

**INSTITUTE OF CHARTERED
ACCOUNTANTS (GHANA)**



**NOVEMBER 2010 EXAMINATIONS
(PROFESSIONAL)**

PART 2

**AUDIT AND INTERNAL REVIEW
(Paper 2.2)**

Attempt ALL Questions

TIME ALLOWED:

Reading & Planning	-	15 Minutes
Working	-	3 Hours

QUESTION 1

(a) With reference to ISA 520, Analytical Procedures, explain:

(i) what is meant by the term 'analytical procedures'; (2 marks)

(ii) the different types of analytical procedures available to the auditor; (3 marks)

(iii) the situations in the audit when analytical procedures can be used. (3 marks)

(b) Merciful Ltd sells soft drinks to retail outlets. Sales are made to individuals, with income being in the form of cash and cheques. All items purchased are delivered to the customer using Merciful Ltd's own delivery vans. The directors of Merciful Ltd indicate that the company has had a difficult year, but are pleased to present some acceptable results to the members. The income statements for the last two financial years are shown below:

	31/12/09	31/12/08
	GHS'000	GHS'000
Revenue	15,000	12,700
Cost of sales	<u>(7,000)</u>	<u>(8,600)</u>
Gross profit	8,000	4,100
Operating expenses:		
Administration	(2,400)	(2,600)
Selling and distribution	(2,000)	(1,400)
Interest payable	(200)	(200)
Investment income	<u>300</u>	<u>-</u>
Profit/(loss) before tax	<u>3,700</u>	<u>(100)</u>
Financial statement extract:		
Cash and bank	<u>500</u>	<u>(2,000)</u>

Required:

(i) Identify and provide a possible explanation for unusual changes in the income statement of Merciful Ltd. (9 marks)

(ii) Confirmation of the end of year bank balances is an important procedure.

Required:

Explain the procedures necessary to obtain a bank confirmation letter from Merciful Ltd's bank. (3 marks)

(Total 20 marks)

QUESTION 2

You are the audit manager in the audit firm, Bediako & Co. One of your audit clients is Asunafo Ltd, a company specialising in the manufacture and supply of sporting equipment. Asunafo Ltd has been an audit client for five years and you have been the audit manager for the past three years while the audit partner has remained unchanged. You are now planning the audit for the year ending 31 December 2009. Following an initial meeting with the directors of Asunafo Ltd, you have obtained the following information.

- (i) Asunafo Ltd is attempting to obtain a listing on a recognised stock exchange. The directors have established an audit committee, as required by corporate governance regulations, although no further action has been taken in this respect. Information on the listing is not yet public knowledge.
- (ii) You have been asked to continue to prepare the company's financial statements as in previous years.
- (iii) As the company's auditors, Asunafo Ltd would like you and the audit partner to attend an evening reception in a hotel where Asunafo Ltd will present their listing arrangement to banks and existing major shareholders.
- (iv) Asunafo Ltd has indicated that the fee for taxation services rendered in the year to 31 December 2007 will be paid as soon as the taxation authorities have agreed the company's taxation liability. You have been advising Asunafo Ltd regarding the legality of certain items as 'allowable' for taxation purposes and the taxation authority is disputing these items.
- (v) Finally, you have just inherited about 5% of Asunafo Ltd's share capital as an inheritance on the death of a distant relative.

Required:

- (a) Identify and explain the relevance of any factors which may threaten the independence of Bediako & Co's audit of Asunafo Ltd's financial statements for the year ending 31 December 2009.

(10 marks)
- (b) Explain **four (4)** roles the audit committee would play to meet corporate governance requirements of Asunafo Ltd.

(6 marks)
- (c) Explain why your audit firm will need to communicate with Asunafo Ltd's audit committee for this and future audits.

(4 marks)

(Total: 20 marks)

QUESTION 3

Aduanepa Ltd manufactures a range of dairy products (for example, milk, yoghurt, and cheese) in one factory located in Pramso. Products are stored in a nearby warehouse (which is rented by Aduanepa Ltd) before being sold to supermarkets located within Kuntanase district. The products are perishable with an average shelf life of eight days. Aduanepa Ltd's financial statements year-end is 31 July.

It is four months since the year-end and the annual audit of Aduanepa Ltd is almost complete, but the auditor's report has not been signed. The following events have just come to your attention. Both events occurred in late November.

- (a) A fire in the warehouse rented by the company destroyed 70% of the inventory held for resale.
- (b) A batch of yoghurt produced by Aduanepa Ltd was found to contain some chemical impurities. Many consumers have complained about food poisoning after eating the yoghurt. The result is that about 50% of the supermarkets have stopped purchasing Aduanepa Ltd's products and about 30% are considering whether to stop purchasing from Aduanepa Ltd. Lawyers acting on behalf of the consumers are now presenting a substantial claim for damages against Aduanepa Ltd.

Required:

In respect of **EACH** of the events at Aduanepa Ltd mentioned above:

- (i) Describe the additional audit procedures you will carry out. (10 marks)
- (ii) State, with reasons, whether or not the financial statements for the year-end require amendment. (10 marks)

(Total: 20 marks)

QUESTION 4

- (a) You are the audit manager in Ibn Dauud & Co. One of your new clients this year is Prosperity Ltd, a company having net assets of GHS5 million. The audit work has been completed, but there is one outstanding matter you are currently investigating. The directors have decided not to provide depreciation on a landed property in the financial statements, although International Accounting Standards suggest that depreciation should be provided.

Required:

State the additional audit procedures and actions you should now take in respect of the above matter.

(6 marks)

(b) Unfortunately, you have been unable to resolve the matter regarding depreciation of the landed property; the directors insist on not providing depreciation. You have therefore drafted the following extracts for your proposed audit report.

1. We conducted our audit in accordance with International Standards on auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement (remaining words are the same as normal unmodified report).
2. As discussed in Note 6 to the financial statements, no depreciation has been provided in the financial statements which practice, in our opinion, is not in accordance with International Accounting Standards.
3. The charge for the year ended 31 December 2009, should be GHS50,000 based on the straight-line method of depreciation using an annual rate of 2% for the buildings.
4. Accordingly, the non-current assets should be reduced by accumulated depreciation of GHS200,000 and the profit for the year and accumulated income surplus should be decreased by GHS50,000 and GHS200,000, respectively.
5. In our opinion, except for the effect on the financial statements of the matter referred to in the preceding paragraph, the financial statements give a true and fair view ... (remaining words are the same as for an unmodified opinion paragraph).

The extracts have been numbered to help you refer to them in your answers.

Required:

State the purpose of each of the above extracts in your draft audit report.

(10 marks)

(c) State the effect on your audit report of the following alternative situation:

Depreciation had not been provided on any non-current asset for a number of years, the effect of which if corrected, would be to turn an accumulated profit into a significant accumulated loss.

(4 marks)

(Total: 20 marks)

QUESTION 5

(a) ISA 620, **Using the Work of an Expert**, explains how an auditor may use an expert to obtain audit evidence.

Required:

State **three (3)** factors that the external auditor should consider when assessing the competence and objectivity of the expert.

(3 marks)

- (b) Auditors have various duties to perform in their role as auditors, for example, to assess the truth and fairness of the financial statements.

Required:

Identify **five (5)** rights that enable auditors to carry out their duties.

(5 marks)

- (c) List **five (5)** assertions relevant to the audit of tangible non-current assets and state one audit procedure which provides appropriate evidence for each assertion.

(5 marks)

- (d) Explain the term 'audit risk' and the **three (3)** elements of risk that contribute to total audit risk.

(7 marks)

(Total: 20 marks)