SOLUTION AUDIT AND INTERNAL REVIEW MAY 2007

QUESTION 1

(a) According to the provisions of Section 134(4) of the Companies Code, 1963, Act 179

(i) Auditors of a company shall be appointed by shareholders by an ordinary resolution not withstanding any provision to the contrary

(ii) The directors may appoint the first auditors of the company and may fill any casual vacancy in the office of auditors

(iii) If a company shall have no auditors for a continuous period of three months the Registrar may appoint auditors for the company.

(b) (i) Auditor's remuneration include the fees and sums paid or payable by the company in respect of auditors expenses

(ii) In the case of the auditors appointed by the directors their remuneration may be fixed by the directors for the period expiring at the conclusion of the next Annual General Meeting of the company

(iii) In the case of the auditors appointed by the Registrar, the Registrar may fix their remuneration for the period expiring at the conclusion of the next Annual General Meeting of the company

(iv) Subject to the above, the remuneration of the auditors shall be fixed by an ordinary resolution of the company or in such manner as the company by ordinary resolution may determine.

(c) The responsibilities of the directors in relation to the accounting function of the company include:

(i) to ensure that the company keeps proper accounting records as required by the Companies Code, 1963, Act 179.

(ii) to safeguard the company's assets and to prevent and/or detect fraud, errors and irregularities

(iii) to prepare annual financial statements to show a true and fair view of the state of the companies affairs at the end of its financial year and of the profit or loss of the company for its financial year

(iv) to deliver to the regulatory authorities a copy of the company's audited financial statements within the stipulated period after the financial year end of the company

(v) to set up internal control system in the company to ensure that all the above are carried out

(d) (i) The functions of Internal Audit may vary from one entity to another but may typically include:

(ii) Examination and evaluation of financial and operating information

(iii) Review of the economy, efficiency and effectiveness of operations including non-financial controls – value for money audit

(iv) Review of compliance with internal policies and external laws, statutes and regulations

(v) Risk assessment; and

(vi) Conduct of special investigations including fraud investigations.

QUESTION 2

(a) Substantive procedures over investments include:

(i) Confirm ownership of investments by reference to

- share certificates, correspondence with nominees etc
- payment for securities, brokers' bought notes or contract notes
- dividends/interest from investments

(ii) Confirm valuation by reference to:

- appropriate financial publications for listed securities
- directors valuation or audited accounts for unlisted companies
- consider whether provisions for impairment in value are adequate by examining copies of accounts of companies in which investment are held

(iii) Movements during the year should be confirmed by reference to:

- board approval for acquisitions or disposals
- transaction documents – brokers bought notes or contract notes

(iv) Confirm investment income by reference to:

- known interest rates for fixed interest securities
- share information service eg Ghana Stock Exchange for listed companies

(v) Check action taken on bonus and right issues in favour of the company

(vi) Check the classification, description and disclosure of investments and investment income in the financial statements

(vii) Ensure that the amount stated in the financial statements is in agreement with the accounting rewards.

(b) The audit of salaries and wages will include:

(i) Select at random a sample of employees from top management to junior staff

(ii) Check the rates of pay with letters of appointment increment letters etc

(iii) Where employees are paid on time basis agree the number of hours worked with time sheets clock cards etc

(iv) Check the arithmetical accuracy of the computation for the industrial employees selected

(v) Check the computation of tax liability and contribution to social security

(vi) Check the cast of the payroll

(vii) Tabulate from payroll summary the gross wages and allowances chargeable to expenses and compare with amounts in manufacturing trading and profit and loss account

(viii) Check the total cheques drawn and agree with total net pay due to employees

(ix) Ensure that directors fees are not charged to salaries and wages

(x) Check the postings to the ledger ensuring that the amounts charged to expenses and credited to PAYE accounts are current

(xi) Carry out analytical review procedures by comparing the current year’s monthly salaries and wages against previous years, or current year’s budget and investigate any unusual fluctuations or items.

QUESTION 3

(a) The term “audit software” describes the computer software used by auditors to assist them in their work when examining and testing the output of a computer-based accounting system.

(b) Functions performed audit software include:

(i) Highlighting of exceptions: used by the auditor to identify exceptional items eg payments outside stated parameters, for further inquiry

(ii) Calculation checks: to ensure revenue and costs are correctly totaled in the general ledger

(iii) Stratification of data: to divide a population of inventory lines etc with a view to examining only material items

(iv) Selection of items for testing: used by the auditor to select debtors and creditors for circularisation

(v) Performance of sequence checks: to verify completeness of information for example of sales reporting by ensuring that all invoices have been recorded.

(c) Benefits of computerized accounting system to a company:

(i) Enhance the timeliness, availability and accuracy of information

(ii) Facilitates the additional analysis of information

(iii) Enhance the ability to monitor the performance of a company’s activities and its polices and procedures

(iv) Reduces the rise that controls will be circumvented

(v) Consistently applies pre-determined business rules and performs complete calculations in processing large volumes of transactions or data

(vi) Enhances the ability to achieve effective segregation of duties by implementing security controls in applications, data bases and operating systems.

(d) The circumstances giving rise to a qualification of opinion will generally fall into one of the two categories:

(i) Where there is an uncertainty which prevents the auditor from forming an opinion on a matter.

This may result from:-
- limitation on the scope of work
- inherent uncertainty

(ii) Where the auditor is able to from an opinion on a matter but this conflicts with the view given by the financial statements. This may arise from:-

- disagreement on acceptable accounting policies
- disagreement on facts
- disagreement on nature and form of disclosure
- non-compliance with relevant legislation and reporting standards

In both cases the effect of the matter must be material to result in the issue of a qualified opinion.

QUESTION 4

(a) The objectives of adequate audit planning include:

(i) it helps to ensure that the intended means of achieving the audit objectives are established
(ii) appropriate attention is devoted to important areas of the audit
(iii) potential problems are promptly identified
(iv) the work can be completed expeditiously
(v) facilitation of easy co-ordination of work.

(b) The importance of analytical review technique for gathering audit evidence include:

(i) it is needed at the planning stage to identify initial audit areas such as new development
(ii) it is used to obtain evidence and help manage the audit
(iii) it guides the auditor as to whether his conclusion arrived at can be supported. This done at the review stage
(iv) cost – effectiveness: it is cheap but requires high quality staff and the use of computer audit software
(v) it is mandatory – the Ghana National Standards on Auditing states that is mandatory.

(c) Types of analytical devices include:

- Ratio analysis
- Trend analysis
- Time series modeling
- Regressing analysis
- Financial modeling
- Decrement analysis such as Z-scores

- Reasonableness tests

(d) If the management refuses to sign a letter of representation, the auditor should:

- Seek reasons for the refusal
- Point out that such a letter forms an important part of audit evidence and that refusal to sign costs doubt upon the accuracy of the financial statements
- Send to the client a summary of his understanding of the representations made to him and ask the client to confirm or notify him of any part of those representations which the client does not accept
- If the management still refuses to reply to the auditors letter or to provide their own letter of representation, the auditor should consider what effect this will have upon audit procedures and the opinion in his report
- The auditor should discuss the legal implications with his legal counsel
- The auditor may consider resigning.

(e) The letter of representation should be dated as close as possible to the date of the signing of the audit report. It should never be dated after the date of signing of the auditors report because it is part of the evidence the auditor uses in arriving at his opinion.

QUESTION 5

(i) Random Sample Selection Method

(1) This is a method of sample selection in which items in a population have the same statistical probability of being selected

(2) The method involves the use of random number tables or computer-generated random numbers

(3) It can be used for both tests of control and substantive tests

(4) This method of selection is appropriate in both statistical and non-statistical sampling but is often more time consuming than other sample selection methods.

(ii) Walk-through test.

(1) This is a test of the recording of transactions to determine if the auditor has obtained a current description and understanding of the client's system

(2) It involves taking a few transactions of each type and training them through every stage of the transaction cycle. For example training a purchase transaction from purchase requisition to settlement of the suppliers invoice

(3) The objective is not to test the effectiveness of the system but that the auditor has obtained correct description and understanding of the system.

(iii) Materiality

(1) Information is material ifhyu its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements

(2) There is an inverse relationship between materiality and the level of audit risk. The higher the materiality, the lower the audit risk and vice versa.

(3) In essence determing what is material is the exercise of professional judgement to override the conventions in accounting in the interest of clearity of presentation to the users of the accounting information

(4) It involves the use of judgement to disclose what needs to be disclosed and to omit the trivial or irrelevant in order to make the financial information more meaningful to users

(5) It deals with qualitative and quantitative factors. Qualitative aspects include inaccurate or inadequate description of an accounting policy

(6) Quantitatively an amount of say ¢10 million may be absolutely immaterial in the accounts of a large company whereas in small company the reserve would probably be true.

(iv) Audit Risk

(1) Audit risk is the risk that the auditor expresses an inappropriate audit opinion on the financial statements. He may qualify his opinion when the financial statements give a true and fair view or he may express an unqualified opinion when the financial statements do not give a true and fair view.

(2) Inherent risk – the susceptibility of an assertion to a misstatement, that could be material, individually or when aggregated with other misstatements assuming that there were no related internal controls

(3) Control risk – the risk that a misstatement that could occur in an assertion that could be material, individually or when aggregated with other misstatements, will not be prevented or detected and corrected on a timely basis by the entity's internal control

(4) Detection risk – the risk that the auditor's procedures will not detect a misstatement that exists in an assertion that could be material, individually or when aggregated with other misstatements