (ii) Providing assurance that;
  - a) Transactions are properly recorded;
  - b) Assets and liabilities are recorded at correct amounts; and
  - c) Fraud or error in processing information will be detected.

#### 7.5 THE PROBLEMS ASSOCIATED WITH AUDITING SOLICITORS' ACCOUNTS.

Problems relating to auditing solicitors' account are like any other problems relating to small businesses.

- 1) Income is derived from limited sources – fees and commission.
- 2) Many are sole proprietors or partnership of two or three members.
- 3) Book keeping is unsophisticated.
- 4) Controls are limited.
- 5) Danger of override of control could be real.
- 6) Accounting knowledge of personnel may be weak or limited.
- 7) Formal processes or systems may be non-existent.

#### 7.6 SOLUTIONS TO THE PROBLEMS ASSOCIATED WITH AUDITING SOLICITORS' ACCOUNTS.

The solution to these problems lies in the conduct of such audit with due care and exercise of professional skepticism. The relevant Nigerian standards on Auditing (NSAs) should also be followed so as to minimize audit risks. In this regard, the Nigerian Statement on Audit Practice (NSAP) I relating to small businesses is of crucial importance. Some of the guiding principles of the NSAP 1 include compliance with the following Auditing Standards:

- (i) Audit engagement –NSA 2;
- (ii) Quality Control – NSA 3;
- (iii) Documentation – NSA 4; and
- (iv) Understanding the entity – NSA 9

## **7.7 PROBLEMS PECULIAR TO THE AUDITING OF THE ACCOUNTS OF UNINCORPORATED BODIES**

Unincorporated bodies are business entities registered under part B of the Companies and Allied Matters Act (CAMA) CAP C20 LFN 2004 dealing with business names. The description relates to individual, firm or company. Sections 569 through 589 relate to it. According to section 588 which deals with definition, a ‘firm’ is “an unincorporated body of two or more individuals or one or more individual and one or more corporations, or two or more corporations, who or which have entered into partnership with one another with a view to carrying on business for profit”.

Consequently strict regulations and protections afforded stakeholders of incorporated entities are non-existent in this form of business organization. Auditing problems are therefore, similar to those relating to small businesses since most of unincorporated businesses are small and uncoordinated. Additionally, it is not mandatory for unincorporated companies to submit audited financial statements. Among other requirements, section 587 only requires statement of affairs to be filed with the annual returns.

Nonetheless, because some unincorporated entities may be associated with incorporated entities, due care as expected of incorporated entities are advisable.

## **7.8 SOLUTIONS TO THE PROBLEMS ASSOCIATED WITH AUDITING OF THE ACCOUNTS OF UNINCORPORATED BODIES**

This is similar to those relating to small businesses since most of unincorporated businesses are small and uncoordinated. Nonetheless, it should be noted that as soon as practicable viable entities should be incorporated to enjoy full benefits of incorporation.

## **7.9 THE PROCESS OF AUDITING THE ACCOUNTS OF UNINCORPORATED BODIES**

An unincorporated body is such not registered with the Corporate Affairs Commission under parts A or C. They are registered under part B and are essentially small companies. In some cases companies other than limited liability companies are so described. Auditing of such entities should follow the normal process of:

- (i) Planning the audit, including agreement on the term of engagement.
- (ii) Execution of appropriate field work
- (iii) Writing of formal audit report.

The process of auditing the accounts of unincorporated bodies follows the general pattern, the only difference being that provisions of the Companies and Allied Matters Act (1990) may not apply. Letters of engagement must be obtained, the environment must be understood, internal control system must be evaluated, controls must be tested, analytical procedure must be applied where necessary and finally audit reports must be produced and presented to directors of the company.

All audit procedure methodologies such as observation, inspection etc. as illustrated below should be employed.



For ease of comprehension, the elements of audit procedures are recaptured below:

- **Inspection** – Inspection is the most commonly used method. Under this, the auditor checks every transaction/ document against written steps, procedures to ensure accuracy.

- **Observation** – Under this technique of audit, the auditor usually tries to inspect others doing/ performing a particular process. E.g., An auditor may observe steps followed in processing GRN against goods purchased.
- **Confirmation** – This type is applied to ensure the correctness of financial statements either from internal sources within the auditee organization or from external sources.
- **Recalculation** – Under this audit method, the auditor usually crosses the checks information presented by the client. It is generally used in case of checking mathematical accuracy.
- **Reperformance** – Using this procedure, the auditor re-perform the entire process is performed by the client to find out gaps, audit findings, etc.

The auditor may evaluate outstanding customer balance by preparing debtors' aging schedules etc. The auditor may compare the same for two different audit periods and find conclusions based on thereon. Like if there is no change in credit policy, no significant change in sales, debtors balance should almost be the same, etc.

- Ratio analysis: The auditor may use this method as while checking the working capital auditor may compare the current ratio of the different **reporting period**. This comparison of current assets/current liabilities should be almost the same unless the organization amended its policies related to any of the working capital items.
- The auditor may check and compare the employee benefits **expense accounts** for the different accounting periods. This amount should be the same or rise following promotion/ incremental policies. If an auditor finds a different reason for rising/ decline other than due to policies or employee turnover, there are chances of fraudulent payments being processed to fake employees through the payroll system.
- Cross-checking any expenses in line with the quantity and rate and matching with actual figures. For example, suppose 5KGs of potatoes of N25/Kg results in 1 KG of potato chips. The auditor should check actual expenditure should be around N25 for producing 1 KG of potato chips.
- Examine a trend line of any expenses. This amount should vary in accordance with production. If not matching, there are chances that management may not be correctly recognizing expenses promptly.

## QUIZZES

1. Procedures in auditing special types of organizations may include inspection, ....., confirmation, ....., and re-performance
2. One auditing feature common to special types of organizations is .....
3. A solicitor must keep professional records distinct from .....
4. In Nigeria, a small company must have .....but must be devoid of .....
5. Studying this topic is important to me because .....

## REVISION QUESTIONS

1. You have just been appointed by Zeroz Ltd, a small company at Ilupeju, as an External Auditor.  
Required:
  - (a) Show how Zeroz Ltd may not be different from another of your client, Banga & Co., a firm of Solicitors.
  - (b) Indicate two problems you may encounter in the audit of Zeroz Ltd.
  - (c) Explain the measures you may take to solve the problems inherent in the assignment.
2. You have just won the contract to provide assurance services to Tinubu and Sons Limited, a trading company having just one shop and six employees at the personal residence of the proprietor, Chief Miogbayiun Tinubu. For the year ending December 31, 2019:
  - (a) Cite three statutory conditions aside any manifest in the description above, to qualify the company as a small company in Nigeria;
  - (b) State four reasons why it is necessary to be diligent in performance assurance service functions on the company; and
  - (c) Explain three audit procedures which you will adopt in verifying cash balance in the company's shop at Ojuelegba on December 31, 2019.
3.
  - (a) Why is it necessary to exercise due care while auditing Jokotola Pharmacy having just one shop and six employees at the personal residence of the proprietor, Chief Emeka Ajala?
  - (b) Explain three audit procedures you will adopt in verifying cash balance in the shop.

## ASSIGNMENTS

You have just been appointed by Zeroz Ltd, a small company at Ilupeju, as an External Auditor.

Required:

- (a) Show how Zeroz Ltd may not be different from another of your client, Banga & Co., a firm of Solicitors.



- (b) Indicate two problems you may encounter in the audit of Zeros Ltd.
- (c) Explain the measures you may take to solve the problems inherent in the assignment.

## 8.0 CHAPTER EIGHT

### UNDERSTAND THE INTRODUCTION, FUNCTIONS AND OPERATION OF AN INTERNAL AUDIT DEPARTMENT

At the end of the lecture, students are expected understand the Introduction, Functions and operation of an Internal Audit Department. Specifically, they should be able to:

- 8.1 Define internal audit
- 8.2 Distinguish between internal audit and **internal control system**.
- 8.3 State the functions of **internal audit department**
- 8.4 Compare and contrast internal audit and **statutory audit**.
- 8.5 Describe how an internal audit department can be established.
- 8.6 Explain why internal auditor's independent is necessary
- 8.7 Explain how the internal auditor's independent is maintained
- 8.8 Explain special areas of internal audit such as management audit, cost audits, detection of error and fraud and ensuring laid down system are maintained by management.
- 8.9 State the matters that the internal auditor must include in his report.
- 8.10 Explain the role of the internal audit in an internal investigation.

## 8.1 DEFINITION OF INTERNAL AUDIT

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.<sup>[1]</sup> Internal auditing is a catalyst for improving an organization's effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business processes. With commitment to integrity and accountability, internal auditing provides value to governing bodies and senior management as an objective source of independent advice. Professionals called internal auditors are employed by organizations to perform the internal auditing activity.

The scope of internal auditing within an organization is broad and may involve topics such as the efficacy of operations, the reliability of financial reporting, deterring and investigating fraud, safeguarding assets, and compliance with laws and regulations.

Internal auditing frequently involves measuring compliance with the entity's policies and procedures. However, internal auditors are not responsible for the execution of company activities; they advise management and the Board of Directors (or similar oversight body) regarding how to better execute their responsibilities. As a result of their broad scope of involvement, internal auditors may have a variety of higher educational and professional backgrounds.

Publicly-traded corporations typically have an internal auditing department, led by a Chief Audit Executive ("CAE") who generally reports to the Audit Committee of the Board of Directors, with administrative reporting to the Chief Executive Officer.

The profession is unregulated, though there are a number of international standard setting bodies ([IIA](#), [IAASB](#), [ISACA](#)... Cf. paragraph *standard setting* below).

### Other definitions

The definition above (first sentence of this page) is in essence the [IIA](#)'s definition.<sup>[2]</sup> A similar definition has been developed by the accounting profession and adopted by government auditors. The **ISA 610** and the **INTOSAI's standard ("ISSAI") 1003** define the internal audit function as *"An appraisal activity established or provided as a service to an entity. Its functions include, among other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control."*

Internal audit is an integral part of an internal control system which is made up of internal checks and internal audit functions as learnt in ACC 213 – Auditing 1.

## 8.2 DISTINCTION BETWEEN INTERNAL AUDIT AND INTERNAL CONTROL SYSTEMS

What are internal controls?

Internal controls are processes within a department or organization, which are designed to provide reasonable assurance regarding the achievement of the following objectives:

- >Reliability and integrity of information.
- >Compliance with policies, plans, procedures, laws, and regulations.
- >The safeguarding of assets.
- >The economical and efficient use of resources.
- >Effectiveness and efficiency of operations.
- >Reliability of financial and operational reporting.

Internal controls help assure that operations are conducted according to plan. They are tools used every day by managers, from the unit levels to the Officeholders, Judges, Executive Director's, and Superintendent's of the County, which include written policies and procedures, organizational design, and physical barriers.

Through careful design, internal controls can help your department operate efficiently and effectively and provide a reasonable level of assurance that the processes, services, or products for which you are responsible are adequately protected.

In short, a control is any action taken by the administration/management to enhance the likelihood that established objectives and goals will be achieved. Conceptually, it is made up of internal check and internal audit functions as shown diagrammatically below:

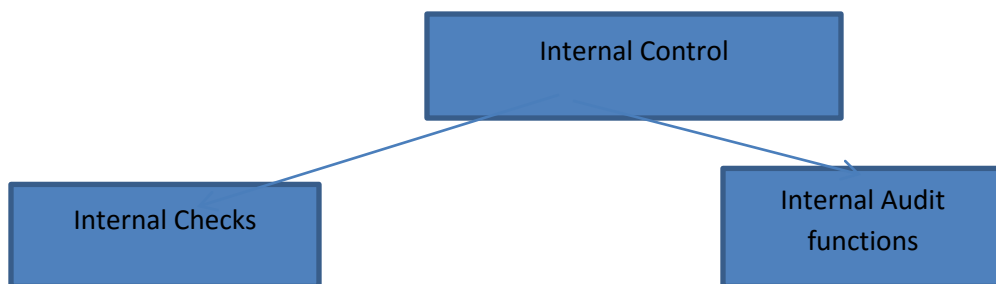


Figure 8.1: Components of an internal control System

Some differences between Internal Audit and Internal Control are tabulated below:

Internal Audit vs Internal Control	
Internal audit is a function that provides independent and objective assurance that an organization's internal control and risk management system are functioning effectively.	Internal control is the system implemented by a company to ensure the integrity of financial and accounting information, and that the company is progressing towards fulfilling its profit and operational objectives in a successful manner.
Main Responsibility	
The main responsibility of the internal audit is to review the effectiveness of the internal control system.	Ensuring that sound internal control procedures are in place is the main responsibility of internal control system.
Nature	
Internal audit is a preventive measure.	Internal control is a detective measure.

In summary, difference between internal audit and internal control is due to the distinction between the nature and applicability of the two concepts. While mitigating risks and ensuring that objectives are achieved is the purpose of internal control, verifying whether such controls are functioning as intended is the objective of the internal audit. Furthermore, internal audit is an integral part of internal control. A number of large-scale corporates such as Enron and Lehman Brothers have collapsed due to the absence of sound internal control systems and effective internal audit function. In Nigeria, corporate entities like the Skye Bank Plc and the Oceanic Bank Plc have also collapsed due to inefficient internal control and internal audit.

Adapted from:

### Difference Between Internal Audit and Internal Control

May 24, 2017 Posted by [Dili](#)

<https://www.differencebetween.com/difference-between-internal-audit-and-vs-internal-control/#:~:text=The%20key%20difference%20between%20internal%20audit%20and%20internal,to%20ensure%20the%20integrity%20of%20financial%20and%20>

Retrieved on July 29, 2020

### 3 THE FUNCTIONS OF INTERNAL AUDIT DEPARTMENT.

## Role in internal control

Internal auditing activity is primarily directed at improving [internal control](#). Under the [COSO Framework](#), internal control is broadly defined as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following internal control categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with laws and regulations.

Management is responsible for internal control. Managers establish policies and processes to help the organization achieve specific objectives in each of these categories. Internal auditors perform audits to evaluate whether the policies and processes are designed and operating effectively and provide recommendations for improvement.

In the [United States](#), internal auditors may assist management with compliance with the [Sarbanes-Oxley Act](#) (SOX).

## Role in risk management

Internal auditing professional standards require the function to monitor and evaluate the effectiveness of the organization's [Risk management](#) processes. Risk management relates to how an organization sets objectives, then identifies, analyzes, and responds to those risks that could potentially impact its ability to realize its objectives.

Under the [COSO](#) enterprise risk management (ERM) Framework, risks fall under strategic, operational, financial reporting, and legal/regulatory categories. Management performs risk assessment activities as part of the ordinary course of business in each of these categories. Examples include: strategic planning, marketing planning, capital planning, budgeting, hedging, incentive payout structure, and credit/lending practices. [Sarbanes-Oxley](#) regulations also require extensive risk assessment of financial reporting processes. Corporate legal counsel often prepares comprehensive assessments of the current and potential litigation a company faces. Internal auditors may evaluate each of these activities, or focus on the processes used by management to report and monitor the risks identified. For example, internal auditors can advise management regarding the reporting of forward-looking operating measures to the Board, to help identify emerging risks.

In larger organizations, major strategic initiatives are implemented to achieve objectives and drive changes. As a member of senior management, the Chief Audit Executive (CAE) may participate in status updates on these major initiatives. This places the CAE in the position to report on many of the major risks the organization faces to the Audit Committee, or ensure management's reporting is effective for that purpose.

Internal auditors may help companies establish and maintain [Enterprise Risk Management](#) processes.<sup>[13][14]</sup> Internal auditors also play an important role in helping companies execute a [SOX 404 top-down risk assessment](#). In these latter two areas, internal auditors typically are part of the risk assessment team in an advisory role.

# Role in corporate governance

Internal auditing activity as it relates to [corporate governance](#) is generally informal, accomplished primarily through participation in meetings and discussions with members of the Board of Directors. Corporate governance is a combination of processes and organizational structures implemented by the Board of Directors to inform, direct, manage, and monitor the organization's resources, strategies and policies towards the achievement of the organizations objectives. <sup>[15]</sup> The internal auditor is often considered one of the "four pillars" of corporate governance, the other pillars being the Board of Directors, management, and the external auditor. <sup>[16]</sup>

A primary focus area of internal auditing as it relates to corporate governance is helping the Audit Committee of the Board of Directors (or equivalent) perform its responsibilities effectively. This may include reporting critical internal control problems, informing the Committee privately on the capabilities of key managers, suggesting questions or topics for the Audit Committee's meeting agendas, and coordinating carefully with the external auditor and management to ensure the Committee receives effective information.

## FUNCTIONS OF INTERNAL AUDIT DEPARTMENT

According to International Standard on Auditing (ISA) 610, functions of internal auditing include:

- (i) Examining;
- (ii) Evaluating; and
- (iii) Monitoring

the adequacy and effectiveness of internal control.

It has also been noted that internal audit helps to improve the:

- (i) Effectiveness of risk management - by providing insights and recommendations based on findings especially on the implementation and enforcement of policies as designed by management;
- (ii) Control – by assessing data and business processes, safeguarding assets and resources of the business; and
- (iii) Governing processes- being a source of independent advice thus supporting management in efficient and effective operation of the enterprise.

## OTHER FUNCTIONS OF THE INTERNAL AUDIT DEPARTMENT

These include:

- i) Establishing and communicating the scope and objectives of the audit to the appropriate management;

- ii) Developing an understanding of the business area under review including objectives, measurements and key transaction types. This may involve documentary reviews and interviews using flowcharts, narratives and other analytical tools as appropriate;
- iii) Describing the key risk factors relative to the business entity within the scope of the internal audit;
- iv) Identifying control procedures used to ensure proper evaluation and monitoring each key risk and transaction type;
- v) Developing and executing a risk-focused sampling and testing approach to decide if key controls are functioning as expected;
- vi) Reporting problems identified and negotiating action plans with the management;
- vii) Following-up the reported findings at appropriate intervals and in most cases, maintaining a follow-up data base for the purpose.

## 8.4 COMPARISON AND CONTRAST INTERNAL AUDIT AND STATUTORY AUDIT

The task here relates to showing similarities as well as distinctions between internal audit and statutory audit. These are presented below:

Similarities

### Similarities between Internal Audit & External Audit

These include:

#### **Freedom of Internal Audit and External Audit**

- (i) **Independence**

Both the internal and external audit work independently. The independence perceives that both have a working independence from liberty of minds to physical.

- (ii) **Reporting**

Both internal audit and external audit present their reports after their task is over though their statements may differ in format, content and objective.

- (iii) **Costing Implication**

The two audits cost the entity some resources. Apart from operational departments, the internal audit department is a cost centre that must be serviced in a entity where it exists. The same applies to statutory audit where fees must be paid to the professional engaged.

- (iv) **Quality of Work**

Both the internal and the external audits require the high quality of works to guarantee that the results of their examinations are reliable by the associated parties.



Consequently, they all depend on professional standards established by relevant regulatory bodies to execute necessary procedures.

**(v) Testing on sample basis**

Both the external and internal auditor are involved in testing routines. Where the sample to be tested is large, both draw out samples to represent the population of evidence rather than testing all available evidence or documents.

**(vi) Professionalism**

Both the internal and the external audits are based on a professional discipline and functions to professional principles. They both cooperate closely in their duties. In most cases practitioners belong to the same professional accounting bodies, i.e., the Institute of Chartered Accountants of Nigeria though the Institute of Internal Auditors also exists.

Adapted from:

<https://www.knowswwhy.com/similarities-between-internal-audit-and-external-audit/>

Retrieved on July 29, 2020

Differences between internal audit and external audit include the following:

**(i) Engagement**

Internal Audit is a constant audit activity performed by the internal audit department of the organization comprising of staffs engaged as personnel of the entity. External Audit is an examination and evaluation by an independent professional, who is not under the influence or authority of the management of the entity.

Moreover, the engagement of an internal auditor is not subject to any statutory provision whereas the engagement of an external auditor is guided by sections 358 dealing with qualification and section 357 dealing with the need to appoint an auditor at general meeting.

**(ii) Discretion**

Internal Audit is discretionary, as its reports are sent to top management or the audit committee without being copied to the operational managers. Furthermore, there is no statutory requirement for internal audit, especially for private companies. This is not so for external audits where reports are published and read out at a general meeting in accordance with section 359 of the Companies and Allied Matters Act (CAMA) CAP C20 LFN 2004.

**(iii) Continuity**

Internal Audit is a continuous process carried out routinely within a financial year whereas the External Audit is conducted once on a yearly basis- usually at the end of the financial year..

#### (iv) Purpose

The purpose of Internal Audit is reviewing the routine activities of the business, especially the effectiveness of the internal control systems as well as and suggestions for improvement. Conversely, External Audit aims at analyzing and verifying the accuracy and reliability of the financial statement and expressing professional opinion to lend credibility to the financial information provided by the entity.

Internal Audit provides an opinion on the effectiveness of operational activities of the organization. On the other hand, External Audit gives an opinion of the true and fair view of the financial statement.

Adapted from:

<https://keydifferences.com/difference-between-internal-audit-and-external-audit.html>

Retrieved on July 29, 2020

## 8.5 DESCRIPTION OF HOW AN INTERNAL AUDIT DEPARTMENT CAN BE ESTABLISHED

### How an internal audit department can be established

The following suggestions and resources are suggested by the American Institute of Internal Auditors (IIA).

#### **Step 1:**

Establish the authority of the internal audit activity and review the [definition of internal auditing](#) and the [International Standards for the Professional Practice of Internal Auditing \(Standards\)](#) to become familiar with what is required. The attached [Establishing Authority presentation](#) should help you in any discussions with management and the audit committee.

#### **Step 2:**

**Interview senior management and board of directors/audit committee chairmen** to build rapport, to ensure those at the top have a clear picture of the internal audit function, and to clarify expectations of all. Use this opportunity to quickly learn and address what management and the board view as the greatest risks to the organization, while keeping in mind issues, problems, and opportunities that have already been

identified. Develop a system for cataloging such information, including date and name of person interviewed for quick reference in the future. There are many considerations that should be evaluated in determining the optimal structure and source for internal auditing resources. Those responsible for making such determinations should evaluate the additional guidance and considerations outlined in The IIA's Position Paper "[Role of Internal Audit in Resourcing the Internal Audit Activity](#)."

### **Step 3:**

**Obtain and review the audit committee charter.** Of course, no sample charter encompasses all activities that might be appropriate to a particular audit committee, nor will all activities identified in a sample charter be relevant to every committee. Accordingly, this charter must be tailored to each committee's needs and governing rules.

### **Step 4:**

**Understand "benchmarking" needs,** i.e., industry, specialty groups, organizations with same staff size, etc. Ask senior management who they consider to be leaders and laggards in your organization's market niche. Check out IIA's [GAIN](#) services. Review past GAIN [surveys](#).

### **Step 5:**

**Obtain and review your organization's written policies and procedures,** especially the policy pertaining to management's responsibility to control the organization.

### **Step 6:**

**Discuss** with external auditors open and closed **internal control issues**, which they may have identified during their reviews.

### **Step 7:**

Start to **develop the "audit universe,"** or the list of all auditable entities.

### **Step 8:**

**Map the major processes/operations** within the organization. Meet with operations managers, including those in information technology, in order to understand their risks and concerns.

**Step 9:**

**Develop a risk assessment** for your organization. This should be a macro-level assessment, which includes both external and internal risk factors.

**Step 10:**

**Develop a charter for Internal Audit.** Ensure that both senior management and the audit committee review and approve the charter. Information on audit charters can be found within the *International Professional Practices Framework* , Establishing an Internal Audit Activity Manual and Essentials: An Internal Audit Operations Manual.

**Step 11:**

**Build the budget**, including personnel and travel.

**Step 12:**

Based on your risk assessment, **develop an audit plan**. The amount of the plan that can be accomplished in the allotted time period (usually a year) will depend on the risks identified and the internal audit resources and staff. You should always leave time in your audit plan for management requests (usually 10 percent).

**Step 13:**

**Hire your staff and develop a plan for staff training.** Ensure your staff covers the range of expertise needed based on your risk assessment. You may also consider outsourcing portions of your audit plan to outside service providers or using professionals internal to the organization. Additional information is available within The IIA's Position Paper "Role of Internal Audit in Resourcing the Internal Audit Activity."

**Step 14:**

**Ensure that senior management notifies other departments of the existence** of the Audit department and call for their complete cooperation. (The IIA has complimentary brochures, such as "All in a Day's Work," "Adding Value Across the Board", and "Guidance for the Profession".) Become familiar with The IIA's Web site and use the search feature on its home page to help you identify valuable resources.

**Step 15:**

**Work with management** to establish best-practice reporting relationships, to ensure internal audit is promoted throughout the organization, and to develop a methodology for following up on audit recommendations and measuring performance .

**Step 16:**

**Establish a quality assurance program.**

8.6 Explain why internal auditors' independence is necessary.

To perform their role effectively, internal auditors require organizational independence from management, to enable unrestricted evaluation of management activities and personnel. Although internal auditors are part of company management and paid by the company, the primary customer of internal audit activity is the entity charged with oversight of management's activities. This is typically the Audit Committee, a sub-committee of the Board of Directors. To provide independence, most Chief Audit Executives report to the Chairperson of the Audit Committee and can only be replaced with the concurrence of that individual.

([http://www.theiia.org/guidance/standards-and-guidance/audit-function/audit-function---](http://www.theiia.org/guidance/standards-and-guidance/audit-function/audit-function---establish/)

establish/ )

Retrieved on July 23, 2012)

## 8. HOW THE INTERNAL AUDITOR'S INDEPENDENCE IS MAINTAINED

To ensure their independence, internal auditors must carry out their work freely and objectively. They cannot subordinate their judgment on audit matters to that of others,

and they should have the support of senior management, the board of directors and the audit committee. Use the following to determine internal audit independence.

## **ORGANIZATIONAL STATUS**

The director of internal auditing should report to an individual in the organization with sufficient authority to:

- Promote independence.
- Ensure broad audit coverage.
- Ensure adequate consideration of audit reports.
- Ensure appropriate action on audit recommendations.

The director communicates directly with the board, meets privately with the board annually and regularly attends and participates in board meetings.

The board concurs in the appointment or removal of the director.

The purpose, authority and responsibility of the internal auditing department is defined in a charter that is approved by senior management and the board of directors and assessed by the director of internal audit. Results of assessments are reported to senior management and the board. The charter should

- Establish the department's position within the organization.
- Authorize access to records, personnel and properties relevant to the performance of audits.
- Define the scope of internal auditing activities.

The director should submit annually the following for senior management approval and to the board of directors for their information:

- Summary of the departments audit work schedule.
- Staffing plan.
- Budget.
- Activity reports that highlight significant findings and recommendations.

## **OBJECTIVITY**

Staff assignments should ensure that potential and actual conflicts of interest and bias are avoided.

Internal auditors should report to the director on any situation indicating a possible conflict of interest.

Staff assignments should be rotated periodically.

Internal auditors do not assume operating responsibilities.

It is also important that the internal auditors' obligation of Independence must be respected to enshrine independence within an organization. According to the [Institute of Internal Auditors](#), the Internal Auditor's obligation of Independence refers to:

- **1) The reporting line or status of the CAE**

*The Chief Audit Executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity (IIA standard 1110).*

*Organizational independence is effectively achieved when the chief audit executive reports functionally to the board (IIA practice advisory 1110A1). The board is a governing body, such as the board of directors, supervisory board, head of an agency or legislative body, board of governors or trustees of a nonprofit organization, or any other designated body of the organization, including the audit committee to whom the chief audit executive may functionally report (IIA Glossary).*

- **2) Attitude of auditors, procedures of the internal audit department.**

*The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results (IIA practice advisory 1110A1).*

- **3) Communication right.**

*The chief audit executive must communicate and interact directly with the Board of Directors (IIA standard 1111)*

Like the statutory auditor, the independence of an internal auditor must not be compromised.

Source: The Institute of Internal Auditors, *Standards for the Professional Practice of Internal Auditing* .

<https://www.journalofaccountancy.com/issues/1997/jan/check.html#:~:text=INTERNAL%20AUDIT%20INDEPENDENCE%20To%20ensure%20their%20independence%2C%20internal,the%20board%20of%20directors%20and%20the%20audit%20committee.>

Retrieved on July 27, 2020

## 8.8 SPECIAL AREAS OF INTERNAL AUDIT

Management audit

Management audit

Management audit is the analysis and assessment of the competencies and capabilities of a company's management in carrying out corporate objectives. Its

purpose is to appraise the effectiveness of the management team rather than individual executive performance of corporate goals and objectives. Such goals may include safeguarding the interests of shareholders, maintain good relations with employees, and uphold reputational standards – both local and international.

Management audit may address issues such as:

- What organizational structure has been set up by management? Are there clear lines of reporting, or is there confusion?
- What are the policies and procedures regarding finance, marketing or any other key area as well as the level of compliance?
- How effective are current risk management measures?
- What is the state of relations among the employees of the organization?
- How does management put together its annual budget?
- Are the company's IT systems kept up-to-date?
- Is the management group responsive to shareholders?
- How effective is workforce recruitment and retention? Are there training programs to keep skills current among employees?
- Is management doing its job to ensure the company is a "good corporate citizen"?
- Is management strategically guiding the company toward its financial targets?

## COST AUDIT

Cost audit is an investigation of cost records. It is conducted in addition to the financial audit. It could be regarded more as a special audit being an audit of efficiency, minute details of expenditure while the work is in progress rather than a post mortem examination. It is mainly preventive, a guide for management's policy and decision in addition to being a barometer of performance.

## DETECTION OF ERRORS AND FRAUDS

This is an expected outcome internal auditing. The position of the Institute of Internal Auditors clearly explains that a good internal auditing system should lead to detection of errors and fraud as well as the bases and funding for fraud. An excerpt is presented below to enrich our knowledge.

Fraud and internal audit  
The IIA's Perspective



Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Its role includes detecting, preventing, and monitoring fraud risks and addressing those risks in audits and investigations. It should consider where fraud risk is present within the business and respond appropriately by auditing the controls of that area, evaluating the potential for the occurrence of fraud and how the organization manages fraud risk (Standard 2120.A2) through risk assessment, and audit planning. It is not internal audit's direct responsibility to prevent fraud happening within the business. This is the responsibility of management as the first line of defense.

The internal auditor should not be expected to have the expertise of a person whose primary responsibility is to investigate fraud. Such investigations are best carried out by those experienced to undertake such assignments.

Internal audit should use its expertise to analyze data sets to identify trends and patterns that might suggest fraud and funding abuse. Where the experience is not available within the internal audit team, the organization should consider recruiting or engaging resources with sufficient knowledge or expertise.\

The organization should have a suitable anti-fraud response plan outlining key policies and investigation methodologies. The plan should make clear the role of internal audit when there is suspected fraud and associated control failure

Operationally, internal audit should have sufficient knowledge of fraud to:

- ♣ Identify red flags indicating fraud may have been committed.
- ♣ Understand the characteristics of fraud and the techniques used to commit fraud, and the various fraud schemes and scenarios.
- ♣ Evaluate the indicators of fraud and decide whether further action is necessary or whether an investigation should be recommended.
- ♣ Evaluate the effectiveness of controls to prevent or detect fraud

Where electronic evidence is collected, internal audit should provide assurance on whether necessary access rights and legislative requirements are being met.

Where fraud has occurred, internal audit should understand how the controls failed and identify opportunities for improvement. It should consider the probability of further errors, fraud, or noncompliance across the organization and reassess the cost of assurance in relation to potential benefits.

<https://na.theiia.org/about-ia/PublicDocuments/Fraud-and-Internal-Audit.pdf>

## ENSURING LAID DOWN SYSTEMS ARE MAINTAINED.

Internal audit deals with the evaluation of the effectiveness of controls in achieving desired corporate goals and objectives. These systems of control may relate to:

- (i) Performance evaluation:  
Internal audit ensures that systems in this regard are monitored and actual results compared with projected performance. For example, actual sales performance is compared to budgeted sales.
- (ii) Risk management procedures.  
In this case, risk management procedures are evaluated in terms of appropriateness and effectiveness. Standard risk curtailment procedures established by the entity are compared to operational standards and reports made on deviations
- (iii) Regulatory compliance  
This relates to the extent to which external laws and regulations are complied with. Internal audit ensures this by studying relevant laws such as the Companies and Allied matters Act (CAMA), Investment and Securities Act, the Money Laundry Act as well as the pronouncement of regulators such as the Financial Reporting Council of Nigeria. Regular evaluation of compliance with these rules without excluding international norms are essential to internal audit and promote compliance.
- (iv) management control  
This relates more to internal rules and guidelines. The internal auditor enhances compliance by testing the level of compliance with organizational rules and guidelines which may relate to various operational activities. On payroll for example, the internal auditor reviews standard pay structure and verifies payroll monthly before disbursement thus preventing significant errors or fraud.
- (v) Governance processes  
Corporate entities are expected to pursue best professional management practices, failing which the reputation of an entity may be brought into disrepute. Clear organogram is expected to be

established showing lines of authority while limits of approval are distinctively spelt out. Internal audit processes including examination of the extent to which critical rules are being breached by the board, management and front line worker will strengthen compliance. In 2013 for instance, internal audit procedures revealed that governance was being compromised by the Nigerian entity of Ecobank Transinternational. The discovery led to the step down of the Nigeria Chairman of the bank in person of Chief Lawson.

It must be noted that the internal audit procedures must be continuous and at times impromptu. Also, suggestions should be made for correction while the report must be communicated to the appropriate authorities on time. Unresolved issues must be emphasized until corrective action is taken.

## 8. THE MATTERS AN INTERNAL AUDITOR MUST INCLUDE IN HIS REPORT

### **Internal audit reports**

Internal auditors typically issue reports at the end of each audit that summarize their findings, recommendations, and any responses or action plans from management. An audit report may have an executive summary; a body that includes the specific issues or findings identified and related recommendations or action plans; and appendix information such as detailed graphs and charts or process information. Each audit finding within the body of the report may contain five elements, sometimes called the "5 C's":

1. Condition: What is the particular problem identified?
2. Criteria: What is the standard that was not met? The standard may be a company policy or other benchmark.
3. Cause: Why did the problem occur?
4. Consequence: What is the risk/negative outcome (or opportunity foregone) because of the finding?
5. Corrective action: What should management do about the finding? What have they agreed to do and by when?

The recommendations in an internal audit report are designed to help the organization achieve its goals, which may relate to operations, financial reporting or legal/regulatory compliance. They may relate to effectiveness (i.e., whether goals were met or [compliance](#) with standards was achieved) or efficiency (i.e., whether the outputs were generated with minimum inputs).

Audit findings and recommendations also relate to particular assertions about transactions, such as whether the transactions audited were valid or authorized, completely processed, accurately

valued, processed in the correct time period, and properly disclosed in financial or operational reporting, among other elements.

## 8.10 THE ROLE OF THE INTERNAL AUDIT IN AN INTERNAL INVESTIGATION

The internal audit may need to play a dominant role in internal investigations. Internal auditors are well versed in auditing procedures which are key in any type of investigation. Though specific procedures may differ depending on the situation, internal audit play the following roles in an investigation:

- Gathering evidence through surveillance, interviews, or written statements.
- Collecting and preserving evidence critical to understanding the misconduct and proving supporting conclusions.
- Determining the techniques used to perpetrate the focus of investigation.
- Chronologically recording all reports, documents, and evidence in a detailed log, including such things as hard copies and electronic forms of computer files, financial records, phone records, vendor information, public records, news articles, and social media posts.
- Interviewing personnel and witnesses involved, and then the accused individual after applicable evidence has been obtained.
- Knowing the rights of persons within the scope of the investigation.
- Being responsible that the process is handled consistently and prudently.
- Assessing the complicity of the fraud throughout the organization, which can be critical to not destroying or tainting crucial evidence?
- Adequately securing evidence collected, maintaining chain-of-custody procedures appropriate for the situation

Adapted from

When Audits Become Investigations

Jim Pelletie March 07, 2018

<https://iaonline.theiia.org/blogs/Jim-Pelletier/2018/Pages/When-Audits-Become-Investigations.aspx>

Retrieved on July 28, 2020

## QUIZZES

1. Internal audit is an integral part of .....
2. One function of internal audit is .....compared to internal control which aims at .....
3. The Chief Internal Auditor should report to .....in order to endure independence.
4. Internal audit is similar to statutory audit in that .....
5. ....is a special area of internal audit.

## REVISION QUESTIONS

3. (a) Distinguish between Internal Audit and Statutory Audit.  
(b) You have just been appointed the External Auditor of Yakoyo Plc, a firm manufacturing hair products. You intend suggesting to the management of company to establish an Internal Auditor. In a memo to the Managing Director of the company, indicate:  
(i) Two major areas where internal auditing may strengthen corporate performance;  
(ii) Four areas where both the internal auditor and the external auditor could collaborate for improved financial reporting.
4. Explain ten steps in the establishment of an Internal Audit Office at Ojukin Plc., where you are the Finance Director
5. You are the managing Director of Tyukon Construction Company Plc., Uyo with a large internal audit department. Discuss how the independence of the internal audit functions will be maintained and sustained.
6. (a) Briefly identify three contents of the report of an internal audit.  
(b) Explain the direction of communication in internal auditing compared to statutory auditing.
7. (a) What is internal audit?  
(b) Explain the need for management audit in the era of Covid-19.

## ASSIGNMENTS

1. Visit a limited liability company and a public limited liability company within Ikeja. Describe the nature of internal audit known to each company.
2. With the aid of an appropriate diagram, distinguish between internal control and internal audit.

## 9.0 CHAPTER NINE SHARE TRANSFER AND AUDIT

At the end of the lecture, students are expected to understand the process of Share Transfer and Audit. Specifically, they should be able to:

- 9.1 Define the term share transfer
- 9.2 Differentiate between share transfer and share transmissions
- 9.3 Explain the statutory requirements for share transfer
- 9.4 Explain how other statutory requirements (e.g through the memorandum of association etc) could be determined.
- 9.5 Explain and tests for compliance with statutory and other requirement for the transfer of shares.
- 9.6 Explain the process of share transfer audit

## 9.1 SHARE TRANSFER

‘Transfer of Shares’ refers to the act of conveying ownership of shares from one person to the other. This may also take place in succession.

Transfer implies conveyance of title or other interests in property from one person to another and could be by gift or sale.

(The Longman Dictionary of Law 7<sup>th</sup> ed., 2007 p. 585).

Shares are transferable subject to any restriction in a company’s articles and as a consequence of orders imposing restriction. CAMA 1990 defines ‘transfer’ to mean a conveyance which is duly stamped and otherwise valid. It does not include a transfer which the company refuses and does not register (Section 146(7)). Section 151 of the Companies and Allied Matters Act (CAMA) CAP C20 LFN 2004, deals with share transfer.

## SHARE TRANSMISSION

This is the vesting of shares in another person not by virtue of transfer, but by the operation of law. This may be on the death of the original owner or bankruptcy of such holder.

(The Longman Dictionary of Law 7<sup>th</sup> ed., 2007 p. 585)

Section 155 of CAMA 2004, deals with share transmission.

## 9.2 DIFFERENCES BETWEEN SHARE TRANSFER AND SHARE TRANSMISSIONS

Transfer of shares is a willful endeavor by the shareholder through sale or gift whereas transmission of share may not be so willful as in the case of bankruptcy or without the input of the holder as in the case of death. Hence, transfer is applicable before death or bankruptcy whereas transmission is applicable thereafter. Furthermore, in the case of transfer, the election option of Section 155(5) relating to transmission does not apply. The subsection allows directors of a company whose shares are being transmitted to compel the beneficiary to elect either to be registered himself or to transfer the shares to a third party within 90 days. Payment

of all dividends, bonuses or other moneys payable in respect of the shares could be withheld until the requirement is complied with.

## 9.3 STATUTORY REQUIREMENTS FOR SHARE TRANSFER AND SHARE TRANSMISSION (SECTION 151-155)

### 9.3.1 Statutory requirements for share transfer

These are detailed in sections 151 to 154 of the Companies and Allied Matters Act, (CAMA) CAP C20 LFN 2004, According to the sections, transfer shall be by:

- (i) An instrument of transfer and without restriction unless as provided in the articles;
- (ii) Such instrument must be delivered to the company;
- (iii) The instrument is executed by or on behalf of the transferor and transferee;
- (iv) The holder of the shares is deemed owner until the name of the transferee is entered in the register in respect of the shares;
  
- (v) Any member of a company may transfer all or any of his holding by instrument in writing in any usual or common form or any order which the directors may approve (s.151 (5))

The implication of this is that an instrument of transfer may be:

- a) In writing – in an usual or common form; or
- b) Any order as approved by the directors of a company.

The requirement is subject to the provision of the Article of Association of the company.

Registration may be refused where:

- a) The shares have not been fully paid for, in which case the directors may need to approve of the personality involved;
- b) The company has a lien on the shares;
- c) The instrument of transfer is not accompanied by the share certificates to which it relates or such other evidences as the directors may determine to elicit the right of the transferor to carry out the deal;
- d) The instrument of transfer is not in respect of only one class of shares; or
- e) The required fee (if any) in respect of the instrument has not been paid.

### 9.3.2 Statutory requirements for share transmission

These are detailed in section 155 of the Companies and Allied Matters Act, (CAMA) CAP C20 LFN 2004, the section provides as follows:

‘(1) In case of the death of a member, the survivor or survivors where the deceased was a joint holder, or the legal personal representative of the deceased where he was a sole holder, shall be the only persons recognised by the



company as having any title to his interest in the shares; but nothing in this section shall release the estate of a deceased joint holder from any liability in respect of any share which had been jointly held by him with other persons.

(2) Any person becoming entitled to a share in consequence of the death or bankruptcy of a member may, upon such evidence being produced as may, from time to time, properly be required by the directors and subject as hereafter provided in this section, elect either to be registered himself as holder of the share, or to have some person nominated by him registered as the transferee of the share; but the company shall, in either case, have the same right to decline or suspend registration as they would have had in the case of a transfer of the share by that member before his death or bankruptcy, as the case may be.

(3) If the person so becoming entitled elects to be registered himself, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and if he elects to have another person registered, he shall testify his election by executing to that person a transfer of the share.

(4) All the limitations, restrictions and provisions of this Act and the company's articles relating to the rights to transfer and the registration of transfers of share, shall be applicable to any such notice or transfer as mentioned in subsection (3) of this section as if the death or bankruptcy of the member had not occurred and the notice or transfer were a transfer signed by that member.

(5) A person becoming entitled to a share by reason of the death or bankruptcy of the holder, shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not, unless the articles otherwise provide, before being registered as a member in respect of the share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company:

Provided that the directors may at any time give notice requiring any such person to elect either to be registered himself or to transfer the share, and if the notice is not complied with within 90 days the directors may thereafter withhold payment of all dividends, bonuses or other moneys payable in respect of the share until the requirements of the notice have been complied with.'

## 9.4 HOW OTHER STATUTORY REQUIREMENTS COULD BE DETERMINED

Statutory requirements could be determined by perusing the Memorandum of Association and the Articles of Association. In case of private companies, it should be noted that transfer of shares is often restricted.

## 9.5 TESTS FOR COMPLIANCE WITH STATUTORY AND OTHER REQUIREMENT FOR THE TRANSFER OF SHARES

Tests of compliance with statutory requirements are carried out by;

- (i) Reviewing statutes such as the Companies and Allied matters Act, 1990, the companies Memorandum of Association and the Article of Association;

- (ii) Reviewing regulatory laws such as the Investment and Securities Act, 2007, Banking and Other Financial Institutions' Act, 2004, the Insurance Act, Central Bank laws, pronouncements by the Nigerian Deposit Insurance Corporation rules etc;
- (iii) Reviewing minutes and resolutions relating to share transfer with the audit period;
- (iv) Evaluating the internal control measures relating to transfer of shares in the company;
- (v) Collecting data relating to shares transferred during the financial year;
- (vi) Where the internal control is deemed sufficiently adequate, substantive tests may not be required. Transactional tests may be sufficient. Otherwise substantive tests should be carried out.

## 9.6 THE PROCESS OF SHARE TRANSFER AUDIT

The following procedure may be adopted:

- (i) Obtain background information on how shares could be transferred in the company, given the Memorandum of Association, the Articles of Association and the Companies and Allied Matters Act, 1990;
- (ii) Obtain share transfer forms and confirm proper endorsement by the parties – the transferors and the transferees;
- (iii) Verify the signature of the transferor, from share purchase forms, previous transfers or bank confirmation;
- (iv) Obtain and review the register of shareholders to ensure that transfers have been properly effected;
- (v) Verify that the original certificate has been cancelled and a new one issued in replacement bearing the identity of the transferee;
- (vi) Where part transfer was effected, the figures should be reconciled;
- (vii) Where the transfer is substantial, confirmation may be required from the transferor;
- (viii) Where applicable, it should be verified that the transactions have been properly stamped according to the Nigerian Stock Exchange (NSE) or other government regulations;
- (ix) If the shares had been demutualized, balancing figures should be traced to the respective accounts of the relevant parties with the Central Security Control System;
- (x) Where possible, independent data should be collected from the NSE and compared to returns from the Registrar on share transfers for the period involved.
- (xi) Consider likely areas where fraud could be introduced into the share transfer process based on an objective evaluation of the requisite internal control system;
- (xii) Report on your finding suggesting how to improve the procedure.

## QUIZZES

1. ....is a willful conveyance of ownership of shares from a transferor to a named transferee by sale or ...
2. Sections 151 to .....deal with share transfer.
3. By reason of section 146 (7) of CAMA CAP C20 LFN 2004, a common tread between share transfer and share transmission is that.....
4. One procedure in share transfer audit is .....
5. A procedural difference between a share transfer and a share transmission is that .....

## REVISION QUESTIONS

1. What is transfer of shares? State how it differs from transmission of shares.
2. Write briefly on the position of CAMA, 1990 on transfer and transmission of shares.
3. Indicate five steps you will take to execute a share transfer audit.
4. State the steps you would take to carry out a transmission of shares audit in a private limited company.
5. Explain why tests of compliance are essential in share transfer audit.

Show how you would execute tests of compliance regarding share transfer audit in a conglomerate listed in the Nigerian Stock Exchange

## ASSIGNMENTS

1. (a) State one similarity and one difference between transfer of shares and transmission of shares.  
  
(b) Indicate the relevant sections of CAMA 1990 to justify your position in (a) above.
  
2. (a) Explain the audit risks involved in auditing transfer of shares in a company in an accounting year.  
  
(b) Ojulari invested N120,000 in shares of JKN Plc at N15 per unit on June 4, 2010. On July 16, 2013 he disposed of all the shares at N87 each. Indicate five steps you would take to verify the transfer.