

**MAY 2020 PROFESSIONAL EXAMINATIONS  
AUDIT AND ASSURANCE (PAPER 2.3)  
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

**EXAMINER'S GENERAL COMMENTS**

In my opinion, candidates performed well in this paper, having a pass rate of 69%, Candidates performed very well in questions one (1), two (2) and three (3) having pass rates of over 50%. Questions four (4) and five (5) scored pass rates of less than 50%. Lecturers and Candidates are encouraged to look critically at the topics that featured in questions four (4) and five (5) and others since the topics would continue to be examined by the Institute.

**STANDARD OF THE PAPER**

The standard of the paper continues to be very high and very comparative with previous examined papers at this level. The marks allocation followed the weightings in the syllabus but during this diet, I realized questions on ISAs were a bit over weighted recording almost 27 marks in total. Questions were not overloaded and marks allocations were not over-generous. There were no ambiguities/errors/typing problems that adversely affected performance in the examinations.

**PERFORMANCE OF CANDIDATES**

The general performance of candidates in the subject is 69% that is out of a total number of 140 candidates who wrote the paper, 97 passed and 43 failed. The performance is therefore, more than average. High performers for this examination was evenly spread across all centres.

Unfortunately, Candidates' performance in questions four and five were below 50%. Candidates' performance for questions four (4) was abysmal. Only 35% of candidates passed this question even though the topic was within reach of candidates. Low performance were not concentrated in a particular centre. The above performance was found in most of the centres. There were no signs of copying at a particular centre.

The level of preparedness of most candidates in most of the topics were good and this inured to the high rate of passes in three (3) of the questions during the examinations.

**NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES**

Candidates performed well in questions bordering on ISA 700/701 involving the auditors opinion on the financial statements of being true and fair view and are fairly presented in all material respects in accordance with applicable financial reporting framework where unmodified opinion is expressed.

Also, candidates understanding of business risks and planning of the audit was good. The above topics recorded a pass rate of a whopping 87.5% by candidates. Candidates also performed well in ISA 500 of Audit Evidence, which recorded a pass rate of 67.5%. The above shows specific area in which candidates demonstrated strengths. The strengths were wide spread amongst candidates in various centres.

The pass rate for each question was wide spread and not concentrated in peculiar centres alone. Questions one, two and three recorded 87.5%, 55% and 67.5% pass rates

respectively. Only questions four and five recorded pass rates below 50%. To this end, candidates in the various centres must be assisted to overcome their weakness in the topics that featured in questions four and five to perform well in future examinations.

#### **DETAILED QUESTION - BY - QUESTION ANALYSIS OF PERFORMANCE**

Q1	-	87.5%
Q2	-	55%
Q3	-	67.5%
Q4	-	35%
Q5	-	42.5%

From the above analysis, it could be observed that questions four and five were poorly answered by candidates. Candidates, however, performed well in questions one, two and three since they were all above 50% pass rates.

#### **CONCLUSION**

In conclusion, the following points would assist to strengthen our examination:

- More and intensified teaching and learning by lecturers and students should be continued. More innovative strategies should be explored to strengthen teaching and learning with the emergence of Covid-19 pandemic.
- A lot of mock test should be conducted on-line prior to the main examinations so that all rough edges could be smoothed.
- Candidates should practice more past and other auditing questions on their own prior to the examinations.
- The Institute's school should be opened in most of the big towns including some districts where the examinations take place to prepare candidates adequately for the examination. Other private tuition institutions must be empowered by the Institute including on-line portals to assist our candidates, both in Ghana and in elsewhere.
- The Distance Learning (DL) concept must be encouraged by the Institute to help candidates to prepare adequately for the examinations.
- Examiners of questions should continue to set questions from the Institute's recommended texts and to a limited extent from current issues on Audit and Assurance.
- The May, 2020 questions were in line with the syllabus and very good so I am not surprised candidates passed with almost 69%.

#### **LOOKING AHEAD OF FUTURE EXAMINATIONS**

Some candidates do not carry forward, their answered questions onto continued pages in the answer packets and this action of candidates create problems to examiners and moderators.

Some candidates still do not follow the details of directions to candidates, legibly stated at the back of the answer booklet.

Some candidates do not write legibly at all thus making reading of solutions by examiners extremely difficult.

## QUESTION ONE

- a) The main objective of an audit is to enable the auditor express an opinion on the financial statements being audited. ISA 700/701 requires that the auditors' opinion should state whether the financial statements give a true and fair view and are fairly presented in all material respects in accordance with applicable financial reporting framework where an unmodified opinion is expressed.

**Required:**

Explain what is meant by *true* and *fair view*.

**(5 marks)**

- b) Unbalanced and Co. Ltd. is a trading company at Abossey Okai. It deals in auto parts. It is owned by a husband and wife; Divine and Grace. Divine travels to South Korea twice a year to buy auto parts for the business whilst Grace run the day to day administration of the shop.

Divine borrows (loans) from friends to add up to the company's money to buy parts when he travels. These loans are repaid when the goods are sold back home. The loans are not receipted. Some of the loans are banked, others are not. The company's money and the loans collected are changed into foreign currency, some through the bank, and others not through the bank. The company does not keep receipts for air tickets, hotel bills and the expenses made by the owners. However, Divine can reel off what he paid without batting an eyelid.

Import duties are paid by bankers' drafts so those are clearly stated in the bank statements. Grace has a note book in which she enters the daily sales but the records in the book is scanty. However, all imports invoices are properly filed. Most of the sales are banked and the bank statements are readily available. Grace is assisted by one attendant.

The success of the business, you understand, depends on the vigilance and strictness of the owners.

**Required:**

- i) Identify the *business risks* in the passage and explain why they are risks. **(10 marks)**  
ii) What general factors would you consider when planning the audit? **(5 marks)**

**(Total: 20 marks)**

## QUESTION TWO

- a) *ISA 320: Materiality in Planning and Performing an Audit* explains the concept of materiality and how it is used by the auditor in engagement to reach important conclusions regarding procedures and evidence obtained. Concept of materiality is the core concept in risk-based audit approaches.

As per ISA 320, the auditor is required to determine materiality in order to reach important conclusions including; assessing risk of material misstatement, designing audit procedure in response to assessed risk and materiality level determined, in estimating the effects of

undetected misstatements and lastly in forming an audit opinion. An Auditor determines the materiality by exercising his professional judgment.

**Required:**

- i) Explain *materiality*. (2 marks)
  - ii) Briefly assess **FOUR (4)** ways *materiality* impacts on an audit. (4 marks)
- b) *ISA 501 - Audit Evidence - Specific Considerations for Selected Items* deals with three specific items that may be contained within a set of general purpose financial statements and for which the auditor may need to obtain sufficient appropriate audit evidence. It deals with specific considerations for: inventory; litigation and claims; and segment information.

**Required:**

What should an auditor do:

- i) To obtain sufficient appropriate audit evidence regarding the existence and condition of inventory where inventory is material to the financial statements? (2 marks)
  - ii) When physical inventory counting is conducted on a date other than the date of the financial statements? (2 marks)
- c) The auditors of Obuasi Ltd resigned on 21 August 2019 after they had been validly appointed and accepted. The directors of Obuasi Ltd appointed Ofori Ansong and Co. Chartered Accountants as their new auditors on 10 October 2019. The Registrar General refused to accept Ofori Ansong and Co as auditors on the grounds that the directors had acted beyond their powers since, the Registrar General has the power to appoint auditors.

**Required:**

Comment on the action of the Registrar General. (7 marks)

- d) Your client Abeka Ltd is threatening to remove your firms as auditors as a result of disagreement on account of the use of inappropriate accounting policies.

**Required:**

Describe **THREE (3) rights as an auditor** in relation to the disagreement and subsequent threat of removal. (3 marks)

**(Total: 20 marks)**

### QUESTION THREE

- a) *ISA: 500 Audit evidence* requires the auditor to obtain sufficient, appropriate evidence to be able to draw reasonable conclusions on which to base the audit opinion. That evidence should be relevant to the *financial statements assertions*.

**Required:**

- i) Explain the *main assertions* about account balances and provide an example of each one by reference to the audit of trade receivables. **(8 marks)**
- ii) Identify **FIVE (5)** of the seven main audit testing procedures (for example inspection) and give an example of how each might be used in the audit of plant and machinery. State the assertion that is being tested in each case. **(5 marks)**

- b) Tamale Pharma specialises in the development of drugs for the pharmaceutical industry.

**Required:**

State how you could verify the following items appearing in the statement of financial position of Tamale Pharma as at 31 December 2018. You are not required to consider presentation and disclosure:

- i) Patents.
- ii) Research and development.

**(7 marks)**

**(Total: 20 marks)**

### QUESTION FOUR

- a) Your audit firm has almost completed the audit of SG Ltd. At the review stage the audit manager assembled the engagement team and wanted to find out whether the audit evidence obtained shows that the company is a going concern.

**Required:**

- i) Outline whose responsibility it is to ensure that the going concern basis used in the preparation of the financial statements is reasonable and acceptable. **(7 marks)**
- ii) Outline with examples the **THREE (3)** broad classification of going concern indicators. **(3 marks)**

- b) AA&A Chartered Accountants have been auditing ABC Company Ltd for the past four years. The company intends to list on the Ghana Stock Exchange of which one of the requirement is the establishment of an internal audit department if the company does not have one already. Management has asked your firm to brief them about internal audit and you have been asked to assist in the briefing.

**Required:**

- i) Outline **TWO (2)** major categories of services that internal audit function undertakes. **(5 marks)**
- ii) Outline the scope of *internal audit function*. **(5 marks)**

**(Total: 20 marks)**

## QUESTION FIVE

- a) *ISA 220 - Quality Control for an Audit of Financial Statements*, deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, where applicable, the responsibilities of the engagement quality control reviewer. According to ISA 220, the auditor should consider certain factors before accepting a new engagement or continuing an existing engagement.

**Required:**

Discuss **THREE (3)** of such factors.

**(10 marks)**

- b) You have completed the audit of ABC Ltd for the year ended October 31, 2019.

**Required:**

- i) Outline the procedures for communicating deficiencies in internal controls to those charged with governance and management. **(6 marks)**
- ii) Illustrate how the deficiencies are reported **(4 marks)**

**(Total: 20 marks)**

## SOLUTION TO QUESTIONS

### QUESTION ONE

a) There is no formal (legal or professional) definition of the term true and fair view. However, from general usage, the meaning of the term can be looked at from its components, namely:

- **True:** The accounts are free from material misstatements and therefore reflects the underlying records.
- **Fair:** Implies there is no undue bias in the financial statements or the way in which they have been presented.

Additionally, it connotes that judgement exercised in the preparation and auditing of the financial statements are properly exercised in line with appropriate financial reporting standards.

Judgment is used both by directors of the company in preparing financial statements and auditors in performing they work. However “True and Fair” or “present fairly” assures that the judgment are fair and are in line with financial standards and that the Financial Statements can be relied upon.

(5 marks)

b) i)

**The following business risks are noted from the question:**

- Divine traveling to South Korea to buy goods for resale, because the currencies he deals in are not at parity and prices are influenced by inflation, there is a risk of exchange loss which can cripple the finances of the company.
- Risk of pricing goods. Correct price may not be assigned to the goods procured. Goods may be underpriced or overpriced.
- Loans contracted are not recorded. Actual loan amount may not be accounted for
- Banked loans may be accounted for as sales or sales figures may be accounted for as loans thereby, distorting the financial records of the company.
- Not all money converted for purchases go through the bank, as that, purchases not invoiced and money used by John for his personal purpose may not be captured.
- No invoices are kept for air tickets, hotel bills and expenses incurred by John. There is the likelihood that those expenses many be understated.
- Most of the sales are banked. An indication that sales are likely to be understated.
- Inadequate control, vigilance and strictness are not good measure of control.
- Inadequate documentation, making it difficult for business transactions to be documented.

(Any 5 points @ 2 marks each =10 marks)

ii.

- **The nature of the industry** - what is the industrial practice in recognizing income and expenditure. What is the profit margin for its operation? What tax obligation and concession does the industry have etc. Regulatory framework for the industry.
- **The company** - consider the following: The experience and literacy level of the directors; John and Grace. How often they travel to procure goods in a year, what their profit expectation has been. How much they spend to run the business;

monthly, yearly, how much they spend as their personal expenditure what their stock levels have been

- Understand the control established by the owners over the activities of the business; how they capture sales, how they are able to account for imports and other purchases, how they account for expenses, how they make sure that some of the goods are not stolen, how they make sure that money from sales do not get to the wrong hands.
- Previous Account, if any, must be examined.
- Isolate the risks and evaluate them.
- Ensure the accounts are prepared by independent person.

**(5 points @ 1 mark= 5 marks)**

**(Total: 20 marks)**

## **QUESTION TWO**

### **a) Materiality**

i) Misstatements or omissions are generally consider material, individually or in aggregate if they can reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the omission or misstatement judged in its particular circumstances. Materiality provides a threshold or cut off point rather than being a primary qualitative characteristic which information must have to be useful. **(2 marks)**

### **ii) Impact of materiality on audit:**

- Materiality helps auditors determine which items to test, as material items must be subject to substantive procedures.
- Materiality helps auditors determine whether to use sampling (for example, if all items in a population are material, sampling will be inappropriate).
- Materiality helps determine what level of misstatement will lead to a modified audit opinion.
- Materiality must be calculated at the planning stage and kept under review and must be reassessed during the course of the audit.
- Auditors must also consider whether factors make items material by reason other than value during the audit.
- Auditors must keep a record of misstatements and assess whether they are collectively material.

**(Any 4 points for 4 marks)**

b) In accordance with ISA 501- Audit Evidence – Specific Consideration for Selected Items:

i) If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:



- Attendance at physical inventory counting, unless impracticable
- Evaluation of management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting
- Observation of the performance of management's count procedures
- Inspection of the inventory
- Performance of test counts.

**(2 points for 2 marks)**

ii) Where physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required as per b) i) above, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

**(2 marks)**

c) Section 134 sub section 3 of the Companies Act 1963 (Act 179) requires that the first Auditors of a company incorporated after the commencement of the companies act be appointed within 3 months of incorporation of the company or prior to the delivery to the registrar of the particulars required under section 27 of the act;

**(2 marks)**

- It also requires every existing company, without auditors to appoint auditors within three months after the commencement of the act;

**(2 marks)**

- Sub section 4 (a) also empowers the directors to appoint the first auditors for the company and fill any casual vacancy in the office of the auditor. Sub section 4 (b) says that if a company shall have no auditors for a continuous period of three months, the registrar may appoint auditors;

**(2 marks)**

- On the basis of the above the registrar is not right by rejecting Ofori Ansong and Co since 21st August 2019 to 10th October 2019 is less than three (3) months.

**(1 mark)**

d)

- The rights to receive a copy of any written resolution proposal if it concerns him
- Where a resolution being proposed which concerned him the right to attend and be heard at any such meeting.
- Right to make written representation in case he is being replaced.
- A right to hold office till the close of a general meeting if a proposal is made to remove him.

**(1 mark each for any 3 valid point made)**

**(Total: 20 marks)**

### QUESTION THREE

#### i) The Account Balances Assertions and The Audit Of Trade Receivables

<b>Financial statement assertion</b>	<b>Example from the audit of trade receivables</b>
<b>Completeness:</b> There are no unrecorded assets, liabilities, or equity interests and all related disclosures that should have been recorded have been.	Obtain the listing of year-end trade receivables and check it agrees with the balance on the sales ledger control account. Check a sample of customers on the list and against individual sales ledger accounts.
<b>Accuracy, valuation and allocation:</b> Assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded and related disclosures have been appropriately measured and described.	Trade receivables are stated at their recoverable amounts (i.e. irrecoverable debts are written off and allowances for receivables are made). This would usually be tested via the direct confirmation of trade receivables and alternative procedures such as the receipt of cash after the year end.
<b>Rights and obligations:</b> The entity holds or controls the rights to assets and liabilities are those of the entity.	Trade receivables are not overstated/belong to the entity. Again, this would usually be tested via the direct confirmation of trade receivables.
<b>Existence:</b> Assets, liabilities and equity interests exist.	
<b>Classification:</b> Assets, liabilities and equity interests have been recorded in the proper accounts.	Trade receivables, net of any allowance for receivables, are disclosed within current assets on the statement of financial position.
<b>Presentation:</b> assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.	Using a disclosure checklist to ensure that the trade receivables disclosure complies with IAS/IFRS requirements.

(8 marks)

ii) **The seven main audit testing procedures and the audit of plant and machinery**

<b>Procedure</b>	<b>Example from the audit of plant and machinery</b>
Inspection	Physical inspection of plant (relevant to existence).
Observation	Observing maintenance procedures (relevant to accuracy, valuation and allocation).
Inquiry	Inquiring about useful lives/profits or losses on disposal (relevant to accuracy, valuation and allocation).
Confirmation	Writing to third parties which hold client's plant and asking them to confirm the existence of such plant (relevant to existence).
Recalculation	Recalculating the depreciation charge for the year (relevant to accuracy, valuation and allocation).
Reperformance	Reperform a control over plant originally carried out by the client (e.g. checking that a sample of plant taken from the asset register exists).
Analytical procedures	Calculate depreciation as a percentage of total asset value, compare to previous years and ensure any change is in line with expectations (relevant to accuracy, valuation and allocation).

**(5 marks)**

b)

i) Patents

- A register should be maintained giving a description of each patent, its cost, depreciation and net book value. Test a sample of the patents from the register against patent documents.
- Ensure patent documents are stored in a secure place.
- Vouch additions in the year (or a sample) to purchase documentation, including authorisation in the board minutes, or evidence of approval by a senior company official. If the patent originates from the company itself, vouch to filing documentation.
- Agree costs of the company's own patents to the documentation supporting the direct costs of application. All other related costs should be treated as research and development.
- Ensure that patents are written off over their useful lives, and that the rates used are reasonable.
- Check (a sample of) the amortisation calculations.

- Consider whether the useful lives being used are reasonable.
- Consider whether there are any business circumstances which might necessitate the need for an impairment write off.
- Ensure any impairment has been correctly dealt with.

**(3 points for 3 marks)**

**ii) Research and development**

Examine supporting documentation (e.g. invoices, timesheets) to ensure that any amounts capitalised are development costs, and comply with the strict criteria laid down in IAS 38 i.e.

- ✓ probable economic benefits
- ✓ intention to complete the asset and use or sell it
- ✓ resources exist to complete the project
- ✓ ability to use or sell the asset
- ✓ technical feasibility of completing the asset
- ✓ expenditure can be measured reliably.

To verify these costs, consider:

- ✓ project evaluation reports
- ✓ whether an independent assessor should be consulted if the information is of a highly technical nature
- ✓ ensure that any non-current assets used for the purposes of research and development have been capitalised and depreciated as required by IAS 16.

**(4 marks)**

**(Total: 20marks)**

## **QUESTION FOUR**

**a) i)**

- The responsibility for the preparation of the financial statements which should give a true and fair view is that of management.
- This responsibility includes the choice of going concern basis for the preparation of the financial statements. If the financial statements are prepared on a going concern basis but the entity lacks ability to continue in operational existence for the foreseeable future such financial statements will not give a true and fair view.
- The choice of going concern basis for the preparation of the financial statements requires that management should carry out going concern assessment during the preparation of the financial statements and ensure that the basis chosen is reasonable and acceptable before approving the financial statements.

The auditor however also has a responsibility to evaluate the going concern basis used in the preparation of the financial statements. This will enable him form conclusion that the basis used is reasonable and acceptable and therefore the financial statement give a true an fair view or to express a modified opinion if the

basis used is not acceptable and management has not adopted an alternative suitable basis to present the financial statements. **(7 marks)**

- ii) The three broad categories of going concern indicators are:
- Financial indications. Examples include inability to pay debt as and when they fall due and borrowing far above borrowing limits.
  - Operational indicators. For example loss of key managerial or technical staff without immediate replacement.
  - Other indications for example natural disaster or government action, expropriation, or new law rendering the operations illegal.
- (3 points for 3 marks)**

**b)**

- i) According to the Institute of Internal Auditors, internal auditing is an independent objective assurance and consulting activity designed to add value and improve an organizations 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. From the definition it can be deduced that the two broad categories of activity or engagements that internal audit would be involved in are:

**Assurance Services:** These involve an objective examination of evidence for the purposes of providing an independent assessment on risk management, control and governance process for the organization. Example may include financial performance, compliance, systems security and due diligence engagement. It the activities which engage in measuring performance against identified criteria to give assurance on correct performance. It is more of historical work on looking back on what has been done and assure management that the things are moving in the right direction or not.

**Consultancy Services:** Advisory and related client service activities, nature and scope of which are agreed with the client and which are intended to add value and improve an organization governance, risk management and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation and training. It is more future intended than historical. **(5 marks)**

- ii) The scope of internal audit work may vary from organization to organization but may typically encompass the following:
- To determine whether the risk management control and governance processes, as designed and presented by management, are adequate and functioning in a manner to ensure that:
  - Risks are appropriately identified and managed
  - Interaction with various governance groups occur as needed
  - Significant financial, managerial and operating information is accurate, reliable and timely

- Accounting procedures are effective
  - Employees' actions are in compliance with policies, standards, procedures and applicable laws and regulations.
  - Resources are acquired economically, used efficiently and adequately protected
  - Programmes, plans and objectives are achieved
  - Quality and continuous improvements are fostered and are recognised and addressed appropriately
  - Opportunities for improving management control and the organisations image may be identified during audits and communicated to the appropriate level of management
- (5 points for 5 marks)**  
**(Total: 20 marks)**

## QUESTION FIVE

- a) As per ISA 220 – Quality Control for Audits of Financial Statements  
Audit firms should only accept a new client or continue an existing client relationship where it;
- Has considered the “Integrity of the Client”
  - Is “Competent to perform” the engagement (capabilities / time / resources)
  - Is in compliance with “Ethical Requirements”
- (1 mark)**

### **Integrity of the Client**

- Client Reputation
  - Nature of Client Operations
  - Attitudes of Key Players (Aggressive Standards Interpretation / internal controls / Low audit fees / limiting scope of work)
  - Money Laundering
  - Outgoing auditors (reason)
- (3 points for 3 marks)**

### **Competency of the Audit Firm to Perform the Engagement**

- Knowledge of Industry / Subject Matter
- Experience with Relevant Statutory / Reporting Requirements
- Sufficient Personnel and Time / Capacity
- Experts where Necessary
- Ability to Perform Quality Control Review

**(3 points for 3 marks)**

### **Ethical Considerations**

- Audit Firm and Individual Personnel – Independence.
- No perceived Conflict of Interest with an existing audit client.
- The company has no dispute with outgoing auditors in terms of fees.

**(3 points for 3 marks)**

b)

- i) Procedures relevant to communicating deficiencies in internal control to those charged with governance are as follows:

- Deficiencies discovered during the audit are first noted on the relevant section of the audit programme and initially discussed with the auditees operatives.
- The deficiencies are summary on the file divider for management letter.
- A formal discussion is held with management for their responses.
- The deficiencies together with management responses are used to write a formal letter to those charged with governance and management.
- Management is requested to acknowledge receipt of the letter and to indicate actions already taken or intended to be taken to rectify the deficiencies and/ or prevent their reoccurrence. **(4 points @ 1.5 marks =6 marks)**

ii) The format for reporting the deficiencies is as follows:

- Internal control cycle where deficiency has been discovered with a brief description of the actual deficiency.
  - The effect of the deficiency on the operations of the business and / or the financial statements.
  - Possible management response.
  - Recommendations to rectify the deficiency and /or prevent future reoccurrence. **(4 points @ 1.5 marks =6 marks)**
- (Total: 20 marks)**