NOVEMBER 2019 PROFESSIONAL EXAMINATION
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME

STANDARD OF THE PAPER

The standard of the paper is fairly high. The verbs used in setting the questions include appraise, recommend, prepare a checklist, discuss, analyse and evaluate. Candidates were tasked to use analytical and practical applications to skills to answer the questions. The paper covered a substantial aspect of the syllabus. However area such as quality control, corporate governance, should have been examined.

The solutions adequately responded to the requirements of the questions. The marking scheme based on the solutions was structured with fairness to the candidates in mind.

PERFORMANCE OF CANDIDATES

Looking at level of difficulty of the questions candidates were expected to have performed very poor but that was not the case. It appeared some candidates did take their time to understand the requirements of the questions. Questions were practically oriented which is excellent. This time candidates did not stray with the columns reserved for examiners and moderators in the answer booklets. However some candidates continue to put page numbers in the space for question numbers which confused examiners.

The practical nature of the questions resulted in higher performance by candidates. Performance this session was better than the performance in the previous sessions. This is evident from the percentage passes achieved in the three sessions – November 2018 pass rate was 37%, May 2019 pass rate was 42%, whilst the current pass rate for November 2019 was 67%.

It was evident that many candidates have the knowledge but lack the ability or skill to apply the knowledge to solve problems.

QUESTION ONE

a) Asumasi Opoku has recently been appointed as a partner of Offei-Ansah & Co, a firm of Chartered Accountants. He has been a close friend of the Engagement Partner (EP), the firm's managing partner for many years. Asumasi was previously the training manager in the firm and he has now been asked to act as training partner. This is the first time Offei-Ansah & Co have designated a particular partner as having responsibility for training.

One of the audit trainees, Ellen Danso, noted that she was disturbed by something that had happened on an audit of a company called Bremang Ltd, a medium-sized family-run business and longstanding client of Offei-Ansah & Co.

Ellen was auditing purchases of non-current assets when she noticed a transaction that she thought might be suspicious. There was a charge of GH¢125,000 (an individually material amount) for a Power Plant for an address in a rural area (no electricity) with no obvious link to the company. When she asked Bremang's financial controller about the matter, she was told it referred to the installation of such a plant in a house owned by the Chief Eexecutive Officer (CEO). This was to facilitate excellent communications and interaction with the CEO especially during the last quarter of the year when he liked to reside there with his family. She further explained that part of the cost was attributed to having to pay for a personal broadband connection since the house was in an isolated area where normal broadband connections were unavailable.

The financial controller appeared surprised and even irritated by the queries about the matter and said that auditors had not previously been concerned about the company being charged for non-current assets and operational expenses at properties owned by the CEO.

The engagement partner on the assignment happened to be the managing partner. Ellen told him what she had found and the Engagement Partner simply said that the charge could probably be ignored. He did, however, say that he would include a reference to the matter in the written representations letter required by ***ISA 580: Written Representations*** adding with a smile that "paper never refused ink". About two months later, Ellen looked at the completed files and the letter of representation in which there was no reference to the matter.

When Asumasi Opoku heard about Ellen's concerns, he realised that there was an ethical issue. At the very least the transaction should have been disclosed as a related party transaction under ***IAS 24: Related Party Disclosures*** but the situation was made more complicated by the fact that the Engagement Partner was (for all practical purposes) still Asumasi's boss in Offei-Ansah & Co.

Required:

i) Explain **TWO (2)** reasons why integrity in professional relationships such as those described in the above scenario. **(2 marks)**

ii) Evaluate **FOUR (4)** ethical and professional behaviour issues relating to the stance of the Engagement Partner. **(8 marks)**

b) You are a partner in a two-partner practice in a small rural town in Ashanti Region. Some local community groups recently got together and established a Non-Governmental Organisation (NGO). It aims to reduce poverty and inequality by supporting, influencing and advocacy around three interconnected pillars; Agriculture, Essential Services and Extractive Industry Governance.

The organisation is registered as a charity with a legal requirement to reinvest any excess of income over expenditure into the operation, or into other local community initiatives, as the management committee sees fit. The organisation is run by a management committee consisting of a member of the community council, the principal of the local school, two local business people and the Parish Priest. Although, between them, they have considerable experience of various ‘for-profit’ and ‘not-for-profit’ ventures, none has particular experience of managing NGOs or charity organisations. The organisation is run on a day-to-day basis by the manager who is the only full-time employee experienced in the type of businesses involved. There is one other paid part-time employee - the assistant manager - but all other staff are volunteers.

It has been just over a year since the NGO was incorporated, and you are approached by a member of the management committee (a local business owner who is also one of your largest clients) to become the auditor of the NGO. He tells you that the committee, of course, would not expect you to provide this service entirely pro bono (free of charge). He also mentions that he knows you wouldn’t want to be seen to turn down this opportunity, given the way that “news can travel around in a small town”.

He is well aware that, the revenue generated by the organisation is very low. The committee feels that the absence of an audit could be perceived as “negligent” or a “cover up” should any problems involving, for example, the misappropriation of assets emerge in the future.

Required:
Evaluate **FIVE (5)** challenges and other risks presented to your practice as a result of the request from your client to become the auditor of this NGO. **(10 marks)**

(Total: 20 marks)

QUESTION TWO

Retail Specialist Co. Ltd (RSCL) is a large company, operating in the retail industry, with a year ended 31 December, 2018. You are a manager in Jen & Co, responsible for the audit of Retail Specialist Co. Ltd (RSCL), and you have recently attended a planning meeting with Olivia Danso, the finance director of the company. As this is the first year that your firm will be acting as auditor for Retail Specialist Co. Ltd (RSCL), you need to gain an understanding of the business risks facing the new client. Notes from your meeting are as follows:

Retail Specialist Co. Ltd (RSCL) sells clothing, with a strategy of selling high fashion items under the RSCL brand name. New ranges of clothes are introduced to stores every eight weeks. The company relies on a team of highly skilled designers to develop new fashion ranges. The designers must be able to anticipate and quickly respond to changes in consumer preferences. There is a high staff turnover in the design team.

Most sales are made in-store, but there is also a very popular catalogue, from which customers can place an order on-line, or over the phone. The company has recently upgraded the computer system and improved the website, at significant cost, in order to integrate the website sales directly into the general ledger, and to provide an easier interface for customers to use when ordering and entering their credit card details. The new on-line sales system has allowed overseas sales for the first time.

The system for phone ordering has recently been outsourced. The contract for outsourcing went out to tender and Retail Specialist Co. Ltd (RSCL) awarded the contract to the company offering the least cost. The company providing the service uses an overseas phone call centre where staff costs are very low.

Retail Specialist Co. Ltd (RSCL) has recently joined the Ethical Trading Initiative. This is a ‘fair-trade’ initiative, which means that any products bearing the RSCL brand name must have been produced in a manner which is clean and safe for employees, and minimises the environmental impact of the manufacturing process. A significant advertising campaign promoting Retail Specialist Co. Ltd (RSCL)’s involvement with this initiative has recently taken place. The RSCL brand name was purchased a number of years ago and is recognised at cost as an intangible asset, which is not amortised. The brand represents 12% of the total assets recognised on the statement of financial position.

The company owns numerous distribution centres, some of which operate close to residential areas. A licence to operate the distribution centres is issued by each local government authority in which a centre is located. One of the conditions of the licence is that deliveries must only take place between 8 am and 6 pm. The authority also monitors the noise level of each centre, and can revoke the operating licence if a certain noise limit is breached. Two licences were revoked for a period of three months during the year.

To help your business understanding, Olivia Danso has e-mailed to you extracts from the draft statement of comprehensive income, and the relevant comparative figures, which are shown below.

Extract from draft Statement of Comprehensive Income

Year ending 31 December	2018 Draft	2017 Actual
	GH¢ million	GH¢ million
Revenue: Retail outlets	1,030	1,140
Phone and on-line sales	425	395
Total revenue	1,455	1,535
Operating profit	245	275
Finance costs	(25)	(22)
Profit before tax	220	253
Additional information:		
Number of stores	210	208
Average revenue per store	GH¢ 4·905 million	GH¢ 5·77 million
Number of phone orders	680,000	790,000
Number of on-line orders	1,020,000	526,667
Average spend per order	GH¢ 250	GH¢ 300

Required:

a) Prepare briefing notes to be used at a planning meeting with your audit team, in which you evaluate **FIVE (5)** business risks facing Retail Specialist Co. Ltd (RSCL) to be considered when planning the final audit for the year ended 31 December 2018. **(10 marks)**

b) Using the information provided, identify and explain **FIVE (5)** risks of material misstatements that may affect the financial statements you are going to audit. **(10 marks)**

(Total: 20 marks)

QUESTION THREE

You are the manager responsible for the audit of CGL, a public interest entity, for the year ended 31 December 2018. Your firm was appointed as auditors of CGL in September 2017. The audit work has been completed, and you are reviewing the working papers in order to draft a report to those charged with governance. The statement of financial position (balance sheet) shows total assets of GH¢ 78 million (2017 – GH¢ 66 million). The main business activity of CGL is the manufacture of farm machinery.

During the audit of property, plant and equipment it was discovered that controls over capital expenditure transactions had deteriorated during the year. Authorisation had not been granted for the purchase of office equipment with a cost of GH¢ 225,000. No material errors in the financial statements were revealed by audit procedures performed on property, plant and equipment.

An internally generated brand name has been included in the statement of financial position (balance sheet) at a fair value of GH¢10 million. Audit working papers show that the matter was discussed with the financial controller, who stated that the GH¢ 10 million represents the present value of future cash flows estimated to be generated by the brand name. The member of the audit team who completed the work programme on intangible assets has noted that this treatment appears to be in breach of IAS 38 Intangible Assets, and that the management refuses to derecognise the asset.

Problems were experienced in the audit of inventories. Due to an oversight by the internal auditors of Charged with Governance Limited (CGL), the external audit team did not receive a copy of inventory counting procedures prior to attending the count. This caused a delay at the beginning of the inventory count, when the audit team had to quickly familiarise themselves with the procedures. In addition, on the final audit, when the audit senior requested documentation to support the final inventory valuation, it took two weeks for the information to be received because the accountant who had prepared the schedules had mislaid them.

Required:

a) Identify **FIVE (5)** purposes of including 'findings from the audit' (management letter points) in a report to those charged with governance. **(5 marks)**

b) From the information provided above, identify the matters which should be included as 'findings from the audit' in your report to those charged with governance, and explain the reason for their inclusion. **(15 marks)**

(Total: 20 marks)

QUESTION FOUR

a) The framers of the 1992 Republican Constitution of Ghana realised that the Controller and Accountant General and the Auditor- General alone cannot completely ensure the proper use and accountability of resources of Ghana. It is in this vein that Parliament has also been assigned some responsibility in the respect.

Required:
Assess the role of Parliament under the constitution in ensuring judicious use of the resources and proper accountability. **(10 marks)**

b) To ensure that government business is carried out properly in Ministries Department and Agencies (MDAs) and Metropolitan, Municipal and District Assemblies (MMDAs) the Auditor-General may carry out compliance audit and report the outcome to the auditee and Parliament.

Required:
i) Explain compliance audit in relation to MMDAs. **(2 marks)**
ii) Assess the basis for the conduct of compliance audit in MMDAs. **(4 marks)**
iii) Discuss the main information that should be contained in the compliance audit report **(4 marks)**

(Total: 20 marks)

QUESTION FIVE

a) Recently one of your clients in the financial service sector has had its ICT system hacked and large sums of depositors' funds stolen. He called and inform you about what happened. You intimated to him that his company needs a cyber security policy and cyber security audit. He requested a briefing on the issue.

Required:
i) Outline the purposes of cyber security policy **(5 marks)**
ii) Explain cyber security audit and what it is intended to achieve **(5 marks)**

b) You are the manager responsible for the audit of Obeyeyie Co. Ltd (OCL), a manufacturing company with a year ended 31 December 2018. The audit work has been completed and reviewed and you are due to issue the audit report in three days. The draft audit opinion is unmodified. The financial statements show revenue for the year ended 31 December 2018 of GH¢ 15 million, net profit of GH¢ 3 million, and total assets at the year-end are GH¢ 80 million.

The finance director of OCL e-mailed you this morning in addition to a whatsapp message to tell you about the announcement yesterday, of a significant restructuring of OCL, which will take place over the next six months. The restructuring will involve the closure of a factory, and its relocation to another part of the country. There will be some redundancies and the estimated cost of closure is GH¢ 250,000. The financial statements have not been amended in respect of this matter.

Required:

In respect of the announcement of the restructuring:

i) Comment on the financial reporting implications, and advise the further audit procedures to be performed; and **(6 marks)**

ii) Recommend the actions to be taken by the auditor if the financial statements are not amended. **(4 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)

OFFEI-ANSAH & CO.

Integrity is vital in professional relationships because:

- It provides assurance to colleagues of good intentions and truthfulness. It goes beyond any codes of professional behaviour and describes a set of character traits that mean a person of integrity can be trusted. In this particular case it means that the Engagement Partner (EP) is obliged to do his best for his clients; for his fellow partners; and also for his staff. Conflicts will inevitably arise but they should be dealt with in an honest and straightforward way. From the above scenario, there is evidence of EP not acting in this way and "fobbing off" Ellen when she raises important issues with him.
- Time and energy spent in monitoring can be reduced when integrity and openness can be assumed (the opposite of an audit situation where the professional scepticism should be exercised). The Engagement Partner is the managing partner and, if he cannot be trusted, this undermines the control environment in the audit firm.
- It cultivates good working relationships in professional situations. It encourages a culture of mutual support that can have a beneficial effect on organisational effectiveness. Once again, EP's apparent lack of professional integrity threatens to undermine this.

(Any 2 points well explained for 2 marks)

ii)

- The first point to be noted about the EP's behaviour in this case is that it gives the impression of unprofessionalism and possibly, even, of corruption. GH¢125,000 is an individually material amount but notwithstanding the amount, the allocation of company funds on what could be little more than an expensive plaything for the CEO's children is something that should be challenged.

- The EP's failure to act on the information strongly suggests that he has failed in his duty to other users of Bremang's financial statements such as lenders and even the taxation authorities. EP may not feel a duty of care towards, for example, Revenue but financial statements should not be signed off unless they show a "true and fair view". The risk of, for example, the practice being censured in some way by the Revenue may be low but that does not reduce the imperative to act with integrity.

- The EP promised Ellen that he would, at least, get a written representation on the matter - albeit he seemed to downplay the significance of this - but in the end he apparently failed to do even that and again was dismissive of Sarah when she challenged him on the matter.

- The EP, therefore, gave the appearance of a lack of objectivity in his actions, possibly as a result of the threats to independence. This shows a lack of respect for Ellen's professionalism and could lead her to develop a "why bother?" attitude if a similar issue arises in the future. Ellen will therefore possibly be lead into a poor professional attitude herself or, alternatively, become disillusioned with the firm and will seek alternative employment as soon as she can.

- The EP is complicit in a probable breach of IAS 24 on Related Party Transactions. There is a disclosure requirement of all related party transactions regardless of value, and concealment of this is both unprofessional and technically irregular. Lack of disclosure should have led to a qualified opinion on the basis of material misstatement in the audit report.

(4 points @ 2 marks each = 8 marks)

b) **Challenges and other risks presented to your practice as a result of the request from your client to become the auditor of this NGO**

- The audit risk of this charity is likely to be high due to its size and consequent difficulty of implementing adequate controls (e.g. segregation of duties, supervision); due to the lack of the experience of the management committee of this particular type of business; and due to the fact that many of the staff are volunteers. This could lead to excessive reliance on the only paid members of staff – the manager and the assistant manager.

- In this case the client is pressurising the auditor to take on the audit of a small charity in which they are involved and do so for less than the full commercial fee. This puts the auditor in a difficult position and amounts (almost) to an intimidation threat to the auditor's independence.

- It also raises a wider question of auditors doing work pro bono for charities or other good causes and brings up the issue of how this affects their independence. One view might suggest that never collecting a fee from the client would enhance independence since, if the auditor withdraws from the audit, or modifies the audit report, it will have no direct financial consequences for the audit firm.

- Another view would be that it would be much better if auditors charged in full for all work they did. They could still, as a firm, make charitable donations to perceived good causes, or for example, sponsor local fundraising events, but the decision to do that should be at arm's length from any particular dealings with an individual client.
  In this case, there is the need to consider if the fact that the request came from a committee member who is a client has any particular impact on the audit of that client. It might be going too far to suggest that it impugns the individual's integrity but it certainly suggests a willingness on his behalf to use his relationship with the audit firm in a way that might not be considered wholly appropriate.

- Also, there is a heightened risk of bad publicity if anything goes wrong due to the fact that this is a charity and there could be significant publicity locally about the matter.

(5 points well explained @ 2 marks each = 10 marks)
(Total: 20 marks)

EXAMINER'S COMMENTS

- Q1. This question comprised two sub-questions with total marks of 20. Knowledge and understanding of professional ethics, and Challenges and other risk in practice of auditing NGO. Section A was answered well whilst section B was poorly answered.
- 1A i. Some candidates were able to appraise the relevant matters and gave the required ethical guidance required.
- 1 A ii. Many candidates were able to provide the right answers of the role of the engagement partner required by the examiner.
- 1 B. This question involved challenges of the auditor in auditing NGO. A lot of students could not understand the question.

QUESTION TWO

a)

Briefing notes

Subject: Business risks facing Retail Specialist Co. Ltd (RSCL)

Introduction

These briefing notes evaluate the business risks facing our firm's new audit client, Retail Specialist Co. Ltd (RSCL), which operates in the retail industry, and its year under review ended 31 December 2018.

Ability to produce fashion items

The company is reliant on staff with the skill to produce high fashion clothes ranges, and also with the ability to respond quickly to changes in fashion. If Retail Specialist Co. Ltd (RSCL) fails to attract and retain skilled designers then the clothing ranges may not be desirable enough to attract customers in the competitive retail market. The high staff turnover in the design team indicates that Retail Specialist Co. Ltd (RSCL) struggles to maintain consistency in the design team. This could result in deterioration of the brand name and, ultimately, reduced sales.

There would be a high cost associated with frequently recruiting – this would have an impact on operating margins.

Inventory obsolescence and margins

There is a high operational risk that product lines will go out of fashion quickly, because new ranges are introduced so quickly to the stores (every eight weeks), leading to potentially large volumes of obsolete inventory. These product lines may be marked down to sell at a reduced margin. The draft results show that operating margins have already reduced from 17·9% in 2017 to 16·8% in 2018. Any significant mark down of product lines will cause further reductions in margins.

Wide geographical spread of business operations

Retail Specialist Co. Ltd (RSCL) operates a large number of stores, many distribution centres, and has an outsourced function which is located overseas. This type of business model could be hard to control, increasing the likelihood of inefficiencies, systems deficiencies, and theft of inventories or cash.

E-commerce – volume of sales

On-line sales now account for GH¢ 255 million (GH¢ 250 per order x 1,020,000 orders). In the previous year, on-line sales accounted for GH¢ 158 million (GH¢ 300 per order x 526,667 orders). This represents an increase of 61·4% (255 – 158/158 x 100%). One of the risks associated with the on-line sales is the scale of the increase in the volume of transactions, especially when combined with a new system introduced recently. There is a risk that the system will be unable to cope with the volume of transactions, leading possibly to unfilled orders and dissatisfied customers. This would harm the reputation of the company and the RSCL brand.

The company has recently upgraded its computer system to integrate sales into the general ledger. A disaster plan should have been put into place, for use in the event of a system shutdown or failure. The risk is that no plan is in place and the business could lose a substantial amount of revenue in the event of the system failure.

E-commerce – security of systems
It is crucial that the on-line sales system is secure as customers are providing their credit card details to the site. Any breach of security could result in credit card details being stolen, and Retail Specialist Co. Ltd (RSCL) may be liable for losses suffered by customers if their credit card details were used fraudulently. There would clearly be severe reputational issues in this case. Additionally, the system must be secure from virus infiltration, which could cause system failure, interrupted sales, and loss of customer goodwill.

E-commerce – tax and regulatory issues
There are several compliance risks, which arise due to on-line sales. Overseas sales expose Retail Specialist Co. Ltd (RSCL) to potential sales tax complications, such as extra tax to be paid on the export of goods to abroad, and additional documentation on overseas sales that may be needed to comply with regulations. Another important regulatory issue is that of data protection. Retail Specialist Co. Ltd (RSCL) faces the risk of non-compliance with any data protection regulation relevant to customers providing personal details to the on-line sales system.

Retail Specialist Co. Ltd (RSCL) is now making sales overseas. If these sales are made in a different currency to Retail Specialist Co. Ltd (RSCL)'s currency, the business will be exposed to exchange rate fluctuations which will have an impact on the company's profit margin.

Outsourcing of phone ordering system
The fact that Retail Specialist Co. Ltd (RSCL) engaged the outsource provider offering the least cost could lead to business risks. Staff at the call centre may not be properly motivated, due to low wages being paid, and may fail to provide a quality service to Retail Specialist Co. Ltd (RSCL)'s customers, leading to loss of customer goodwill. As the call centre is overseas, the staff may have a different first language to Retail Specialist Co. Ltd (RSCL)'s customers, leading to customer frustration if they are not understood, and incorrect orders possibly being made. In addition, there may be staff shortages due to the low wage offered, leading to delay in answering calls and lost sales.

Overseas call centres are not always popular with customers, so Retail Specialist Co. Ltd (RSCL) may find that fewer customers use this method of purchase. However, the on-line system is there as an alternative for customers, and is proving popular, so this may not be a significant risk for the company.

The fact that Retail Specialist Co. Ltd (RSCL) opted for the lowest cost provider for the phone ordering system could pose a potential problem in that the provider may not be sustainable in the long term. If the provider fails to generate sufficient profit or cash, it may shut down, leaving Retail Specialist Co. Ltd (RSCL) without a crucial part of the sales generating system.

Ethical Trading Initiative
Retail Specialist Co. Ltd (RSCL) has aligned itself to an initiative supporting social and environmental well-being, presumably to promote its corporate social responsibility. The risk associated with this is that the claims that products have been produced in a responsible way can easily be undermined if the supply chain is not closely managed and monitored. Such claims are often closely scrutinised by the public and pressure groups, and any indication that Retail Specialist Co. Ltd (RSCL)'s products have not been sourced responsibly will lead to loss of customer goodwill and waste of expenditure on the advertising campaign.

Distribution centres
There is a risk of non-compliance with the operating licence issued by the local government authority. The authority will monitor the operating hours of the distribution centres, and also the noise levels created by them. Breaches of the terms of the licence could lead to further revocations of licences, causing huge operational problems for Retail Specialist Co. Ltd (RSCL) if the centres are forced to close for any period of time. Fines and penalties may also be imposed due to the breach of the licence.

Financial performance
Total revenue has decreased by GH¢ 80 million, or 5·2% (80/1,535 x 100). Operating profit has also fallen, by GH¢ 30 million, or 10·9% (30/275 x 100). The information also shows that the average spend per order has fallen from GH¢ 300 to GH¢ 250. These facts may signify cause for concern, but operating expenses for 2010 are likely to include one-off items, such as the costs of the new on-line sales system, and the advertising of the 'fair-trade' initiative. The fall in spend per customer could be a symptom of general economic difficulties. The company has increased the volume of on-line transactions significantly; so on balance the overall reduction in profit and margins is unlikely to be a significant risk at this year-end, though if the trend were to continue it may become a more pressing issue.

Retail Specialist Co. Ltd (RSCL)'s finance costs have increased by GH¢ 3 million, contributing to a fall in profit before tax of 13%. The company has sufficient interest cover to mean that this is not an immediate concern, but the company should ensure that finance costs do not escalate.

Conclusion
Retail Specialist Co. Ltd (RSCL) faces a number of operational and compliance risks, the most significant of which relate to the need for constant updating of the product lines and the potential for obsolete inventory. The new on-line sales

system also raises risks in terms of security, systems reliability and the sheer volume of transactions. Retail Specialist Co. Ltd (RSCL) must also carefully manage the risk of non-compliance with local government authority regulations. The trend in financial performance should be carefully monitored, as further reductions in revenue and margins could indicate that a change in business strategy is needed.

(5 points well explained @ 2 marks each = 10 marks)

b) **Risk of material misstatements**

Valuation of inventory

High fashion product lines are likely to become out-of-date and obsolete very quickly. Retail Specialist Co. Ltd (RSCL) aims to have new lines in store every eight weeks, so product lines have only a short shelf life. Per IAS 2 Inventories, inventory should be valued at the lower of cost and net realisable value, and could be easily overvalued at the year-end if there is not close monitoring of sales trends, and necessary mark downs to reflect any slow movement of product lines. The decline in revenue could indicate that the RSCL brand is becoming less fashionable, leading to a higher risk of obsolete product lines.

Orders made over the phone or by the internet are prone to higher levels of returns than items purchased in a store, as the customer may find that the item is not the correct size, or they do not like the item when it arrives. The risk is insufficient provision has been made in the financial statements for pre year-end sales being returned post year-end.

Completeness/existence of inventory

Retail Specialist Co. Ltd (RSCL) has 210 stores and numerous distribution centres. It may be hard to ensure that inventory counting is accurate in this situation. There may be large quantities of inventory in-transit at the year-end, which may be missed from counting procedures, meaning that the inventory quantities are incomplete. Equally, it may be difficult for the auditor to verify the existence of inventory if it cannot be physically verified due to being in-transit at the year-end. Inventory could be the subject of fraudulent financial reporting, as it would be relatively easy for management to 'inflate' quantities of inventory to increase the amount recognised on the statement of financial position. The clothing items could also be at risk of theft, making inventory records inaccurate.

Unrecorded revenue

The on-line and phone sales systems could contribute to a risk of misstated revenue figures. Firstly, the on-line sales system is integrated with the general ledger, so sales made through the system should automatically be recorded in the accounting system. However, the system is new, and it is possible that the integration is not functioning as expected. The scenario does not state whether the phone sales system is integrated, but it is unlikely given that the function is outsourced, so a similar risk of unrecorded transactions may arise here.

Sales made in store will include a proportion of cash sales. The risk is that the cash could be misappropriated, and the revenue unrecorded.

Over-capitalisation of IT/website costs
The on-line sales system has been upgraded at significant cost. There is a risk that costs have been incorrectly capitalised. SIC 32 Intangible Assets – Website Costs states that only costs relating to the development phase of the project should be capitalised, but costs of planning, and all costs when the website is operational should be expensed. Software development costs follow similar accounting principles. Hence there is a risk of overvalued assets and unrecognised expenses.

Overvaluation of the brand name
The RSCL brand name is recognised as an intangible asset, which is the correct accounting treatment for a purchased brand. The risk is that the asset is overvalued, for two reasons. Firstly, if no amortisation is being charged on the asset, management are assuming that there is no end to the period in which the brand will generate an economic benefit. This may be optimistic, and there is a risk that the brand is overvalued, and operating expenses incomplete if there is no annual write-off. An intangible asset which is not being amortised should be subject to an annual impairment review according to IAS 38 Intangible Assets. If no such review has been conducted, the asset could be overvalued. The falling revenue figures could indicate that the asset is overvalued.

Secondly, a significant amount has been spent on promoting the brand name during the year. This amount should be expensed, and if any has been capitalised, the brand is overvalued, and operating expenses incomplete.

Overvaluation of properties
There are two indications from the scenario that properties may need to be tested for impairment, and so could be overvalued. The first is the potential for distribution centres' operating licences to be revoked. If this were to occur, the asset would cease to provide economic benefit, triggering the need for an impairment review. Secondly, the average revenue per store has fallen. IAS 36 Impairment of Assets suggests that worse economic performance than expected is an indicator that an asset could be impaired. For these reasons, both stores and distribution centres have the potential to be overvalued.

Unrecognised provision/undisclosed contingency
The revocation of an operating licence could lead to a fine or penalty being paid to the local authority. Two licences have been revoked during the year. The risk is that Retail Specialist Co. Ltd (RSCL) has not either provided for any amount payable, or disclosed the existence of a contingent liability in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Opening balances and comparative figures
As this is our first year auditing Retail Specialist Co. Ltd (RSCL), extra care should be taken with opening balances and comparative figures, as they were not audited by our firm. Additional audit procedures will need to be planned.

(5 points well explained @ 2 marks each = 10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
Q2 (ai-ii) – These two sub-questions were to identify (A) Business Risk in planning the final audit and (B) Identifying the Risk of material misstatement. Many candidates were able to provide right answers. Best answered question.

QUESTION THREE

a) Purposes of including findings from audit

- A report to those charged with governance is produced to communicate matters relating to the external audit to those who are ultimately responsible for the financial statements.

- **ISA 260 Communication of Audit Matters with those charged with governance** requires the auditor to communicate many matters, including independence and other ethical issues, the audit approach and scope, the details of management representations, and the findings of the audit. The findings of the audit are commonly referred to as management letter points.

- By communicating these matters, the auditor is confident that there is written documentation outlining all significant matters raised during the audit process, and that such matters have been formally notified to the highest level of management of the client.

- For the management, the report should ensure that they fully understand the scope and results of the audit service which has been provided, and is likely to provide constructive comments to help them to fulfil their duties in relation to the financial statements and accounting systems and controls more effectively.

- The report will also help include, where relevant, any actions that management has indicated they will take in relation to recommendations made by the auditors.

(5 points for 5 marks)

b) Matters to be included in findings from audit and the reason for inclusion

- **Control weakness**

  ISA 260 contains guidance on the type of issues that should be communicated. One of the matters identified is a control weakness in the capital expenditure transaction cycle. The assets for which no authorisation was obtained amount to 0·3% of total assets (225,000/78 million x 100%), which is clearly immaterial. However, regardless of materiality, the auditor should ensure that the weakness is brought to the attention of the management, with a clear indication of the implication of the weakness, and recommendations as to how the control weakness should be eliminated.

  The auditor is providing information to help those charged with governance improve the internal systems and controls and ultimately reduce business risk. In this case there is a high risk of fraud, as the lack of authorisation for purchase of office equipment could allow expenditure on assets not used for bona fide business purposes.

- **Disagreement with accounting treatment of brand**
  Audit procedures have revealed a breach of IAS 38 Intangible Assets, in which internally generated brand names are specifically prohibited from being recognised. Charged with Governance Limited (CGL) has recognised an internally generated brand name which is material to the statement of financial position (balance sheet) as it represents 12·8% of total assets (10/78 x 100%). The statement of financial position (balance sheet) therefore contains a material misstatement.

  The report to those charged with governance should clearly explain the rules on recognition of internally generated brand names, to ensure that the management has all relevant technical facts available. In the report the auditors should request that the financial statements be corrected, and clarify that if the brand is not derecognised, then the audit opinion will be qualified on the grounds of a material disagreement – an 'except for' opinion would be provided. Once the breach of IAS 38 is made clear to the management in the report, they then have the opportunity to discuss the matter and decide whether to amend the financial statements, thereby avoiding a qualified audit opinion.

- **Audit inefficiencies**
  Documentation relating to inventories was not always made readily available to the auditors. This seems to be due to poor administration by the client rather than a deliberate attempt to conceal information. The report should contain a brief description of the problems encountered by the audit team. The management should be made aware that significant delay to the receipt of necessary paperwork can cause inefficiencies in the audit process. This may seem a relatively trivial issue, but it could lead to an increase in audit fee. Management should react to these comments by ensuring as far as possible that all requested documentation is made available to the auditors in a timely fashion.

(3 points well explained @ 5 marks = 15 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Q3 This question was subdivided into two parts;

- 3.A Candidates were asked to provide five purposes of including findings from the audit(management letter). To our surprise majority of the students could not submit right answers. .
- 3B Candidates were asked to provide and identify matters which should be included as findings from audit in a report to those Charge with governance..
  The question posed serious challenges to many candidates. Students did not read that aspect of the syllabus hence Performance was poor.

QUESTION FOUR

a) The 1992 Constitution of Ghana gives Parliament the following roles in Public Accountability and judicious use of resources:

- Taxation: No taxation shall be imposed otherwise than by or under the authority of an Act of Parliament.
- Where an act of Parliament confers power on any person or authority to waive or vary any tax imposed by Parliament, the exercise of the power of waiver or variation in favour of any person or authority shall be subject to prior approval of Parliament by resolution.
- Apart from the Consolidated fund and Contingency fund, Parliament has the authority to establish other public funds by an act of Parliament.
- Parliament also has the power to authorise any authority or department to retain any revenue received by them for the purposes of defraying the expenses of that department.
- It is also Parliament that can authorise payment of monies into or withdrawal from the Contingency fund.
- No monies shall be withdrawn from the consolidated fund unless it is authorised by an appropriation act passed by Parliament or by supplementary estimate approved by a resolution passed by Parliament for that purpose.
- Parliament may by resolution authorised government to enter into an agreement for a loan out of any public fund or public account.
- Apart from the finance function, Parliament also has Public Accounts Committee which receives the annual report of the Auditor General
- The committee pursues the implementation of the recommendations of the Auditor General's report to ensure that MDAs and MMDAs comply with the recommendations.

(1 mark for every point= 9 marks)
(1 mark for presentation)

b)

i) Compliance Audit in relation to MMDAs

Government entities are subject to a variety of laws and regulations not generally applicable to private sector, profit making entities. For example local laws may restrict the authority of Metropolitan, Municipal and District Assemblies to issue debt, and they may be required to pay the proceeds from internally generated funds into special funds etc, other laws may restrict the disbursement of social service payments to eligible applicants.

Violations of any of these, among other laws and regulations could have a direct and material effect on the operations of those entities and their financial statements.

The Auditor General is required to bring to light the infractions of laws and regulations in the annual report.

The compliance audit determines the extent to which, rules, policies, laws, covenants or government regulations are followed by the entity being audited.

(2 marks)

ii) The basis for compliance audit are:

- The laws and regulations under which the entity being audited operates and of which it is required to comply. This will ascertain those laws and regulations to determine whether the auditee is fully aware of them and the consequences of any breach thereof.
- Internal rules, procedures and directives. These involve ascertaining the entities procedures designed to ensure that the operations and activities are designed to be in compliance with the laws and regulations.
- Compliance with the laws and regulations: The audit is conducted to ascertain the extent of compliance or non-compliance with the laws and regulation and the determination of whether non-compliance is deliberate or due to ignorance.
- Consequence of non-compliance: The audit will determine the possible sanctions or punishment that would arise as a result of the non-compliance.

(4 points for 4 marks)

iii) The compliance audit report will highlight the following:

- The laws and regulations governing the entity that ought to be complied with. This may be termed as the criteria against which the entity's compliance is measured.
- The entities awareness of the laws and regulations and the conduct of operations in line with the laws and regulation. The conditions noted.
- The effect of non-compliance. The consequences of the non-compliance will be clearly spelt out in the report.
- Recommendations. These are intended to enable the auditee to rectify and/or prevent future reoccurrence of the non- compliance.

(4 points for 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- Q4a. Candidates were required to assess the role of Parliament in ensuring judicious use of the resources and proper accountability. Many Students were able to answer the questions well.
- 4b Many candidates were not able to answer this question on compliance audit well.

QUESTION FIVE

a)

i) Purposes of cyber security policy

- Organisations using electronic systems for conduct of business need to have cyber security policy and strategy. By their design cyber security policies serve many purposes including informing organisation users and third parties of their obligations to protect the organisation's digital assets.

- It describes what must be protected and outlines possible threats to those assets. Cyber security policies also provide information on what is acceptable usage. For example employees cannot use the organisation's internet outside office hours or for private work.

- Another element of a cyber security policy is classification of digital assets, where system files, data and equipment can be classified either as confidential or non-confidential.

- A good cyber security policy recognises the fact that employees are the biggest security threat to an organisation because their wilful action or inaction can cause damage.

- It provides mitigations such as limited access to qualified persons only, logging the usage of the system and making it mandatory for employees to change their password periodically.

(5 points for 5 marks)

ii)

Cyber security audit is a formal process of carrying out cyber security assessment. It is an assessment carried out by a certified third party, an independent organisation or consultant. Cyber security audits usually involve an external assessment to ascertain the level of cyber risks an organisation is exposed to.

The audit process covers processes such as digital assets management, cyber security awareness training, data security, resources planning, information and communication.

(2 marks)

What it is intended to achieve

- When done properly a cyber security audit can help the organisation understand what risks to information system and software exist in the situation.

- It can help prioritise these risks, align the information protection to that of the central authority such as the Data commission, Communication Authority or even the central bank and to external security frameworks such as National Standards and Technology Institute (NISTI) cyber security framework of USA and European Network and Security agency (ENISA) as well as the ISO/IEC 2700 family on information security management systems.

- Once the audit and assessment is completed the reviewer will provide a detailed report articulating gaps or vulnerabilities in the organisation's security profile.

- The tangible outcome of cyber security audit is clear cut road map which is expected not only to improve cyber security readiness, but also ensure long term compliance and robust system of risk management.

(3 points for 3 marks)

b)

i) Financial Reporting Implications

The announcement of a restructuring after the reporting date is a non-adjusting event after the reporting date, according to ***IAS 10: Events After the Reporting Period***. This is because the event does not provide evidence in relation to a condition that existed at the year end.

Materiality calculations in respect of the potential cost of closure are as follows:
Based on revenue: GH¢ 250,000/15 million = 1·67%
Based on profit: GH¢ 250,000/3 million = 8·3%
Based on assets: GH¢ 250,000/80 million = <1%

Therefore this amount is material to the statement of comprehensive income.

Per IAS 10, a note should be provided to the financial statements, which describes the nature of the event, and provides an estimate of the financial effect.

Tutorial note: credit will also be awarded for discussion of whether a provision for the restructuring costs is required under IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

(2 marks)

Audit procedures could include:

- Review any potential note to financial statements which should disclose the non-adjusting event, providing a brief description of the event, and an estimate of the financial effect.
- Discuss the reason for the restructuring with a member of key management personnel, and read minutes of board meetings where the plan was discussed, in order to gain an understanding about the reason for the restructuring.
- Verify the approval of the plan itself, and the approval of the announcement of the plan, which can be performed through a review of board minutes.
- Confirm the date on which the plan was approved, and also the date of the announcement, using supporting documentation such as press release, letters sent to employees, internal meetings held with employees, etc.

- Obtain a copy of the announcement and review for details, particularly a description of the exact nature of the restructuring, including the number of employees to be affected.
- Agree the GH¢ 250,000 potential cost of closure to supporting documentation, including a schedule showing the number and grade of staff to be made redundant, which should be supported by payroll/contract details.
- Using the results of the discussion with management, assess the planned restructuring in the context of the auditor's knowledge of the business, considering whether any further costs are likely to be incurred.

(Any 4 points for 4 marks)

ii) **Actions to be taken by the auditor:**

- If no note is provided to the financial statements, then there is a breach of IAS 10. In this case there is insufficient disclosure provided in the notes to the financial statements regarding a material non-adjusting event after the reporting date.

- According to **ISA 701: Modifications to the Independent Auditor's Report,** in cases where the auditor is in disagreement(material misstatement) with management regarding the application of a financial reporting standard and where the disagreement is material to the financial statements, the auditor should express a qualified or an adverse opinion. Here, the matter is material (as discussed in (b)(i) above) but is not pervasive to the financial statements, so a qualified 'except for' opinion should be given.

- The audit report should contain a paragraph which explains the reason for the qualification, specifying the breach of accounting standards, and stating the relevant financial amount. It would also be best practice for the auditor to clarify that the profit for the year is not affected by the breach of accounting standards, and that the disagreement is solely due to inadequate disclosure in the notes to the financial statements.

- The auditors should ensure that the matter, and the potential consequence for the audit report, has been made known to those charged with governance. This will allow the highest level of management (including executive and non-executive directors) the opportunity to discuss the matter, having reference to all relevant facts of the disagreement and implications thereof.

- Finally, the auditors could choose to raise this issue at the annual general meeting, where the matter leading to the qualified audit opinion should be explained to the shareholders of the company.

(4 points for 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- Q5(A) This question involved cyber security policy and what it is intended to achieve. Some students display ill knowledge in this area. The question seemed to be too practical to many candidates. Some of those who knew could not get the answers right because they could not differentiate the information technology policy from those of cyber Security Policy. However some candidates performed well.
- Q5(B) Some candidates could not differentiate adjusting events and non-adjusting events. The question was on the financial reporting implications of restructuring announced and actions by the auditor. In all 5 (bi) was poorly answered whilst the action by the auditor was well answered.

- 5b. Two scenarios were given and candidates were to evaluate the implications of the matters for audit opinions in each scenario. Candidates needed to evaluate the implications of the matters in each scenario determine what circumstances they represented and consider the appropriate audit opinion to issue. While candidates were able to determine the circumstances after evaluating the implications of the matter, some could not form the right audit opinions.