

**MAY 2020 PROFESSIONAL EXAMINATIONS
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

STANDARD OF THE PAPER

The paper covered all sections of the syllabus. However, section C of the syllabus covered 39% instead of 25%. This resulted in section D of the syllabus covering 11% instead of 25%. The level of difficulty of the questions was reasonable.

PERFORMANCE OF THE CANDIDATES

The performance with regards to pass rate in this paper was 57.45% while that of November 2019 was 66.52%. Answers provided represented the efforts of the individual candidates. The general performance was encouraging. In certain cases it appeared that candidates did not take their time to understand the requirements of the question, resulting in candidates providing answers to certain questions that completely deviated from the requirement. Some candidates did not take their time to write, making reading difficult for markers.

QUESTION ONE

- a) You are an audit manager at Abdulai Afriyie & Co., a firm of Chartered Accountants. You are currently preparing the audit of Adoma Mining & Jewelleries Ltd for the year ended 28 February 2019. Adoma Mining & Jewelleries Ltd is a small Mining and Minerals Company which offers an extensive range of services that covers exploration, jewellery production, industrial applications, decommissioning and closure. You reviewed the previous years' files for this client and noted the following:
- i) The previous financial statements were prepared by the Consulting Division of Abdulai Afriyie & Co. and there is nothing in any of the files to suggest any particular difficulty with the assignment.
 - ii) In the course of the review of the files, it was observed there is a note explaining that on the completion of the assignment, each member of the consulting team with whom the client had come into contact, was given a gift of "presentation box" of the client's Jewelleries. These presentation boxes contain samples of each of the different jewelleries produced by the client. These boxes are not available for sale but are sometimes given as gifts (for example, at Christmas) to loyal customers and others such as school principals who are seen to bring business to the client. Since this was a non-assurance assignment, the gifts were automatically and gratefully accepted.
 - iii) In early January 2019, the company received correspondence from the Ghana Revenue Authority (GRA) claiming that the company has failed to pay certain mineral royalties which are usually charged on the jewellery manufactured. Normally, these levies are automatically deducted when miners or mining companies sell minerals to dealers. In this case, all of the minerals extracted was used to make jewels and ornaments by the company itself; and so the company never considered the possibility that such royalties might apply to it. The Chief Executive Officer (CEO) of Adoma Mining & Jewelleries Ltd tells you that he has done some research into the issue. It is his view that an argument can be made that the royalties do not apply in this case. However, should they apply, the amounts outstanding could be material since a number of years of non-payment might be involved. The CEO is aware that Abdulai Afriyie & Co. has a lot of Jewelleries based clients and has asked if Abdulai Afriyie & Co. would handle this matter as a separate assignment in addition to the audit.

Required:

Discuss **FIVE (5)** ethical issues that may arise for Abdulai Afriyie & Co. in relation to the audit of Adoma Mining & Jewelleries Ltd. **(10 marks)**

- b) Mobilefone Ltd (Mobilefone) is a large communication group which operates from several locations around the world. It has recently announced plans to expand its operations where it will offer a range of mobile communication facilities and provide internet services such as access, navigation and internet related software and services.

You are an Audit Manager of Kasim Hamza & Co. and you have been assigned with the planning work for the audit of Mobilefone and this will be the second year in which your firm has provided its audit services.

You have just met with the Finance Director (FD) of Mobilefone prior to agreeing the engagement letter for this year. The FD has informed you that Mobilefone has continued to grow quickly, with financial accounting systems changing rapidly and appropriate control systems being difficult to maintain. Additional services in terms of review and implementation of control systems have been requested. An internal audit department has recently been established within Mobilefone and the controller wants you to ensure that external audit work is limited by using this department.

You have also learnt that Mobilefone is to market a new type of mobile telephone, which is able to intercept messages from the emergency services. The legal status of this telephone is unclear at present and development is not being publicised. The granting of the franchise to market the mobile telephone is dependent on the financial stability of Mobilefone. The FD has indicated that Kasim Hamza & Co. may be asked to provide a report to the mobile telephone franchiser regarding Mobilefone's cashflow forecast for the year ending 31 March 2019, to support the franchise application.

Required:

As part of risk assessment procedures for the audit of Mobilefone for the year ending 31 March 2019, analyse **FIVE (5)** specific issues pertinent to this particular audit.

(10 marks)

(Total: 20 marks)

QUESTION TWO

You are a manager in Sustainability Ghana, an independent member of Sustainability International, a global firm of Chartered Certified Accountants. You are responsible for evaluating proposed engagements and for recommending to a team of partners whether or not an engagement should be accepted by your firm.

EnvironmentalCare Ghana, a listed company, is an existing audit client and is an international energy producing company, with a global network including 220 countries and 300,000 employees. The company offers electricity using renewable resources to individual and corporate customers, as well as storage and logistical services.

EnvironmentalCare Ghana takes its corporate social responsibility seriously, and publishes social and environmental key performance indicators (KPIs) in a Sustainability Report, which is published with the financial statements in the annual report. Partly in response to requests from shareholders and pressure groups, EnvironmentalCare Ghana's management has decided that in the forthcoming annual report, the KPIs should be accompanied by an independent assurance report. An approach has been made to your firm to provide this report in addition to the audit.

To help in your evaluation of this potential engagement, you have been given an extract from the draft Sustainability Report, containing some of the KPIs published by EnvironmentalCare Ghana. In total, 25 environmental KPIs, and 50 social KPIs are disclosed.

Extract from Sustainability Report	Year ended	
	31 December 2018	31 December 2017
	Draft	Actual
CO ₂ emissions (million tonnes)	26.8	28.3
Energy use (million kilowatt hours)	4,895	5,250
Charitable donations (GH¢ million)	10.5	8.2
Number of serious accidents in the workplace	60	68
Average annual expenditure on training per employee	GH¢180	GH¢175

You have also had a meeting with Kofi Ghana, the manager responsible for the audit of EnvironmentalCare Ghana, and notes of the meeting are given below.

Notes from meeting with audit manager, Kofi Ghana

Sustainability Ghana has audited EnvironmentalCare Ghana for three years, and it is a major audit client of the firm, due to its global presence and recent listing on two major stock exchanges. The audit is managed from the Airport office, which is also the location of the global headquarters of EnvironmentalCare Ghana. The audit work is nearly complete, and the annual report is to be published in about four weeks, in time for the company's meeting, scheduled for 31 January 2019.

No work has been done on the KPIs, other than review them for consistency, as we would with any 'other information' issued with the financial statements. The KPIs are produced by EnvironmentalCare Ghana's Sustainability Department, located in Fartown. There has been no visit to EnvironmentalCare Ghana's offices in Fartown as it is in a remote location overseas, and the departments based there are not relevant to the audit.

Audit procedures were performed on the charitable donations, as disclosed in a note to the financial statements, and our evidence indicates that there have been donations of GH¢9 million this year, which is the amount disclosed in the note. However, the draft KPI has a different figure of GH¢10.5 million, and this is the figure highlighted in the draft Chairman's Statement as well as the draft Sustainability Report. GH¢9 million is material to the financial statements.

Your firm has recently established a sustainability reporting assurance team based at the Airport office and if the engagement to report on the Sustainability Report is accepted, it would be performed by members of that team, who would not be involved with the audit.

Required:

- a) Identify and explain the matters to be evaluated in making the acceptance decision to perform an assurance engagement on the Sustainability Report of EnvironmentalCare Ghana. **(14 marks)**
- b) Recommend procedures that could be used to verify the following draft KPIs:
 - i) The number of serious accidents in the workplace; and **(3 marks)**
 - ii) The average annual expenditure on training per employee. **(3 marks)**

(Total: 20 marks)

QUESTION THREE

GGC Co. Ltd (GGCL) specialises in manufacturing equipment which can help to reduce toxic emissions in the production of chemicals. The company has grown rapidly over the past eight years and this is partly due to the warranties that the company gives to its customers. It guarantees its products for five years and if problems arise during this period, it undertakes to fix them or provide a replacement.

You are the manager responsible for the audit of GGCL and you are performing the final review stage of the audit and have come across the following issues.

Receivable balance owing from Nhyira Co. Ltd

GGCL has a material receivable balance owed by its customer, Nhyira Co. Ltd. During the year-end audit, your team reviewed the ageing of this balance and found that no payments had been received from Nhyira Co. Ltd for over six months. GGCL would not allow this balance to be circularised. Instead management has assured your team that they will provide a written representation confirming that the balance is recoverable.

Warranty provision

The warranty provision included within the statement of financial position is material. The audit team has performed testing over the calculations and assumptions which are consistent with prior years. The team has requested a written representation from management confirming that the basis and amount of the provision are reasonable. Management is yet to confirm acceptance of this representation.

Required:

- a) Describe the *audit procedures* required in respect of accounting estimates. **(8 marks)**
 - b) For each of the two issues above:
 - i) Discuss the appropriateness of *written representations* as a form of audit evidence; and **(6 marks)**
 - ii) Describe additional procedures the auditor should now perform in order to reach a conclusion on the balance to be included in the financial statements. **(6 marks)**
- (Total: 20 marks)**

QUESTION FOUR

- a) Among the factors hindering the development of third world countries is corruption. Corruption has been an obstacle for doing business in many countries. It occurs often in locally funded contracts and several measures have been adopted to curb it but it still persists. One of such measures is the creation of the office of the Auditor-General in many countries.

Required:

Assess the *role* and *constitutional status* of the Auditor-General of Ghana in ensuring public accountability as a means of fighting corruption. **(10 marks)**

- b) The Auditor-General has a responsibility to ensure that government business is being performed in a manner which will bring development and benefits to the citizens. Various aspects of the conduct of government business will engage the attention of the Auditor-General, for example execution of contracts for the construction of a regional hospital.

Required:

- i) Briefly discuss what *performance audit* entails? (2 marks)
 - ii) In carrying out the performance audit, evaluate the **THREE (3)** main factors that the Auditor-General will be concerned with in relation to the construction of the Greater Accra Regional Hospital. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- a) The auditing profession is very dynamic and constantly confronted with new challenges emanating from the political and economic spheres. To meet these challenges the global authority responsible for the regulation of accountancy profession, The International Federation of Accountants (IFAC) has been ensuring that the standards for conduct of audit and assurance engagements are revised and brought up to date all the time.

Required:

- i) Analyse the factors that influence the development of new Auditing Standards. (6 marks)
 - ii) Discuss the procedures for developing new Auditing Standards. (4 marks)
- b) You are the audit manager of Onipa Hia & Co., a local firm of Chartered Accountants located in Adabraka in the Greater Accra Region. You are currently reviewing the audit files for several of your clients for which the audit fieldwork is complete. The Audit Senior has raised the following issues:

African Designs Co. Ltd (ADCL)

ADCL's year end is 30 September, however, subsequent to the year end the company's sales ledger has been corrupted by a computer virus. ADCL's Finance Director was able to produce the financial statements prior to this occurring; however, the audit team has been unable to access the sales ledger to undertake detailed testing of revenue or year-end receivables. All other accounting records are unaffected and there are no backups available for the sales ledger. ADCL's revenue is GH¢15.6 million, its receivables are GH¢3.4 million and profit before tax is GH¢2 million.

Ghana Design Co. Ltd (GDCL)

GDCL has experienced difficult trading conditions and as a result it has lost significant market share. The cash flow forecast has been reviewed during the audit fieldwork and it shows a significant net cash outflow. Management are confident that further funding can be obtained and so have prepared the financial statements on a going concern basis with no additional disclosures; the Audit Senior is highly sceptical about this. The prior year financial statements showed a profit before tax of GH¢1.2 million; however, the current year loss before tax is GH¢4.4 million and the forecast net cash outflow for the next 12 months is GH¢3.2 million.

Required:

For each of the two issues:

- i) Describe the impact on the audit report if the issues remain unresolved. (5 marks)
- ii) Recommend procedures the audit team should undertake at the completion stage to try to resolve the issue. (5 marks)

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

- a) The following may give rise to ethical issues for Abdulai Afriyie and Co:
- i) The preparation of accounts as well as auditing them.
 - ii) The request to deal with the failure to pay royalties and
 - iii) The offer of a gift from the client to members of the audit team.

These issues are addressed below: Accountants producing and then auditing the financial statements of companies is a near-universal practice in the case of private, unlisted entities. Similarly conducting specific extra assignments on behalf of the client would not be unusual. However these situations are not without ethical difficulties. In particular the following threats arise:

Threat	Discussion of threat in this case
Self-Interest threat	Probably not excessively severe in this case but both points of the question will , if they are accepted, mean that extra revenue will be received from the client and thus we will need to be aware of any consequent impairment of our independence.
Self-Review threat	In either of these cases we will inevitably (as a practice) be reviewing our own work and so there is a danger that we will not bring to bear on such a review the same degree of professional scepticism as we would in the case of the work of an outsider. In the case of the potential charge to royalties we may leave ourselves in the invidious position of feeling the need to insist on an accrual for a charge the existence or quantum of which we are, simultaneously, rigorously denying
Familiarity threat	Doing a lot of work for the client and having very frequent contact with them could lead us to lose or dilute our professional scepticism in relation to the client. In simple terms we might become too trusting of the client because we know them very well. The use of different teams for different assignments would be an important safeguard.
Advocacy threat	The assignment in point ii) of the question will, almost by definition, require us to “take the side of the client” and argue the client’s case. We are, therefore, advocating for the client and, for an auditor, that is fundamentally dangerous. The decision on whether to accept will depend on issues such as the materiality of the amounts potentially involved; the degree of disputatiousness likely to arise (in as much as that can be measured); and our ability, as a practice, to put safeguards in place)
Management threat	In the case of both points i) and ii) there is a danger that we, as auditors, will take decisions that should properly be made by the client. For example, decisions about accounting policies should be made by the client. In the second case, the decision on how far to pursue action against the Ghana Revenue Authority on the levies issue should purely be one for the client. The difficulty arises because, if we accept the assignment,

	we will be advising the client, but we must ensure that the client comes to their own decision.
--	---

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

b) **Provide the range of services required**

Mobilefone Ltd. requires an enhanced range of services this year including review of and implementation of additional control systems. This service provides the following risks:

- **Skills necessary**

Kasim Hamza & Co must check whether they can provide these services. Kasim Hamza & Co is only a seven partner firm and so the company must ensure it has the necessary staff and skills to undertake this work.

- **Self-review threat**

There is a self-review threat. If Kasim Hamza & Co are to implement new control systems then they may also be auditing those systems as part of the statutory audit. Kasim Hamza & Co must ensure different staff implement and audit the systems. Preferably different departments in the firm should undertake the work. If insufficient staff are available then Kasim Hamza & Co must refuse the additional systems work.

- **Acceptance of non-audit work**

There is a possibility that Kasim Hamza & Co will be breaching ethical or statutory guidelines by accepting the work. Kasim Hamza & Co will need to ensure that the firm follows guidance in the Ethical Standards to limit any self-review threat.

- **Fee income**

Acceptance of additional work will result in additional fee income for Kasim Hamza & Co. IFAC Code of Ethics and Conduct states that the amount of fee income derived from any one client should not exceed 15% for non-listed audit clients. Kasim Hamza & Co will need to ensure that total fee income from Mobilefone Ltd. does not breach these guidelines.

- **Client growth**

Mobilefone Ltd is growing quickly. The company has poor internal controls providing high risk of financial misstatement. Kasim Hamza & Co will need to ensure sufficient staff of appropriate experience are available and that enough time is allocated to the audit to complete all audit procedures.

- **Internal audit**

Client expectations regarding the use of internal audit may be difficult to meet. As a new department, it will take time for the internal auditors to understand the systems at Mobilefone Ltd and produce any useful reports. Expectation of reduced fee will have to be managed carefully and checks made to ensure the auditor does not limit work because of fee pressure.

- **Association threat**

Mobilefone Ltd are producing a new mobile telephone. The legal status of the telephone is currently uncertain; it may be illegal. Kasim Hamza & Co need to determine the likelihood that the telephone is illegal. The audit firm may not wish to be associated with a company producing illegal products.

- **Report on cash flow**

The mobile telephone application also requires a report on Mobilefone Ltd's cash flow forecast. This will be a separate engagement, with risk to Kasim Hamza & Co because Mobilefone Ltd may attempt to show an unrealistic cash position in the forecast. Mobilefone Ltd must determine exactly what type of report is required (positive or negative) and ensure they have the time and staff with the necessary skills to provide the service.

- **Possible going concern**

It is not clear whether failure to obtain the new mobile telephone licence will result in Mobilefone Ltd no longer being a going concern. Kasim Hamza & Co will need to review the cash flow forecasts closely to determine the company's status in the future.

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

EXAMINER'S COMMENT

Question 1 a) required candidates to identify and discuss the ethical issues in a scenario that may affect the external auditor. This was from section A of the syllabus with 10 marks. Some candidates only explained the threats without relating them to issues in the scenarios that resulted in those threats. Some candidates discussed the ethical principles rather than the threats to independence.

Whiles the b part of question 1, was from section B of the syllabus with 10 marks. It required candidates to identify the risk in the operation of a client (company) that is likely to affect the auditor in the performance of his work. Some answers provided related to risk that the company was likely to face rather than the risk associated with the audit.

QUESTION TWO

a) Matters that should be considered in making acceptance decision

Objectivity

The proposed assurance engagement represents a non-audit service. *IFAC's Code of Ethics for Professional Accountants adopted by Institute of Chartered Accountants- Ghana* does not prohibit the provision of additional assurance services to an audit client, however, the audit firm must carefully consider whether the provision of the additional service creates a threat to objectivity and independence of the firm or members of the audit team. For example, when the total fees generated by a client represent a large proportion of a firm's total fees,

the perceived dependence on the client for fee income creates a self-interest threat. Due to the nature of the proposed engagement, self-review and advocacy threats may also be created, as the Sustainability Report is published with the audited financial statements, and the audit firm could be perceived to be promoting the interests of its client by providing an assurance report on the key performance indicators (KPI)s.

Sustainability Ghana should only accept the invitation to provide the assurance engagement after careful consideration of objectivity, and a review as to whether safeguards can reduce any threat to objectivity to an acceptable level. As EnvironmentalCare Ghana is a 'major client', the fee level from providing both the audit and the assurance services could breach the permitted level of recurring fees allowed from one client. The fact that the company is listed means that the assessment of objectivity is particularly important, and a second partner review of the objectivity of the situation may be considered necessary.

The fact that a separate team, with no involvement with the audit, will be working on the KPIs strengthens the objectivity of the assignment.

EnvironmentalCare Ghana's requirements

Assurance engagements can vary in terms of the level of work that is expected, and the level of assurance that is required. This will clearly impact on the scale of the assignment. For example, EnvironmentalCare Ghana may require specific procedures to be performed on certain KPIs to provide a high level of assurance, whereas a lower level of assurance may be acceptable for other KPIs. Sustainability Ghana should also clarify the expected form and content and expected wording of the assurance report itself, and whether any specific third party will be using the Sustainability Report for a particular purpose, as this may create risk exposure for the firm.

Competence

The audit firm's sustainability reporting assurance team has only been recently established, and the firm may not have sufficient experienced staff to perform the assurance engagement. The fundamental principle of professional competence and due care requires that members of an engagement team should possess sufficient skill and knowledge to be able to perform the assignment, and be able to apply their skill and knowledge appropriately in the circumstances of the engagement. Some of EnvironmentalCare Ghana's KPIs appear quite specialised - verification of CO2 emissions for example, may require specialist knowledge and expertise. Sustainability Ghana could bring in experts to perform this work, if necessary, but this would have cost implications and would reduce the recoverability of the assignment.

Scale of the engagement

The Sustainability Report contains 75 KPIs, and presumably a lot of written content in addition. All of these KPIs will need to be verified, and the written content of

the report reviewed for accuracy and consistency, meaning that this is a relatively large engagement. Sustainability Ghana should consider whether the newly established sustainability reporting assurance team has enough resources to perform the engagement within the required time scale, bearing in mind the time pressure which is further discussed below.

Time pressure

Given that the financial statements are scheduled to be published in four weeks, it is doubtful whether the assurance assignment could be completed, and a report issued, in time for it to be included in the annual report, particularly given the global nature of the assignment. Sustainability Ghana may wish to clarify with EnvironmentalCare Ghana's management whether they intend to publish the assurance report within the annual report, as they have done previously, or whether a separate report will be issued at a later point in time, which would allow more time for the assurance engagement to be conducted.

Fee level and profitability

Such a potentially large scale assignment should attract a large fee. Costs will have to be carefully managed to ensure the profitability of the engagement, especially considering that overseas travel will be involved, as presumably much of the field work will be performed at EnvironmentalCare Ghana's Sustainability Department in Fartown. The fee level would need to be negotiated bearing in mind the specialist nature of the work, and the urgency of the assignment, both of which mean that a high fee could be commanded.

Global engagement

The firm's sustainability reporting team is situated in a different country to EnvironmentalCare Ghana's Sustainability Department. Although this does not on its own mean that the assignment should not be taken on, it makes the assignment logistically difficult. Members of the assurance department must be willing to travel overseas to conduct at least some of their work, as it would be difficult to perform the engagement without visiting the department responsible for providing the KPIs. Other locations may also need to be visited. There are also cost implications of the travel, which will need to be built into the proposed fee for the engagement. Language may also present a barrier to accepting the engagement, depending on the language used in Fartown's location.

Risk

EnvironmentalCare Ghana is a large company with a global presence. It is listed on several stock exchanges, and so it appears to have a high public profile. In addition, pressure groups are keen to see the added credibility of an assurance report issued in relation to the KPIs disclosed. For all of these reasons, there will be scrutiny of the Sustainability Report and the assurance report. Sustainability Ghana should bear in mind that this creates a risk exposure for the firm. If the assignment were taken, the firm would have to carefully manage this risk exposure through thorough planning of the engagement and applying strong quality control

measures. The firm would also need to ensure that the fee is commensurate with the level of risk exposure. Given the inconsistency that has come to light regarding one of the draft KPIs, which appears to overstate charitable donations made by the company, we may need to consider that management are trying to show the company's KPIs in a favourable way, which adds to the risk of the engagement.

Commercial consideration

If Sustainability Ghana does not accept the assurance engagement, the firm risks losing the audit client in future years to another firm that would be willing to provide both services. As EnvironmentalCare Ghana is a prestigious client, this commercial consideration will be important, but should not override any ethical considerations.

(Any 7 points well explained points @ 2 marks each = 14 marks)

b)

i) Procedures to verify the number of serious accidents in the workplace

- Review records held by human resources, which summarise the number and type of accidents reported in the workplace.
- Review the accident log book from a sample of locations.
- Discuss the definition of a 'serious' accident (as opposed to a 'minor' accident) and establish the nature of criteria applied to an accident to determine whether it is serious.
- Review correspondence with legal advisors which may indicate legal action being taken against EnvironmentalCare Ghana in respect of serious accidents in the workplace.
- Review minutes of board meetings for discussions of any serious accidents and associated repercussions for the company.
- Ascertain through discussion with management and/or legal advisors, if EnvironmentalCare Ghana has any convictions for health and safety offences during the year (which could indicate that serious accidents have occurred).
- Enquire as to whether the company has received any health and safety visits (the regulatory authority would usually perform one if an employee has a serious accident). Review documentation from any health and safety visits for evidence of any serious accidents.
- Consider talking to employees to identify if any accidents have not been recorded in the accident book.

(Any 3 points @ 1 mark each = 3 marks)

ii) Procedures to verify the annual training spend per employee

- Review EnvironmentalCare Ghana's approved training budget in comparison to previous years to ascertain the overall level of planned spending on training.
- Obtain a breakdown of the total training spend and review for any items misclassified as training costs.
- Agree significant components of the total training spend to supporting documentation such as contracts with training providers and to invoices received from those providers.

- Agree the total amount spent on significant training programmes to cash book and/or bank statements.
- Using data on total number of employees provided by the payroll department, recalculate the annual training spend per employee.

(Any 3 points @ 1 mark each = 3 marks)

(Total: 20 marks)

EXAMINER'S COMMENT

This question was in two parts. Both parts, a) and b) were from section "C" of the syllabus. The two parts gave a total of 20 marks from a section of the syllabus that require 25 marks.

a) This sub-question demanded that candidates state the matters that auditors would consider in deciding to accept additional assurance services to an audit. This question was fairly answered by most of the candidates.

b) The question required candidates to recommend audit procedures to verify the key performance indicators (KPIs) in respect of social responsibilities. This question was poorly attempted. Some candidates did not attempt it at all.

QUESTION THREE

- a) Procedures the auditor should adopt in respect of auditing accounting estimates include:
- Enquire of management how the accounting estimate is made and the data on which it is based.
 - Determine whether events occurring up to the date of the auditor's report (after the reporting period) provide audit evidence regarding the accounting estimate.
 - Review the method of measurement used and assess the reasonableness of assumptions made.
 - Test the operating effectiveness of the controls over how management made the accounting estimate.
 - Develop an expectation of the possible estimate (point estimate) or a range of amounts to evaluate management's estimate.
 - Review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias.
 - Evaluate overall whether the accounting estimates in the financial statements are either reasonable or misstated.
 - Obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates and estimation uncertainty are reasonable.
 - Obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

(Any 8 points @ 1 mark each = 8 marks)

b)

i) **Appropriateness of written representations**

Receivables balance owing from Nhyira Co. Ltd

The written representation proposed by management is intended to verify valuation, existence and rights and obligations of a material receivables balance. As management has refused to allow the auditor to circularize the balance and there has been little activity on the account for the past six months then there is very little evidence that has been obtained by the auditor.

This representation would constitute entity generated evidence and this is less reliable than auditor generated evidence or evidence from an external source. If related control systems operate effectively then this evidence becomes more reliable. In addition if the representation is written as opposed to oral then this will increase the reliability as an evidence source.

Overall this representation is a weak form of evidence, as there were more reliable evidence options available, such as the circularization but this was not undertaken.

(3 marks)

Warranty provision

In this case the auditor has performed some testing of the provision in order to obtain auditor generated evidence. The team has tested the calculations and assumptions. None of this is evidence from an external source.

The very nature of this provision means that it is difficult for the auditor to obtain a significant amount of reliable evidence as to the level of future warranty claims. Hence the written representation, whilst being an entity generated source of evidence, would still be useful as there are few other alternatives.

(3 marks)

ii) **Receivable balance owing from from Nhyira Co. Ltd.**

In order to reach a conclusion on the balance the following procedures should be performed:

- Discuss with management the reasons as to why a circularisation request was refused.
- Review the post year-end period to identify whether any cash has now been received from Nhyira Co. Ltd.
- Review correspondence with Nhyira Co. Ltd to assess reasons for the continued non-payment.
- Review board minutes and legal correspondence to assess whether any legal action is being taken to recover the amounts due.
- Discuss with management whether a provision or write down is now required.
- Consider impact on audit opinion if balance is considered to be materially misstated.

(Any 3 points @ 1 mark each = 3 marks)

Warranty Provisions

In order to reach a conclusion on the balance the following procedures should be performed:

- Review the post year-end period to compare the level of claims actually made

against the amounts provided.

- Review the level of prior year provisions with the amounts claimed to assess the reasonableness of management's forecasting.
- Review board minutes to assess whether any changes are required to the level of the provision as a result of an increased or decreased level of claims by customers.

(3 points @ 1 mark each = 3 marks)

(Total: 20 marks)

EXAMINER'S COMMENT

a) This question was from section C of the syllabus. Candidates were required to describe the audit procedures required to audit accounting estimates (ISA 540). Most candidates showed lack of understanding of accounting estimates.

bi) This part of the question was from section C of the syllabus. This required candidates to discuss the appropriateness of written representations as a form of audit evidence in respect of receivables and warranty (ISA580). Most candidates displayed lack of understanding of the meaning and purpose of letter of representation.

bii) This question was from section D of the syllabus. It required candidates to describe additional procedures the auditor should perform in order to reach a conclusion on the balance to be included in the financial statements aside written representations. This had been fairly attempted by candidates.

QUESTION FOUR

- a) The Auditor-General is the head of Ghana Audit Service, which is the supreme audit institution of Ghana. The Audit Service was established under the 1992 constitution of Ghana as part of the Public Service of Ghana. The Auditor General is part of the Audit Service board which is responsible for making regulations for the effective and efficient administration of the Ghana Audit Service.

Constitutional provisions in respect of the Auditor General: Constitution of Ghana (1992). The constitution makes the following key provisions in respect of the Auditor General:

- The Auditor General shall audit public accounts of Ghana, as well as all public offices, including courts, central and local government, and any public corporation or other body establish by an act of Parliament.
- The Auditor General shall have access to all books, records, returns and other documents relating or relevant to those accounts.
- The Auditor General must submit his report to Parliament within six months of the year end of each set of accounts.
- The Auditor General must draw attention to any irregularities in the accounts, and to any other matter which in his opinion ought to be brought to the notice of Parliament.
- The President may request the Auditor-General to audit the accounts of any organisation within his remit.

- The Auditor General may disallow any item of expenditure which is contrary to the law. Furthermore, he may then make a surcharge for this amount for any sum not accounted for, or the amount of the loss.

Additional requirement includes:

- The public accounts being audited, including underlying accounting systems, must be kept in a form approved by the Auditor General. Any changes to the accounting system, must be approved by the Auditor General.
- Internal auditors of any public body audited by the Auditor General must also submit copies of their report to him.
- The Bank of Ghana also lies within the jurisdiction of the Auditor General. It is required to submit a statement of foreign exchange receipts and payments or transfer in or outside Ghana.

The Auditor General shall examine the accounts to ascertain whether

- a) The accounts have been properly kept
- b) All public monies are accounted for fully, and the rules and procedures applicable are sufficient to secure an effective check on the assessment, collection and proper allocation of revenue.
- c) Monies have been expended for the purposes for which they were appropriated and the expenditures have been made as authorised.
- d) Essential records are maintained and the rules and procedures applied are sufficient to safeguard and control public funds properly
- e) Programmes and activities have been undertaken with due regard to economy, efficiency and effectiveness.
- f) The auditor is required to examine the reports on public accounts made to the Controller and Accountant General

The Auditor General must adhere to international practices and in particular emerging practices such as environmental and forensic audits. If the Auditor General will exercise the constitutional responsibilities imposed on him properly, he will ensure public accountability and contribute to fighting corruption in the public sector.

(Any 10 points @ 1 mark each = 10 marks)

- b)
 - i) Performance audit involves systematic review of part or all of an organization's activities in relation to the efficient and effective use of resources. The purpose of performance audit is to assess performance, identify areas for improvement, and develop recommendations.

(2 marks)

- ii) In this respect the three factors that the Auditor General will be concerned with in carrying out performance audit on the construction of the regional hospital will be:

- 1) **Economy:** The audit will be designed to check whether the resources used in the construction were obtained at the least cost for best quality or the quantity of items used was least expected under the circumstances.
- 2) **Efficiency:** The measure of the relationship between input and output. Where output is greater than the value of the input efficiency is achieved. However defining output for social and other services is a very difficult task.
- 3) **Effectiveness:** This deals with the ability to achieve the set targets. In the case of the Regional hospital measuring effectiveness will involve whether the intended capacity and facilities have been attained as well as the completion and commissioning of the hospital for public use within the set time frame.
- 4) Check whether the contract for the construction was awarded in line with the Public Procurement Act.

(4 points well explained @ 2 marks each= 8 marks)

(Total: 20 marks)

EXAMINER'S COMMENT

This question was in two parts that is a) and b). Part a) was from section E of the syllabus while b) was from section F of the syllabus.

a) This question required candidates to assess the role and constitutional status of the Auditor-General of Ghana in ensuring public accountability as a means of fighting corruption. This question was well attempted by the candidates.

bi) Candidates were required to briefly discuss what performance audit entails. With the exception of some few candidates who took performance audit to mean compliance audit, this question was well attempted by the candidates.

bii) This question required candidates to evaluate the three (3) factors that the Auditor-General would be concerned with when carrying out the performance audit in relation to the construction of the Greater Accra Regional Hospital. Some candidates could not differentiate between efficiency and effectiveness.

QUESTION FIVE

a)

i) Factors giving rise to new Auditing Standards: International Standards on Auditing (ISAs) are produced by the International Auditing and Assurance Standard Board (IAASB), a technical committee of the International Federation of Accountants (IFAC). New International Auditing Standards arise as a result of the following:

- 1) **Response to new legal requirements:** When new laws are enacted which have global implications for auditing and assurance practice, the IAASB will review the existing standards to determine whether they can adequately address the new legal requirements. If the existing standards are not adequate, a new standard will be produced to replace the existing inadequate one.

- 2) **Changes in the economic and business environments:** Changes are constantly taking place in the economic and business environment. To remain relevant to the business environment, the Standard board on its own initiative or on the prompting of the IFAC governing council produces a new standard to respond to the new demands on the profession. For example, the introduction of ICT into business processes and reporting of financial information electronically required the International Standards on Auditing to guide auditors.
- 3) **Demands from industry players and the general public:** Clients and other stakeholders continue to express dissatisfaction about the performance of their external auditors even though some of the demands may be informed by e.g. the expectation gap. To maintain the good will of the client and other stakeholders the board will respond by revising the existing standards or come out with a completely new standard for example the revision on International Standards on Auditing 700/701 to make the auditors' report on general purpose financial statements more user friendly.
- 4) **Self-introspection:** The IFAC council itself may find that an existing standard has become inadequate or irresponsible to the needs of practitioners and their clientele and would initiate action for the standard board to revise the existing standards or produce a completely new standard.

(4 points well explained @ 1½ marks each = 6 Marks)

- ii) The procedures for developing a new standard:
 - When the need arises for a new standard, the standard board is charged by IFAC council to initiate action
 - The board will initially review the existing standards to determine its adequacy to address the need. The board may determine that the existing standard should be revised or a new standard should be produced.
 - The board then produces an exposure draft.
 - The exposure draft is widely circulated to professional accountancy bodies, governments, industry players and regulators for comments.
 - The comments received are taken into account in producing a new standard for the attention of the IFAC Council.
 - The Council studies the amended draft and suggest improvements which are incorporated.
 - The final draft is debated and voted on by the Council.
 - The approved version becomes the new standard after a waiting period.

(Any 4 points @ 1 mark each = 4 Marks)

b)

i) **African Designs Co. Ltd (ADCL)**

ADCL's sales ledger has been corrupted by a computer virus; hence no detailed testing has been performed on revenue and receivables. The audit team will need to see if they can confirm revenue and receivables in an alternative manner. If they are unable to do this, then two significant balances in the financial statements will not have been confirmed. Revenue and receivables are both higher than the total profit before tax (PBT) of GH¢ 2million; receivables are 170% of PBT and revenue is nearly eight times the PBT; hence this is a very material issue.

The auditors will need to modify the audit report as they are unable to obtain sufficient appropriate evidence in relation to two material and pervasive areas, being receivables and revenue. Therefore a disclaimer of opinion will be required. A basis for disclaimer of opinion paragraph will be required to explain the limitation in relation to the lack of evidence over revenue and receivables. The opinion paragraph will be a disclaimer of opinion and will state that we are unable to form an opinion on the financial statements.

(3 marks)

Ghana Design Co. Ltd (GDCL)

GDCL is facing going concern problems as it has experienced difficult trading conditions and it has a negative cash outflow. However, the financial statements have been prepared on a going concern basis, even though it is possible that the company is not a going concern. The prior year financial statements showed a profit of GH¢1.2 million and the current financial statements show a loss before tax of GH¢ 4.4 million, the net cash outflow of GH¢ 3.2 million represents 73% of this loss (3.2/4.4 million) and hence is a material issue. The auditor will issue a qualified opinion.

(2 marks)

ii) **Procedures to be adopted include:**

African Design Company Limited

- Discuss with management whether they have any alternative records which detail revenue and receivables for the year.
- Attempt to perform analytical procedures, such as proof in total or monthly comparison to last year, to gain comfort in total for revenue and for receivables.

(2 points @ 1 mark each = 2 marks)

Ghana Design Company Limited.

- Discussion with management: Management should be asked to explain the reasons why they consider the going concern assumption to be valid. They should be asked about their future plans for the business since they anticipated a loss for next year, the possible implications of these for the going concern assumption should be discussed extensively with management.

- Cash flow Forecast: The cash flow should be discussed with management. The assumptions in the forecast should be checked and if appropriate challenged. Since there is a forecast of cash shortage, the auditors should discuss with management their plans for obtaining the additional financing that will be required.
- Review of sales order book: If this indicates a decline in sales order, the issue should be discussed with management.
- Review ageing receivables: Check a list of ageing receivables and assess the average
- Time to pay. If customers are taking longer to pay this may have adverse implication for operational cash flow.
- Information on the funding source: Discuss with management the source of funding expected and determine whether it is feasible and reliable
- Letters of Representation: After discussing the issue with management, the auditor should obtain letter of representation from management confirming their opinion that the entity is a going concern.

(3 points @ 1 mark each = 3 marks)
(Total: 20 marks)

EXAMINER'S COMMENT

The question was in two parts that is a) and b). Part a) was from section G of the syllabus. Part b) was further divided into i) and ii). bi) was from section D of the syllabus while bii) was from section C.

a) This question required candidates to analyse the factors that influence the development of Auditing Standards and discuss the procedures for developing new auditing standards. This question was well attempted by candidates.

bi) This question required candidates to describe the impact of issues in two given scenarios on an audit report. Some candidates used qualified opinion instead of modified opinion. Some could not give the appropriate opinion.

bii) This question required candidates to recommend procedures that an audit team should undertake at the completion stage in order to resolve an issue in a given scenario. Some candidates recommended control measures instead of audit procedures.

CONCLUSION

Candidates should take their time to study well before taking the examination. They should study with understanding. There is the need to provide guidance to students on how to answer questions.