MAY 2017 PROFESSIONAL EXAMINATIONS
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME

STANDARD OF PAPER

The standard of the paper was assessed as average. It was not a difficult paper. It however examined most of the learning outcomes of the syllabus. The relevant verbs used included assess, discuss and contrast. Identify, state and describe were used in three sub-questions with total marks of fifteen (15) out of one hundred (100). The paper featured questions from seven (7) out of the nine (9) sections of the syllabus representing eighty (80) percent of the syllabus weighting. Sections C and H representing twenty (20) percent of the syllabus weighting were not explicitly featured but strands of some questions required knowledge of practice management and reporting to fully answer them.

GENERAL PERFORMANCE

The performance of candidates in the paper was nothing to write home about. Many candidates showed clearly that they were not ready for the paper. They did not display the in-depth knowledge and maturity required at level three of the professional examinations. Many candidates did not know the difference between a bad debt which should be written off and a doubtful debt for which a provision should be made. Similarly, many candidates could not distinguish between subsequent events and subsequent events review.

Common faults of candidates included not obtaining understanding of the requirements of the questions before making attempts at answering the question. This resulted in deviations and wrong answers. Secondly, many candidates resorted to the use of lengthy preamble to their answers which did not contain any relevant points to deserve marks.

Some candidates also wrote across the full length of the answer sheets including the spaces reserved for use by the examiners and moderators. However, candidates should be commended for the display of good handwriting and numbering of their points which made reading of scripts easy for the examiners.

QUESTION ONE

You are the audit manager in charge of the audit of Serwah Ghanaba Ltd for the year ended 31 December, 2014. The partner in charge of the audit instructs you to carry out a review of the company's activities during the financial year end. The following issues came up during the review.

i) On 28 February, 2015, Jessica Mensah who owed the company GH¢500,000.00 was killed by some robbers on her way to Accra after a visit to her hometown. The amount was part of the GH¢800,000.00 debtors appearing on the statement of financial position for the year end 31 December, 2014. It was realised that it will not be possible to recover the amount from the family of Jessica Mensah.

ii) In another development, the marketing director of the Company, Stephen Odoi who was due to retire on 31 March 2015 embarked on a 6 month leave prior to retirement with effect from 1 October 2014. Investigation instituted in May 2015 revealed that Mr Stephen Odoi took a contract appointment with another company from 1 November 2014. As a result of the investigation the company decided to bring an action against Mr Stephen Odoi to recover the salary paid to him from 1 November 2014 to 31 March 2015.

Required:

a) Assess the audit implications of issues (i) and (ii) above. **(10 marks)**

b) Describe the nature and purpose of subsequent events review **(5 marks)**

c) Recommend the audit procedures which would be carried out in order to identify any material subsequent events. **(5 marks)**

(Total: 20 marks)

QUESTION TWO

a) Your firm, Osei and Associates has been appointed as the auditors of Dadeka Limited for the first time to perform the audit of the company for the year ended 31 December 2015. The company is in the agro-processing industry and it sells most of its products to overseas customers. The following are two issues:

i) **Tax consultancy services**

The directors appointed a tax consultant to perform certain corporate taxation services for the tax year ended 31 December 2014. On the start of the audit of the financial statements for the year ended 31 December 2015, and a review of the Income tax paid, your firm discovered that the Company did not take advantage of the special tax rate of 8% available for companies in the "export of Non-Traditional goods" in section 1.2(1) of the then Internal Revenue Act 2000 (Act 592). On discussion of this with management of the company, your firm accepted an engagement to act on behalf of the company to negotiate with Ghana Revenue Authority (GRA) and re-open the tax assessment for 2014 and submit a new Tax Assessment. One of the provisions in the engagement letter was that your firm would be paid a fee of 20% of any tax savings the company enjoys as a result of the engagement. **(6 marks)**

ii) **Suspected Illegal Act**

During the observation of the inventory count at the company's warehouse on 31 December, 2015, the representative of your firm discovered that certain items on the premises were sealed and had inscriptions "Do not temper with seal" and these were not counted as part of the company's inventory. On enquiry, the staff member was advised to 'pretend she has not seen that'. It is suspected that the items contain either illegal drugs or ammunitions. This cannot be confirmed**.** **(4 marks)**

Required:
Identify and discuss the ethical and other professional issues raised by items (i) and (ii) above, and recommend what action if any, your firm should take.

b) Stevens and Associates have completed the audit of the accounts of Eno Serwah & Co. Ltd for the year ended 31 December 2015. The auditor's opinion on the financial statement has been favourable to Eno Serwah & Co Ltd. Internal check procedures after the audit revealed a shortage of cash of Two Million Ghana cedis (GH¢2m). The Directors of Eno Serwah & Co Ltd. put a freeze on the payment of the audit fees on the grounds that the audit could not detect the shortage.

Required:
Discuss the stand taken by the Directors of the company. **(10 marks)**

(Total: 20 marks)

QUESTION THREE

a) Your audit firm is auditing the current year's financial statements of a major client in the insurance industry. At the planning stage when the engagement partner was doing the risk assessment, he had an information that the company is under investigation by the National Insurance Commission for non-compliance with regulations. The client may be liable to sanctions if found culpable.

Non-compliance with laws and regulations has many implications for the operations of entities, their financial statements and the audit of their financial statements.

Required:

i) Discuss the implications of the suspected non-compliance with the insurance law by the client on its operations and the financial statements. **(5 marks)**

ii) Evaluate the implications of the client's non-compliance with the Insurance law on your audit. **(5 marks)**

b) The number of international non-governmental organisations (charitable organisation) is increasing in Ghana and your firm Zumah and Co. Chartered Accountants (a small firm) is contemplating entering that segment of the audit market. Your managing partner has asked you as an audit senior to conduct research on the audit of such entities to enable the firm to start bidding for jobs from those entities.

Required:
Write a memo to the engagement partner detailing the characteristics of such audit clients, what the firm needs to do and the audit organisation that your firm may need to join to enhance your chances of securing engagements to audit such entities.

(10 marks)

(Total: 20 marks)

QUESTION FOUR

a) Your firm has been contracted by the Office of the Auditor General (AG) of Ghana to provide the Ministry of Finance (MoF) with the certification of the Projection of Benchmark Petroleum Revenue for 2016.

The Petroleum Revenue Management Act (PRMA), 2011 (Act 815) became law in Ghana on 11 April, 2011 and Section 17 of the PRMA requires the Minister responsible for Finance to make a projection of the amount of petroleum revenue that would accrue to the Government of Ghana in the coming year not later than 1 September of each year.

The first schedule of the Act mandates an independent expert to certify the projection of the Benchmark Petroleum Revenue by the Minister before it would be used in the National Budget for the coming year.

The two major issues in the projection are the quantity of Oil and Gas expected and the world market price at which the oil and gas will be valued.

As part of the documents to be used in performing this assignment, MoF has given you:

- Projection of the Benchmark Petroleum Revenue from oil and gas for 2016 and

- Certification of the Estimate of the Oil and Gas production for 2016 from the existing and expected oil and gas producing fields in Ghana.

The first schedule of the Act prescribes a formula for the calculation of the Average Unit Price for Crude Oil and Natural Gas on the International Market to be used for the year. The certification in the Estimate of the Oil and Gas production was issued by an independent expert in the Oil and Gas industry.

Required:

i) State **FOUR** issues your firm will consider in order to decide whether or not to accept this engagement from the Office of the Auditor General. **(4 marks)**

ii) If your firm decides to accept the engagement, state **FOUR** issues your firm will consider in order to place reliance on the certification issued by the independent expert in the Oil and Gas industry in performing the engagement. **(4 marks)**

iii) State **TWO** audit procedures your firm would perform to determine that the Average Unit Price for Crude Oil and Natural Gas on the International Market for 2016 used by MoF in the Projection of the Benchmark Petroleum Revenue for 2016 are fairly stated. **(2 marks)**

b) The ***Institute of Internal Auditors (IIA)*** defines Internal Auditing as:

"An independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes".

Required:

Assess the importance of **THREE** recommendations the IIA has made to ensure that internal auditors remain independent even though they are employees of the company. **(4 marks)**

c) A public sector organisation has an Internal Audit function and an Audit Report Implementation Committee (ARIC) of the Board of Directors. The Internal Audit function does not have an Internal Audit Charter. Before the PFM Act, 2016 Act 921 was enacted, The ARIC has three members, the Managing Director of the organisation and two other directors, a legal practitioner and a retired career diplomat.

Required:

i) Identify the need for and state **TWO** of the major issues the Internal Audit Charter must cover in a public sector organisation. **(4 marks)**

ii) Discuss the conflict of interest and other issues raised by the composition of the organisation's ARIC in relation to the recommendations of the IIA. **(2 marks)**

(Total: 20 marks)

QUESTION FIVE

a) Your audit firm has been the statutory auditors for Apenkwa Co. Ltd. for the last three years. The company prepares its financial statements to December 31 each year. Due to the size of the company, it has been the practice of the client to prepare interim financial information to June 30 every year. At the request of the client you have been reviewing the interim financial information each year it is prepared.

Required:
Compare and contrast the audit of a completed financial statements and the review of an interim financial statements. **(10 marks)**

b) You are an audit senior in Patampa and Associates, and nearing the end of the audit of Duakor Ltd. for the year ended 30 June 2016. Duakor Ltd owns a chain of clothing stores and also has a manufacturing division where it makes its own label brand "Dumas". Own label clothing represents 50% of the inventory and sales of Duakor Ltd. The financial statements show a profit before tax of GH¢14m (2015 GH¢6m) and a statement of financial position total of GH¢46m (2015 GH¢30m). The following points have arisen on the audit:

i) Duakor Ltd. values its inventory at the lower of cost and net realisable value. Cost is determined by deducting a suitable estimated profit margin from selling price. Inventory in the statement of financial position as at 30 June 2016 was GH¢2,530,000.

ii) Duakor Ltd. has a refund policy which states that a customer who is not satisfied with their purchase may return their goods within 28 days of purchase and obtain an exchange or a cash refund. Experience has shown that exchanges and refunds are common, as Duakor Ltd's shops do not provide fitting rooms, space being at a premium. Duakor Ltd. does not make any provision in the financial statements for refunds.

Required:
Comment on the matters you will consider in relation to the implications of the above points on the audit report of Duakor Ltd.

(10 marks)

(Total: 20 marks)

MARKING SCHEME

QUESTION ONE

a)

i) ***(ISA) 560, "Subsequent Events"*** requires that auditors shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that required adjustments of or disclosure in, the financial statements have been identified.

The issue under consideration is an adjusting event – that is the event provides further evidence of conditions that existed at the end of the reporting period. The GH¢500,00.00 appeared on the statement of financial position for year end 31 December, 2014. In addition the amount is material. There is the need for the debt to be written off in Dec, 2014 financial statement since there is no hope for the amount to be recovered.

If the client refuses to make the write-off, the auditor should consider the type of modified opinion to issue-Qualified opinion or adverse opinion depending on the pervasiveness of the auditor.

(5 marks)

ii) The auditors should first ascertain from the board minutes that the board intend to proceed with the lawsuit and should then attempt to assess the outcome by consulting the directors and the company's legal advisors. Only if it seems probable that the salary paid to Stephen Odei will be recovered should a contingent gain be disclosed in the notes to the accounts along with a summary of the facts of the case. A prudent estimate of legal cost should be deducted.

It could be argued that the breach of contract by Mr Stephen Odei existed at the year end and therefore the salary for November and December 2014 should be treated as contingent assets and that for January - 31st March 2015 should he disclosed in notes to the accounts.

(5 marks)

b)

The auditor's active responsibility extends to the date on which they sign their audit report. As this date is inevitably after the year end, it follows that in order to discharge his responsibilities; the auditor must extend the audit work to cover the period after the year end.

The objective of this review is to ascertain whether management has dealt correctly with any events, both favourable and unfavourable, which occurred after the end of the reporting period and which need to be reflected in the financial statements, if those statements are to show a true and fair view.

The general rule is that, in the preparation of year-end financial statements, no account should be taken of subsequent events unless to do so is required by statute or to give effect to retrospective legislation, or to take into account an event which provides information about a condition existing at the end of the reporting period, for example realisable values of inventory, or indicates that the going concern concept is no longer applicable. Additionally, certain events may have such a material effect on the company's financial condition, for example a merger, that disclosure is essential to give a true and fair view.

(5 marks)

c)

Audit Procedures

- Ask management if there have been any material subsequent events

- Identify and evaluate procedures implemented by management to ensure that all events after the end of the reporting period have been identified, considered and properly evaluated as to their effect on the financial statements.

- Review relevant accounting records to identify subsequent cash received in relation to accounts receivable, to check items uncleared at the year-end on the bank reconciliation, and to check NRV of inventories from sales invoices

- Review budgets, profit forecast, cash flow projections and management accounts for the new period to assess the company's trading position.

- Consider known 'risk' areas and contingencies, whether inherent in the nature of the business or revealed by previous audit experience, or by lawyers letters.

- Read minutes of shareholders and management meetings, and correspondence and memoranda relating to items included in the minutes to identify any matters arising.

- Consider relevant information which has come to the auditors' attention from sources outside the entity, including public knowledge of competitors, suppliers and customers

- Obtain written representations concerning subsequent events from management.

(1 mark each for any 5 valid points)

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 1 (a i)

This question required the treatment of bad debt discovered in the subsequent period as a result of major debtor having been killed by armed robbers with no prospect of recovery of the debt from family members. This was obviously and adjusting event requiring a write off of the debt. Only few candidates gave the right answer. Some candidates suggested a provision for doubtful debt while others considered it a non-adjusting event which should be located in the next financial statement. Poor performance.

Question 1 (a ii)
Candidates were to discuss actions needed in respect of six (6) months salary paid to a retiring director of marketing who went ahead to secure a new contract appointment with another employer when his terminal leave has not ended. This fact was discovered during the auditors subsequent events review and the management would want to sue for recovery of the salary.

Some candidates ruled that the marketing director did not commit any offence without recourse to the terms of his appointment in the employment of the client. However, the question required finding out from management whether they intended to go ahead with the legal issue and their chances of success to determine the probability of a contingent asset and its treatment and any possible provision for legal expenses. A few candidates rightly said since the matter involved a director it is material by nature and should be disclosed in a note to the financial statements. Majority of candidates did not find their way clear.

Question 1 (b and c)
These questions required the description of the nature and purpose of subsequent errors review and a recommendation of procedures to identify any material subsequent events.

Many candidates misunderstood the question and described subsequent events rather than the review. They however got the purpose of the review right. The required procedures were also correctly given. Mixed performance.

QUESTION TWO

a)

i) Tax consultancy services

The ethical issues here are that the Auditor has to report to management of the company about the unsatisfactory service provided by another professional, who may also be a member of the Institute of Chartered Accountants – Ghana (ICAG).

The code of Ethics for Professional Accountants does not prohibit this but cautions that the other professional accountant involved (if he/she can be identified) must be contacted with the permission of the mutual client and be told of the need to discuss the issue with the client, due to, in this case the financial implications to the client.

This will ensure that the other professional accountant (if indeed he/she is a member of ICAG) will not think that we are deliberately destroying his reputation since this will also put our profession in general into disrepute and must be done only if absolutely essential, as in this case, the amount involved could be substantial.

The second ethical issue is that the auditor is accepting an engagement to provide a professional service on the basis of a contingent fee. The code does not frown on this except if the engagement is an assurance one in which the auditor is required to give an opinion for management to rely on. This is a tax consulting assignment and as such, the professional accountant can accept it on contingent fee basis.

The professional accountant need be aware of two issues in this case:
- Accepting this engagement (and on contingent fee basis) so early in your relationship with the new audit client could compromise the independence of the auditor.
- The auditor, if new in practice, would need to be cautious as this fee in addition to the normal audit fee, could take him/her beyond the 15% threshold for fees from one client as this could lead to intimidation threat.

(6 marks)

ii) Suspected Illegal Act

The ethical issue here is that it appears that a crime is suspected but the professional accountant has no evidence to confirm the suspicion. Therefore the need to override the confidentiality requirement due to public interest. Any of the suspected cases, storing of illegal narcotic drugs or storing of ammunitions are both issues of public and national security interest.

The code of ethics requires that under such circumstances, the professional accountant would need to seek legal advice as well as professional advice from the technical department of ICAG but not disclose the identity of the client to any person consulted.

(4 marks)

(b) **Responsibility for Prevention of Fraud**
Management

- The responsibility for the prevention of fraud, other irregularities and errors rest with management. Management has the fiduciary role of safeguarding assets since the directors of a company are regarded in law as acting in stewardship capacity concerning the property under their control. Management can discharge these responsibilities by adopting methods such as;

- The installation of an effective accounting system

- The institution and the operation of an appropriate system of internal control.

- Ensuring that employees understand and comply with relevant codes of conduct.

- Maintaining a register of relevant legal requirements and ensuring that operating procedures and conditions meet the required standards.

- The establishment of an independent internal audit function and the appointment of audit committees.

Responsibility for Detection

The primary responsibility for the detection of fraud, other irregularities and errors rests with management. This role of detection is an extension of its role in preventing.

Auditor

- The auditor is not responsible for preventing fraud, other irregularities or errors. Audit procedures should be designed to give a reasonable expectation of detecting any material misstatement, whether intentional or unintentional in an entity's financial statements. The auditor cannot prevent a fraud or other irregularity from occurring, however, the annual recurring audit may act as a deterrent.

- The auditor is to report to management when he identifies significant weaknesses in the structure of accounting and internal control and deficiencies in their operation.

- The auditor's responsibility regarding the detection of fraud, other irregularities and error is to plan, perform and evaluate his audit work so as to have a reasonable expectation of detecting material misstatement in the financial statement whether they are caused by fraud or other irregularities or errors.

- On the basis of the above it is wrong for the Directors to refuse to pay the audit fees. If it is found that the auditors are negligent in their performance of duty then the directors can bring a charge against them in court or file a complaint with ICAG.

(1 mark each for any 10 valid points)

(Total: 20 marks)

EXAMINER'S COMMENTS
Question 2 (ai)
Candidates were to identify and discuss professional and ethical issues involved in offering tax consultancy services to an audit client to their tax returns to take advantage of 8% special tax rate available to Non-traditional goods exporters, under contingency fee arrangements.

Some candidates were able to identify and discuss the issues correctly, namely, non-prohibition of such service to an audit client as well as the contingent fee arrangement but the 20% of the tax savings as the fee for the engagement could result in self-interest and intimidation threats. Other candidates identified and discussed advocacy and self-review threats instead. Mixed performance.

Question 2 (aii)
This question was suspected illegal act by an audit client, some of whose inventory items have been sealed and marked "Do not temper with seal" and a further instruction by an employee to the audit clerk involved in the inventory comment to turn a blind eye to them. The issue is whether the client is dealing in illegal drugs or ammunition and what actions the audit team should take. Some candidates jumped to a hasty conclusion that the client was engaging in money laundering and should be reported to the financial intelligence centre. Those who knew the answers wrote that they would approach the management to get the items opened for examination. Failure for which they would seek legal advice or consult ICAG for advice without disclosing the identity of the client and avoid tapping-off the client. Mixed performance.

Question 2 (b)
The directors put a freeze on the audit fees of an auditor after the discovery of cash shortage of GH₵2.5million when the auditor had earlier issued a favourable audit report. Candidates were to discuss the issue. Some candidates without hesitation found the auditor negligent and advised the director to sue him for damages. Other candidates rightly reasoned that the prevention and detention of fraud and error are the primary responsibilities of the management even though the auditor has a secondary responsibility to apply tests to give him reasonable chance of discovering same. They argued that the directors should pay the auditors and if they can prove that their company suffered a loss as a result of the auditor's negligence, they can go ahead and sue him. Well answered question.

QUESTION THREE

a)
i) Non-compliance with Insurance law regulations whether suspected or actual has many implications on the clients' operations and Financial Statements
- Non-compliance with the insurance laws can lead to withdrawal of operating licence bringing the operations of the entity to either temporary or permanent halt thereby affecting the going concern of the entity.

- Non-compliance with the insurance laws may results in fines and penalties which can have adverse consequences on the result of operations and financial position of the entity if the amounts involved are substantial.

- If the investigations become public knowledge it may cause existing clients to end their relationship with the Company and prospective clients may refuse to patronise the services of the company.

- Non-compliance with the insurance laws has further implications on the financial statements, which if not properly treated may result in the financial statements not giving a true and fair view. Fines and damage should be correctly treated in the financial statements while provision should be made or disclosed in respect of contingent liabilities.

- Non-compliance with the insurance law if is found to be intentional can affect the integrity of the management and those charged with governance.

(Any 5 points for 5 marks)

(ii)

The implications of the non-compliance with the Insurance law by the client has the following implications for audit.

- Risk assessment: In accordance with ISA 315 as part of our risk assessment we have to obtain knowledge of the clients operations to identify risk areas which include non-compliance with laws and regulations.

- Further audit procedures to perform. Having discovered that the company is under investigation we have to determine further audit procedures to perform to obtain sufficient appropriate audit evidence to determine the proper treatment of the suspected non-compliance with the insurance law in the financial statements.

- Assessing the effect of the suspected non-compliance with the Insurance law on the view given by the financial statements. We have to use the evidence obtained in two above to determine whether management has reflected the possible outcome of the investigation in the financial statements or have adequately disclosed the matter in a note to the financial statements.

- Going concern implication: We have to determine whether the investigations are likely to affect the going concern of the client.

- Audit Opinion: We have to consider the types of audit opinion to issue in the light of our audit findings and conclusion. If management correctly reflected the effect of the suspected non- compliance in the financial statements or adequately disclosed them we may issue an unmodified opinion with an emphasis of matter paragraph or issued a modified opinion depending on the circumstances.

(Any 5 points for 5 marks)

b)

TO: MANAGING PARTNER
FROM: AUDIT SENIOR
SUBJECT: AUDIT CHARACTERISTICS OF INTERNATIONAL NON-GOVERNMENTAL ORGANISATIONS
DATE: ×××

In respect of your request on the above subject matter please find below my findings: Audit of international non-governmental organisations falls under transnational audits. **Transnational audits** means audits of financial statements which are or may be relied upon outside the entity's home jurisdiction for purposes of significant lending, investments or regulatory decisions, this will include audits of all financial statements of companies with listed equity and debt and other public interest entities which attract particular public attention because of their size, products or services.

Other public interest entities include those entities in either the public or private sectors which have significant transactions across national borders, whether or not having either listed equity or debt. These will include for example large charitable organisations or trusts, major monopolies or duopolies, providers of financial or other borrowing facilities to commercial or private customer's deposits taking organisations and those holding funds belonging to third parties in connection with investment and savings.

Significant transactions across national borders shall include transactions such that, there is a reasonable expectation that the financial statements of the entity may be relied upon by the user outside the entity's home jurisdiction for purposes of significant lending, investments or regulatory decision. In principle, the definition of transnational audit should be applied to consolidated entity as a whole including the individual entities comprising the consolidated entity.

An international charity taking donations through various national branches and making grants around the world is clearly considered as a public interest entity and operating across national borders. Further, the international structure would create reasonable expectation that the financial statements would be used across national borders by donors in other countries, if not by others for purposes of significant lending, investments or regulatory decision

Features of Transnational Audits

- In the globalised business environment, many audits are clearly transnational and this produces a number of problems which can limit the reliability of the audited financial statements.
- Regulatory and oversight of audit differs from country to country
- Differences in auditing standards from country to country
- Variability of audits in different countries

Actions needed to prepare the firm to enter the transnational audit market of international charitable organisation.
Since our firm is very small we need to build our capacity and muscle for such audits. Actions needed include:

- Arrangement to merge with other firms to increase our size and capacity.
- Joining the Forum of Firms. This is an international grouping of the big firms founded by the following network BDO, Deloitte, EY, Grant Thornton, KPMG and PWC. These firms have a voluntary agreement to meet certain requirements that are set out in their constitution namely:
- Promoting the use of high quality audit practises including the use of ISAs
- Maintaining quality control standards in accordance with international standards on Quality Control issued by the IAASB and conducting globally internal quality assurance review.

The Transnational Auditor's Committee: The IAASB has set up the Transnational Auditor's Committee (TAC) to provide guidance to the members of the Forum of Firms. Our membership of the Forum of Firms will enable us to benefit from the services of the committee

(10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
Question 3 (a & b)
Candidates were to discuss the implications of suspected non-compliance with the Insurance law by an audit client on the operations and financial statements and on the auditors work.

Majority of candidates were able to discuss the implications of the suspected non-compliance with the insurance law on the operations and financial statements of the client. However, the implications of the client's suspected non-compliance with the law on the auditor's work were not clearly discussed as required. Candidates should have discussed the implications in relation to the planning of the audit and risk assessment, responses to the risk assessment in carrying out the audit and assessment of the non-compliance on the audit report. Mixed performance.

Question 3 (c)
Candidates were requested to write a memo on the characteristics of International Non-Governmental Organizations audit and what a small firm needs to dot to enter that segment of the audit market.

Many candidates did not recognize this as a transnational audit, the report of which will be relied upon across national boundaries. Similarly, many candidates did not know of the existence of the forum of firms and the Transnational Audit Committee (TAC). Performance was poor.

QUESTION FOUR

a)
(i) **Issues to consider**

- Are there any ethical issues that serve as a barrier to us for accepting the engagement?

- Are we professionally qualified to perform this engagements especially due to its specialist nature?

- Do we have adequate staff and other resources, expertise and time to complete the engagement professionally?

- We would need to set up and submit a letter of engagement to the AG and the Ministry of Finance to serve as an agreement for the engagement and state our understanding of the scope, deliverables, timing, fees and other issues associated with the assignment. We shall accept the engagement when the letter of engagement is signed by the relevant authority.

(4 points for 4 marks)

(ii) Issues your firm will consider in order to place reliance on the certification

- We would determine if the expert has the professional certification/membership of an appropriate professional body, in this case an engineering body in the oil and gas industry for this kind of certification.

- The experience and reputation of the expert in the field

- The independence of the expert in relation to the Ministry of Finance and the owners of the oil and gas fields.

- The objectives and scope of the work performed by the expert and the general outline of specific matters covered by the report from the expert

- The intended use of the expert's work since we did not have any input into this before the report was completed.

- The confidentiality and clarity of information used by the expert

- The assumptions and methods used and their suitability to achieving the intended objective of the report.

(Any 4 points for 4 marks)

(iii) Audit Procedures

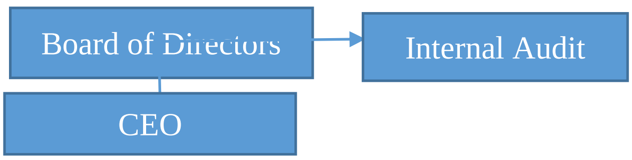
- We have to determine that the formula used is that prescribed by the Act stated.
- We have to reperform the calculation to arrive at the same values.
- We have to examine all the assumptions and methods used to determine that they are reasonable under the circumstances by comparing them to those used in the past few years.

(Any 2 points for 2 marks)

b) One of the most important aspects of IA is to ensure that Internal Auditors remain independent of the functions they audit. To ensure this the IIA makes many recommendations especially for IA since the staff in the IA function are also employees of the same organization they audit.

To promote the independence of IA the IIA makes the following recommendations:

- The IIA recommends that the Chief Audit Executive or the Head of Internal Audit must be appointed and can only be dismissed by the Audit Committee, a sub-committee of the Board of Directors charged with oversight responsibly for all Audit related matters and not by the management of the organization.
- IA reports administratively to the CEO of the organization but functionally (that in its reporting duties) to Audit Committee.
- The IIA also recommends that IA must occupy a position in the Organisational Structure that ensures that the CAE is next to the Board of Directors and above all others on the organization, as shown below:



- The IIA also recommends that internal audit activities shall remain free of influence by any element in the organization, including matters of audit selection, scope, procedures, frequency, timing, or report content; and
- Internal Auditors shall have no direct operational responsibility or authority over any of the activities in the organisation. Accordingly, they shall not develop or install systems or procedures, prepare records, or engage in any other activity which would normally be audited (this is to avoid self-review) and so remain independent of all operational issues in the organisation.

(Any 3 points for 4 marks)

c)
i) **An Internal Audit Charter** serves as the contract between the Internal Audit Function in the Organisation and the Organisation, and serves as the formal document that regulates the relationship between Internal Audit and its clients.

It defines the role and responsibilities of Internal Audit, the scope of its activities and the authority that would allow IA to fulfil the roles and responsibilities.

In a public sector organization in particular, IA Charters are necessary to ensure that the activities of IA are not hindered by the claim of confidentiality of documents or need to provide services to the public in a fast way to avoid IA fulfilling their duty by granting them authority of unhindered access to all records of the organization as in:

Authority is granted for full, free, and unrestricted access to any and all records of the organisation, physical properties, and personnel relevant to any function under review. All employees are requested to assist Internal Auditing in fulfilling their staff function.

The IA Charter will also define the position of IA in the Organizational Structure by stating that IA reports administratively to the CEO of the organization but functionally (that in its internal audit reporting duties) to the Audit Committee, the sub-committee of the Board of Directors charged with oversight responsibly for all Audit related matters.

(4 marks)

ii) **Conflict of Interest**

- The Managing Director of the Public Organisation is an Executive Director and should not be a member of the Audit Committee as he will be in a conflict of interest position if the Audit Committee has to discuss an internal audit report on any area in the organization since he is ultimately responsible for everything that happens in the organization. Institute of Internal Auditors (IIA) recommends that no executive director should be part of an Audit Committee.

- IIA also recommends that an Audit Committee must also have at least one member that is financially literate or can understand and interpret financial statements. The two other members described in the passage do not appear to be person who fit this description and so the composition of the Audit Committee does not, in this respect, satisfy the IIA recommendation.

(2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 4 a(i)

This question was in respect of the appointment of an auditor by the Auditor-General to certify the projection of Benchmark Petroleum Revenue for inclusion in Ministry of Finance Budget proposal as required under the Petroleum Management Act.

Candidates were to state issues the auditor should consider before accepting the appointment.

Question 4 (ii)
This sub-question requires four factors the auditor should consider before placing reliance on the work of independent expert who prepared certification of the estimate of oil and gas production used in the calculation of the revenue projection for the budget.

Question 4 (iii)
This requires the procedures to perform to determine the average unit price of crude oil and gas on the International market used by the Ministry of Finance.

The issues to consider before accepting appointment, factors to consider before placing reliance on the work of the independent expert and procedures to perform to confirm the price used by the Ministry of Finance were correctly given by many candidates. These were best answered questions in the paper.

Question 4 (b)
The question requires three recommendations by IIA designed to ensure the independence of Internal Auditors, namely mode of appointment, organization status and reporting lines and types of assignments to avoid. This question was also well answered.

Question 4 (c i & ii)
These question requires knowledge of internal audit charter and conflict of interest and other issues arising in appointing the Chief Executive Officer, a lawyer and a retired diplomat as members of and the Audit Committee. These questions received mixed treatment

QUESTION FIVE

a) Differences

- Audit is a statutory requirement while review of interim financial statements is at the request of the client.
- The audit report provides an opinion while the review report gives a conclusion.
- The audit opinion provides a high or reasonable assurance while the review conclusion gives a limited or moderate assurance to the user.
- Procedures performed in an audit are more detailed than those performed in a review engagement.

- The audit opinion is in respect of whether the financial statements give a true and fair view while the review conclusion is in respect of whether nothing has come to the auditor's attention to cause him to believe that the information does not give a true and fair view.

(Any 5 points for 5 marks)

Similarities

- **Ethical Consideration**
  The auditor must follow the same requirement in the performance of both arrangements and should apply quality control procedures applicable to the individual engagement.

- **Planning and engagement performance**
  The auditor must plan and assign staff with the requisite qualification and provide the necessary direction, supervision and review of the work for both assignments.

- Both engagements are performed by the auditor of the client using International Standards established by IAASB.

- The auditor performs both engagements with the attitude of professional scepticism.

- For both engagements, the auditor should agree the terms of the engagement with the client.

- At the end of performing procedures and obtaining sufficient appropriate evidence, the auditor must furnish the client with a report.

- In both engagements, the auditor obtains written representation from management on its responsibilities for internal control and the financial information.

(Any 5 points for 5 marks)

(b)

i)**Inventory**

- IAS 2 requires that inventory be valued at the lower of cost and net realisable value. IAS 2 defines cost as all costs of purchase, conversion and other costs incurred in bringing the inventory to its present location and condition.

- The IAS 2 outlines a number of methods of arriving at an approximation of cost in the absence of a satisfactory costing system. One such method is the use of a selling price less an estimated profit margin. This is a costing method commonly used in retail entities. However, this is reasonable only if it can be shown that the method gives a reasonable approximation of cost.

- Given that 50% of Duakor's inventory is manufactured in-house, it appears to be unlikely that they cannot ascertain the cost of the inventory in a better way than the selling price method. The chain of shops is small, and there should be sufficient controls over inventory transfer to enable the company to establish the cost of inventory using a FIFO system.

- While the auditors might suggest to the directors that they look into the costing system and make improvements in future years, it is unlikely that they would modify the audit report in the current year over this matter, assuming that the directors have shown that the accounting policy gives a reasonable approximation of cost. This is because if a reasonable approximation of cost is given, the difference is not going to be material to the financial statements.

- Also, if Duakor has had the policy for a long period, the policy is at least consistent with itself. If the auditors had made recommendations that the system was reviewed in future years and the directors refused to make any amendments to the system in future, the auditors might want to consider taking further action in future years.

- To conclude, if there are no other audit matters arising in relation to inventory, the audit report will be unmodified in this respect.

(Any 5 points for 5 marks)

ii) Provisions

- Duakor offers refunds and exchanges to unhappy customers and experience shows that this offer is commonly taken up. If a sale is refunded, it is as if the sale never took place. It is therefore not prudent for Duakor to recognise profits on such sales. If items are exchanged, the profit element would still exist, so only the inventory element would be potentially misstated.

- As the refund period is 28 days, the issue is isolated to sales made in the last month of the year. In the absence of specific figures, this approximates to 1/12 of annual revenue and profit, and is therefore potentially material. Using these approximations, this would mean that if more than a quarter of June's sales were refunded, this could be material to revenue, and potentially to profit.

- Given that the accounts are unlikely to be finalised before the end of July, the refunds figure for June should be available to both the directors and the auditors. They should both be able to assess whether the potential provision required is material to the financial statements, and how much the provision should be, if one is required.

- In conclusion the audit report would only be modified in respect of this matter if the auditors felt that a material provision was required and the directors refused to include one in the financial statements. In this case, the auditors would issue an 'except for' opinion, on the grounds of material misstatement in the financial statements.

- On the whole it appears likely that in both cases the auditors will issue an unmodified report for the year ended 30 June, 2015.

(Any 5 points for 5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 5 (a)

Candidates were required to compare and contrast the audit of financial statements and a review of interim financial statements by the auditor of an entity. Some few candidates provided the right answers while many candidates confused interim audit with review of interim financial statement resulting in wrong answers being given. Not very good performance.

Question 5 (b)

Candidates were required to comment on matters they will consider in relation to an audit client who values inventory at the lower of cost and net realizable value, where cost is arrived at by deducting estimated profit margin from selling price and the client failing to make provision for returns and exchanges to customers.

Some candidates gave very good answers while others failed miserably especially when it came to the type of opinion to issue under the two scenarios. Mixed performance.

CONCLUSION

Candidates should be encouraged to be more serious with their studies. Some candidates lacked understanding of the fundamental principles hence their inability to apply them to relevant issues. Those who have been exempted from the auditing 1 paper should be encouraged to study the contents of auditing 1 students manual alongside the auditing 2 manual.