

**MAY 2018 PROFESSIONAL EXAMINATIONS
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

STANDARD OF THE PAPER

The topics featured in the paper were all within the scope of the syllabus. Generally, the paper was up to the required standard.

In terms of syllabus coverage and marks allocation, this paper is graded as the best in recent times. All the nine sections of the syllabus were featured and the marks allocation followed strictly the syllabus weighting.

The suggested solutions adequately responded to the requirements of the questions and the marking scheme was structured with fairness to the candidates in mind and the nature of the questions.

GENERAL PERFORMANCE OF CANDIDATES

Performance of candidates fell below expectation considering the level of difficulty of the questions. Candidates approach to the questions appeared very amateurish. They did not display maturity and in-depth reasoning required at this level. Answers were shallow and sometimes long and winding. However, the lengthy and unproductive preambles to answers that characterised previous papers were happily absent. Common faults discovered were wrong numbering of answers, failure to number papers in the booklet and not making reference to papers where answers were continued after a break.

QUESTION ONE

As the Senior Audit Manager in MNO & Co, a firm of Chartered Accountants, you have just had a meeting with a Senior Partner at the firm, in which he informed you that you have to carry out an investigation requested by the Management of ECO Ltd.

FACTS

- i) One of ECO Ltd's subsidiaries, PQR Ltd, has been making losses for the past year. ECO Ltd's management is concerned about the accuracy of PQR's most recent quarter's management accounts. The summarised statements of profit or loss for the last three quarters are as follows:

| | Quarter to 31-Mar 2018 GH¢'000 | Quarter to 31-Dec 2017 GH¢'000 | Quarter to 30-Sep 2017 GH¢'000 |
|--------------------------|---|---|---|
| Revenue | 429 | 334 | 343 |
| Opening inventory | 180 | 163 | 203 |
| Materials | 318 | 251 | 200 |
| Direct wages | 62 | 54 | 74 |
| | <u>560</u> | <u>468</u> | <u>477</u> |
| Less closing inventory | (162) | (180) | (163) |
| Cost of goods sold | <u>398</u> | <u>288</u> | <u>314</u> |
| Gross profit | 31 | 46 | 29 |
| Less overheads | (63) | (75) | (82) |
| Net loss | <u>(32)</u> | <u>(29)</u> | <u>(53)</u> |
| Gross profit (%) | 7.2% | 13.8% | 8.5% |
| Materials (% of revenue) | 78.3% | 70.1% | 70.0% |
| Labour (% of revenue) | 14.5% | 16.2% | 21.6% |

- ii) ECO Ltd's management board believes that the high material consumption as a percentage of revenue for the quarter to 31 March 2018 is due to one or more of the following factors.
- Under-counting or under-valuation of closing inventory
 - Excessive consumption or wastage of materials
 - Material being stolen by employees or other individuals
- iii) PQR Ltd has a small number of large customers and manufactures its products to each customer's specification. The selling price of the product is determined by:
- Estimating the cost of materials;
 - Estimating the labour cost and
 - Adding a mark-up to cover overheads and provide a normal profit.
- iv) The estimated costs are not compared with actual costs. Although it is possible to analyse purchase invoices for materials between customers' orders this analysis has not been done.
- v) A physical inventory count is carried out at the end of each quarter. Items of inventory are entered on inventory sheets and valued manually. The company does not maintain perpetual inventory records and a full physical count is to be carried out at the financial year end, 30 June 2018.

- vi) The direct labour cost included in the inventory valuation is small and should be assumed to be constant at the end of each quarter.
- vii) Historically, the cost of materials consumed has been about 70% of revenue. The management accounts to 31 March 2018 are to be assumed to be correct.

Required:

- a) Identify and describe the matters that you should consider and the procedures you should carry out in order to plan an investigation of PQR Ltd.'s losses. **(10 marks)**
- b) Explain the matters you should consider to determine whether closing inventory at 31 March 2018 is undervalued. **(3 marks)**
- c) Describe the tests you should plan to perform to quantify the amount of any undervaluation. **(3 marks)**
- d) Identify and explain the possible reasons for the apparent high materials consumption in the quarter ended 31 March 2018. **(2 marks)**
- e) Describe the tests you should plan to perform to determine whether materials consumption, as shown in the management accounts, is correct. **(2 marks)**

(Total: 20 marks)

QUESTION TWO

- a) Dzinpa & Associate, a firm of Chartered Accountants, in which you are a partner has the following issues emerged in relation to two of its clients:
 - i) Good Life Insurance Company Limited is a major client and is listed on the Ghana Stock Exchange. The audit of this client has just started with an audit team of six members, of which Sally is the most junior. Sally has invested in a personal pension plan in a company whose investment portfolio is in all the listed companies on the Ghana Stock Exchange.
 - ii) You are the head of a team carrying out due diligence on Dumsor Ltd., a limited liability company which your client, Solar Electricals, is considering taking over. David, your second in command on the team, has confided in you that in the course of his work he has met the daughter of the Finance Director of Dumsor Ltd., and he intends to invite her on a date.

Required:

Comment on the *ethical and other professional issues* raised in the above matters.

(Note: Your answer should outline the threat arising, the significance of the threat, any factors you have taken into account, and if relevant, any safeguards you could apply to eliminate or mitigate the threat.) **(10 marks)**

- b)
 - i) The quality control standard for firms, *ISQC 1: Quality control for firms that perform audits and reviews of financial statements and other assurance services engagements*

sets out standards and guidance that helps firms to comply with ethical, professional and legal requirements in the performance of audit and other professional assignments for the public.

Required:

At the firm level, recommend the elements that should be included in an audit firm's system of Quality Control. **(5 marks)**

- ii) You are a partner in Nii and Nana Associates, a firm of Chartered Accountants. You have just been nominated for the audit of Wine and Dine Ltd. a catering company in the twin-city. The company and its officers are not known to the firm. The company has just been incorporated and has not previously had an audit. You are about ready to accept the nomination.

Required:

Discuss why it is important for auditors to carry out procedures before accepting nomination for appointments. **(5 marks)**

(Total: 20 marks)

QUESTION THREE

- a) At a final meeting with the client, DMS Ltd, one of the Audit Partners of DTR & Co Chartered Accountants had an argument with the Finance Director of DMS Ltd on an issue that borders on compliance with a relevant law. The Environmental Protection Authority had sanctioned the DMS Ltd for environmental regulation breaches for the year 2016. The Finance Director was of the view that the external auditors are to be blamed for negligently failing to plan their audit to detect such non-compliance with environmental regulations.

Required:

- i) Explain the *responsibility of external auditors* in considering laws and regulations in an audit of financial statements. **(2 marks)**
- ii) Explain the issue of *non-compliance* in relation to laws and regulations in an audit. **(2 marks)**
- iii) Explain the *policies and procedures* which may be implemented to assist management in the prevention and detection of non-compliance with laws and regulations. **(6 marks)**
- b) Recent cases of bank failures have called into question the professional competence and integrity of external auditors. Some have explained that an auditor might be misled about the existence of account balances that do not exist. Companies being audited might have furnished the auditor with a document confirming the account's existence and balance as at the reporting date.
Unfortunately, according to allegations, such balances turn out to be either an overstatement or an understatement and the auditor failed to detect a material overstatement of both assets and revenues. Such cases undermine the credibility of auditors and external audit generally in the eyes of users of audited financial statements.

Required:

Explain whether you believe it is possible for such events as the one described above to completely undermine the credibility of external audit. Your explanation should consider the responses that the accountancy profession can put in place in response to such criticisms. **(10 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) Sewerage Corporation was established by an Act of Parliament to provide water to Rural Communities. The team of auditors from the Ghana Audit Service demanded to verify the performance agreements made by the company with the state. The Managing Director refused on the grounds that the auditors were over- stepping the scope of their work.

The auditors also discovered that the corporation has not establish an Audit Committee (AC), as required by the Public Financial Management Act 2016, Act 921. Management response was that AC was not established because it did not see its importance even though it is required by law.

Required:

- i) Comment on the action of the Managing Director on the performance agreement. **(5 marks)**
- ii) Advise the Managing Director on the need to establish an Audit Committee (AC). **(5 marks)**

- b) Recent developments in corporate governance focus on the importance of an organisation's ability to identify and manage risk. It is the responsibility of management to identify and respond to risk, but as part of the organisation's internal control, internal audit can help provide assurance that risks have been managed properly. Internal auditors may also be involved in providing consultancy services. However, a balance needs to be struck between a wish to increase the level of responsibility given to internal auditors, in order to benefit from their skills, and the danger that involvement which amounts to management involvement would compromise the independence of the internal auditors.

Required:

- i) Discuss the nature of consultancy projects in internal auditing and the dangers in internal auditing becoming too involved in consultancy projects. **(6 marks)**
- ii) Recommend **FOUR** actions to be taken to minimize the danger posed by internal audit becoming too involved in consultancy projects. **(4 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) Citilink Airlines was given an exclusive right by the Ministry of Aviation (MOA) to provide twice weekly direct flights between Accra and Johannesburg. The introduction of this service has been well advertised as 'efficient and timely' in national newspapers. The

journey time between Accra and Johannesburg is expected to be significantly reduced, so as to encourage tourism and business development opportunities in Johannesburg. Citilink Airlines operates a refurbished 35-year old aircraft which is leased from an international airline and registered with the MOA. The MOA requires that engines be overhauled every two years. Engine overhauls are expected to put the aircraft out of commission for several weeks. The aircraft is configured to carry 15 First Class, 50 Business Class and 76 Economy Class passengers. The aircraft has a package to reserve holding capacity for Johannesburg's numerous horticultural growers (eg of cocoa, cashew and fruits) and general cargo.

The six-hour journey offers an in-flight movie, a meal, hot and cold drinks and tax-free shopping. All meals are prepared in Accra under a contract with an airport catering company. Passengers are invited to complete a 'satisfaction' questionnaire which is included with the in-flight entertainment and shopping guide. Responses received show that passengers are generally least satisfied with the quality of the food – especially on the Johannesburg to Accra flight. Citilink Airlines employs ten full-time cabin crew attendants who are trained in air-stewardship including passenger safety in the event of accident and illness. Flight personnel (the captain and co-pilots) are provided under a contract with the international airline from which the aircraft is leased. At the end of each flight the captain completes a timesheet detailing the crew and actual flight time. Citilink Airlines was incorporated in South Africa, whose capital town is Johannesburg on March 1, 2017 and now operates in Ghana whose capital town is Accra. Ticket sales are made by Citilink Airlines and travel agents in South Africa and Ghana. On a number of occasions, Economy seating has been over-booked. Customers who have been affected by this have been accommodated in Business Class as there is much less demand for this, and even less for First Class. Ticket prices for each class depend on many factors, for example, whether the tickets are refundable/non-refundable, exchangeable/non-exchangeable, single or return, mid-week or weekend, and the time of booking. Citilink's insurance cover includes passenger liability, freight/baggage and compensation insurance. Premiums for passenger liability insurance are determined on the basis of passenger miles flown.

Required:

- i) Identify and explain **FIVE** business risks facing Citilink Airlines. **(5 marks)**
- ii) Describe how the risks identified in (a) could be managed and maintained at an acceptable level by Citilink Airlines. **(5 marks)**

(Note. Assume it is 31 December 2017)

- b) You are a manager in the Quality Control Review department of Integritas & Co, and are currently responsible for reviewing the appropriateness of your firm's proposed auditor's reports on financial statements. The draft financial statements of Lamptey Group for the year to 30 June 2017 disclose the following notes.

Notes

i) Significant event

During the year, Lamptey Group sold a significant amount of its business and certain assets (plant and equipment and inventory) and commenced a systematic winding down of its operations. The Group's remaining assets (including property, trade receivables and cash) were sufficient to meet the group's liabilities, as at 30 June 2017.

ii) Accounting policies

The consolidated financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards. As described in Note (i), the group has commenced the winding down of its operations and remaining assets have been restated to their net realisable values.

There are no other disclosures relating to the going concern basis although the 'significant event' is referred to in the directors' report under the heading 'principal activities and business review'. Lamptey Group ceased to trade in October 2017. The auditor's report on Lamptey Group's financial statements for the year ended 30 June 2016 was unmodified.

Required:

Comment on the suitability or otherwise of an unmodified auditor's report for Lamptey Group for the year ended 30 June 2017. Your answer should discuss the appropriateness of alternative audit opinions. **(10 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) **Matters to consider in planning**

- Whether our firm has the necessary resources and experience to carry out the investigation of PQR Ltd's losses.
- What reliance is to be placed on the report that we produce as a result of the investigation and whether it will be relied upon by any third parties such as lenders
- What type of report it is to be and what level of assurance will be given
- Whether any potential independence issues exist with other clients that our firm has and therefore potential conflicts of interest
- What level of detail is required in terms of the work to be undertaken Procedures to carry out
- Review staff availability and timings to assess whether sufficient resource for the investigation exists.
- Discuss with the management of ECO Ltd the scope of the investigation and its purpose (eg whether any third parties will be relying on it or whether it is an internal report only) and other issues such as expected timing, fees etc.
- Clarify the terms of reference of this engagement in writing from the management of West.
- Draft an engagement letter for this investigation and obtain agreement of terms in writing from the management of ECO Ltd.

(Any 5 points for 10 marks)

b) **Matters to consider under-valuation of inventory**

- Inventory will be undervalued if cut-off has not been appropriately applied therefore particular focus needs to be on this area of the quarter-end count.
- Inventory will be undervalued if not all inventory items have been included in the count therefore the investigation should focus on the procedures in place for the quarterly counts.
- Inventory will be undervalued if the valuation methods are incorrect. Inventory is valued manually so the investigation should examine how items of inventory, such as scrap are valued.

(Any 2 points for 3 marks)

c) **Procedures to carry out**

- Obtain inventory counting instructions in place at PQR Ltd and review to make an assessment of their adequacy for the quarterly counts, together with discussion with appropriate staff at ECO Ltd.
- Perform analytical procedures using figures from the quarterly management accounts, such as comparisons between 31 March 2018 and 31 December 2017. • Discuss scrap and wastage policy with warehouse staff.
- Examine details of scrap and discuss figures with appropriate staff to establish whether there are any reasons for wastage being higher in this quarter.

- Test cut-off is correct by tracing the last goods delivery notes and despatch notes to the invoices.
- Recast additions on inventory sheets to verify accuracy.

(Any 3 points for 3 marks)

d) Reasons for high materials consumption in quarter ended 31 March 2018

- If closing inventory has been undervalued or undercounted, this could explain a high materials consumption in this quarter. It could also be due to excessive consumption or wastage of materials. If recorded inventory has been stolen from production areas this could be another contributory factor to a high materials consumption in this quarter.
- If cut-off was incorrectly applied, then this would affect the materials consumption, ie if goods delivered after the year end were incorrectly included as purchases in the quarter then this would give rise to a higher materials consumption.
- Also if revenue is understated due to incorrect cut-off, then materials consumption as a % of revenue will be overstated.

(Any 2 points for 2 marks)

e) **Procedures to carry out**

- Test cut-off of purchases and sales has been done correctly by matching purchase invoices to goods received notes and matching despatch notes to invoices raised around the quarter-end date.
- Compare value of inventory identified as obsolete or damaged at the quarter-end to the previous quarter-end, discussing discrepancies with appropriate staff.
- Discuss levels of scrap and wastage with warehouse managers to ascertain normal levels and understand how it arises.
- Review a sample of credit notes received after the quarter-end to identify any returned materials.
- Inspect scrap materials to confirm it is not suitable for manufacture and therefore is not included in inventory.

(Any 2 points for 2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- a) This question required that candidates identify and describe matters to be considered procedures to be carried out in order to plan an investigation into material losses being suffered by a manufacturing company client. Instead of responding to the planning requirements many candidates plunged straight into the investigation itself which was a deviation. This was the worst attempted question.
- b) This involved matters to consider to determine whether closing inventory was undervalued and
- c) (c) tests to perform to quantify the amount of any undervaluation. The factors to consider, namely correct quantity and valuation method were not clearly spelt out.

Some candidates were able to outline the procedures to quantify the undervaluation.

- d) Reason for high consumption of materials during a quarter of the year demanded by the question were correctly given by many candidates.
- e) This required tests to determine the correctness of material consumption shown in the management accounts. The correct tests were to a large extent given by many candidates.

QUESTION TWO

a)

(i)) In relation to Good Life Insurance Ltd., there is a **threat of self-interest arising**, as a member of the audit team has an indirect financial interest in the client.

(1 mark)

The relevant factors are:

- The interest is unlikely to be material to the client or Sally, as the investment is recent and Sally's interest is in a pool of general investments made by the pension scheme on her behalf.
- Sally is the audit junior and does not have a significant role on the audit in terms of drawing audit conclusions or identifying audit risk areas.
- The risk that arises to the independence of the audit here is not significant. It would be inappropriate to require Sally to divest her interest in the audit client. If all the elements of risk in this situation are to be eliminated, then the junior assigned to the team could be simply changed. However such a step is not vital in this situation.

(Any 2 points for 2 marks)

(ii) In relation to Solar Electricals, two issues arise. The first is that the firm appears to be providing multiple services to Solar Electricals, which could raise **self-interest threat**. The second is that the manager assigned to the due diligence assignment wants to engage in a personal relationship with a person connected to the subject of the assignment, which could create **familiarity or intimidation threat**.

(2 marks)

With regard to the issue of multiple services insufficient information is given to draw a conclusion as to the significance of the threat. Relevant factors would be matters such as the nature of the services, the fee income and the team members assigned to each. Safeguards could include using different staff for the two assignments. The risk is likely to be significant only if one of the services provided is audit, which is not indicated in the scenario.

In relation to the second issue, the relevant factors are these:

- The assurance team member, David, has a significant role on the team as second in command.

- The other party is closely connected to a key staff member at the company being reviewed.
- **Timing.**

In this situation, the firm is carrying out a one-off review of the company, and timing is a key issue. Presently David does not have a personal relationship which would significantly threaten the independence of the assignment. Therefore, the safeguard is to request that David does not take any action in that direction until the assignment is completed. If he refuses, then his removal from the team should be considered.

(3 points for 3 marks)

b)

The elements that should be included in an audit firm's system of quality control at firm level as required by ISQC1 are followed:

- **Firm and leadership responsibilities for quality with in the firm:**

Personnel within the firm responsible for establishing and maintaining the firms system of quality control shall have an understanding of the entire text of the ISQC, including the application and other explanatory material, to understand its objectives and to apply the requirements properly, firms are required to ensure that appropriate training is provided to ensure there is complete understanding of the objectives and procedures under ISQC1.

- **Human Resources:**

The firm's overriding desire for quality will necessitate policies and produces on ensuring excellence I its staff, to provide the firm with reasonable assurance that it has sufficient personnel with capabilities, competence and commitment to ethical principles to perform enjoyments in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

- **Assignment of Engagement teams**

The assignment of engagement teams is an important matter in ensuring the quality of an individual assignments. This responsibility is given to the engagement partner.

- **Engagement Performance**

The firm should take steps to ensure that engagements are performed correctly, That is, in accordance with standards and guidance. Firms often produce a manual of standard engagement procedures to give to staff so that they know the standards they are working towards. Ensuring good engagement performance involves:

- ❖ **Direction**

- ❖ Supervision

- ❖ Review

- ❖ Consultation

- ❖ Resolution of disputes.

- **Monitoring**

The standard states that firms should have policies in place to ensure that their quality control procedures are: relevant, adequate, operating effectively and complied with. In other words they must monitor their system of quality control. Monitoring activity should be reported to the management of the firm on an annual basis for correctively action to be taken.

(5 points for 5 marks)

ii) The code of ethics for professional accountants require that professional accountants or auditors accept only engagement which they are competent and capable of performing in addition they must ensure that they comply with the relevant statutory and legal requirements. **It is therefore necessary for them to carry out procedures and consider the following factors:**

- They must consider whether they are professionally and legally qualified to accept the engagement
- They must consider whether there are any ethical issues that may confront them if they accept the nomination. Example threats to the objectivity and independence
- They must consider whether they have the time and resources including expert knowledge and skills to serve the client
- They must consider whether they have been properly nominated and any outgoing auditor has properly parted with his client.
- They must also fulfil the professional etiquette requirement of communication with the outgoing Auditor if any as a sign of courtesy and to require information as to whether there are professional reasons for not accepting the nomination.
- The procedures should also enable the auditors to determine whether the prospective client has integrity and falls within the risk appetite of the firm.
- Therefore on the whole the procedures are carried out to enable the auditor make an informed decision whether to accept or reject the nomination.

(Any 5 points for 5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

a. The sub question on professional ethics demanded that candidates should comment on threats, the significance of the threats and any safeguards to eliminate or mitigate the threats arising in the following scenarios:

i) Sally, the most junior officer in a team of six, investing in a pension plan in a company whose investment portfolio is in all listed companies in the Ghana Stock Exchange of which the audit client is one of such noted companies.

ii) David the second in diligence assignment for client and has indicated that he intends to take the finance director's daughter out on a date.

The threats, their significance and the appropriate safeguard were correctly given by many candidates one of the best answered questions.

b. i) Candidates were required to recommend elements to be included in firm's quality control system in accordance with the requirements of ISQCS1. Strangely this straight forward and context question was not properly treated. While some candidates used the application and other explanatory matter instead of the requirements of ISQC1 and ISA220-quality control on individual engagements. Performance was poor.

ii) Discussion of why it is important for an auditor to carry out procedures before accepting nomination for appointment was demanded many candidates were able to provide the right answers. Good performance.

QUESTION THREE

a)
i) *ISA 250: Consideration of Laws and Regulations in an Audit of Financial Statements* distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows;

The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations; and

Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements. **(2 marks)**

ii) The issue of non-compliance

- If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain;
- An understanding of the nature of the act and the circumstances in which it has occurred; and
- Further information to evaluate the possible effect on the financial statements.
- Seek legal advice if sufficient information not made available on material non-compliance, which auditor suspects.

- If information cannot be obtained consider impact on opinion.
- Consider the impact of non-compliance on auditor's risk assessment and the reliability of written representations, and take appropriate action.

(Any 2 points for 2 marks)

iii) The following policies and procedures may be implemented to assist management in prevention and detection of non-compliance

- Monitor legal requirements and ensure that operating procedures are designed to meet these requirements.
- Institute and operate appropriate systems of internal control including internal audit and an audit committee.
- Develop, publicise and follow a code of conduct.
- Ensure employees are properly trained and understand the code of conduct.
- Monitor compliance with the code of conduct and act appropriately to discipline employees who fail to comply with it.
- Engage legal advisors to assist in monitoring legal requirements.
- Maintain a register of significant laws with which the entity has to comply within its particularly industry.

(4 points @1.5 each= 6 marks)

b)

- There have been several major audit scandals in the past. The fact that audit continues and, indeed, flourishes in the light of these suggests that society has not lost confidence in audit and that it will not do so in the future.
- The major audit scandals appear to be regarded as abnormal occurrences that do not reflect on the work underpinning the vast majority of audits. The cases that have occurred in the past few years represent only a tiny minority of the audits that have been undertaken.
- Each has attracted a great deal of publicity, even notoriety, but there has been nothing to suggest that there is a systematic failure across all audits. Indeed, the publicity generated by each case indicates that these are not routine events.
- Shareholders and other stakeholders almost certainly need the reassurance provided by audit. In the absence of audit they would have little or nothing to support the credibility of the financial statements and this would undermine confidence in investment.
- It would appear that audits are desirable even if they do not offer a guarantee of detecting every single material irregularity in the financial statements. The accountancy profession has done a great deal to enhance the credibility of audit.
- Considerable amounts of time, money and resources have been invested in standard setting, monitoring and regulation of auditors. Major audit scandals are investigated as a matter of routine and any recommendations for the future regulation of audits and auditors are usually implemented as a matter of course.

(Any 5 points for 10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

a. (i,ii and iii) These sub-questions were in relation to responsibility of external auditors, the issue of non-compliance with laws and regulations and procedures management could use to prevent and discover non-compliance with laws and regulations. The auditor's responsibility in relation to laws and regulations in an audit and management actions to prevent and discover non-compliance with laws and regulations were correctly explained by many candidates. The issue of non-compliance was treated as if it was the auditor who failed to comply with the laws and regulation which has a connotation to ethical behaviour rather than non-compliance by the client demanded by the question. Performance was mixed.

b. Candidate were to discuss whether the recent bank failures could undermine the credibility of the external audit and the responses that the accountancy profession can put in place in response to such criticism that external auditors have been failing in the proper execution of their responsibilities. This non-textbook question requires argument that in spite of the bank failures clients continue to demand audit of their accounts, The bank failures that occurred are isolated cases rather than general breakdown and collapse of the banking sector and that the accountancy profession has been taking both proactive and reactive actions to improve the standard of auditing and that regulations and those charged with governance and management must also play their part. Performance was average.

QUESTION FOUR

a)

According to the constitution of Ghana (1992) the Auditor General shall have access to all books, records, returns, and other documents relating or relevant to those accounts.

The Audit Service Act (2000) requires the Auditor General to express his opinion on whether the accounts presented by statutory corporation are fairly presented in line with;

Applicable statutory provisions

Stated accounting policies of the Government

Generally accepted accounting standards

The Auditor General Reports on the following:

The profitability, liquidity, stability and solvency of the corporation and also the performance of the shares of the corporation on the capital markets, where relevant

Whether there was any delay in payment of government portion of any declared dividend, if any, into the Consolidated Fund

Any significant cases of fraud or losses and the underlying causes

Any internal control weakness noted

The general corporate performance indicating

- Achievement against set targets and objectives

- Whether the finances of the body have been conducted with due regard to economy, efficiency and effectiveness having regard to the resources utilised.

In this case, the Managing Director is wrong since the constitution provides that the Auditor general shall have access to all books, records, returns, and other documents relating or relevant to those accounts.

Secondly, by demanding the performance agreement, the Auditors wants to fulfil their role to ensure that general corporate performance are in agreement with set target and objectives.

(5 marks)

ii) The need to establish an Audit Committee (AC)

An AC is mandated to:

- Ensure the implementation of the recommendations in all audit reports of every MDA and MMDA.
- Follow-up Auditor-General and Public Accounts Committee's recommendations as well as recommendations in internal audit reports.
- An AC must ensure that the head of the MDA/MMDA:
- Pursues the review and implementation of matters in all audit reports as well as financial matters raised in the reports of internal Monitoring Units in the institution, body or organisation
- Annually prepares a statement showing the status of implementation of recommendations made in all audit reports as well as the Auditor-General's reports which have been accepted by parliament and any other related directives of Parliament:

The statement shows remedial actions taken or proposed to be taken to avoid or minimize the recurrence of undesirable features in the accounts and operations of the institution, body or organisation, and the time frame for action to be completed. The statement referred to above shall be endorsed by the relevant Minister and forwarded to Parliament, Office of the president, the Director-General of Internal Audit Agency (IAA) and the Auditor-general within six months after Parliamentary decisions on the Auditors General's reports.

- In relation to internal audit, the AC shall: Review and advise on the strategic and annual internal audit plans; Monitor the performance of internal Audit Units against its annual internal audit plans and strategic plans; Monitor the implementation agreed audit recommendations.

(5 points for 5 marks)

b)

i) Consultancy projects are one-off projects designed to address adhoc issues. It is playing an increasing role in the work of internal audit. Taking on this projects enables internal auditors to extend their skills and the organization to draw on the knowledge of internal auditors. However there are dangers in becoming too involved in consultancy projects.

(2 marks)

The resultant dangers include:

- Internal audit staff may be diverted to consultancy projects, and the regular audit reviews may be inadequately resourced.
- By taking on consultancy projects and suggesting solutions, internal audit could be getting too much involved in operational concerns. There is a serious lack of independence if internal audit has to review solutions that internal audit staff have provided.
- Management is relying on internal audit to solve problems instead of having operational staff and managers solve or preferably prevent them. Certain steps can be taken in order to avoid these problems.

(Any 2 points for 4 marks)

ii) Steps to be taken to minimize the danger posed by internal audit becoming involved in consultancy projects include:

- The terms of reference of the internal audit department should draw a clear distinction between regular audit services and consultancy work.
- Enough resources for regular audit services should be guaranteed. Consultancy work should be separately resourced and additional resources obtained if necessary.
- If managers are concerned about improving controls, reviewing these improvements can legitimately be included in the work of internal audit.
- Regular audit reviews and consultancy projects can be undertaken by different staff.
- If consultancy work identifies serious control deficiencies, these must be incorporated into internal audit reviews.

(Any 4 points for 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

a. (i and ii) These sub-questions were on public sector audit and involved a managing director refusing to release a performance contract document to auditor generals appointed auditors and failure to establish an audit committee as required by the Financial Management Act 2016 Act 921. These questions required knowledge of the 1992 constitution in relation to the powers and rights of the auditor general to books and documents and also the requirement of the audit service act. Knowledge of the establishment of audit committee as required by Act 921 is needed. These sub-questions were to a large extent correctly answered.

b. This question is in relation to consultancy assignments undertaken by internal auditors, the possible dangers it poses and action to mitigate the dangers. Some candidate gave the correct answers but some candidates treated it as the internal auditors performing consultancy assignment for external clients. Mixed performance.

QUESTION FIVE

a)

Business risks

(i) *Leasing of equipment and specialist staff.* As Citilink Airlines leases its equipment and the most specialised of its staff from another airline, there is a risk that its equipment and/or pilots could be withdrawn leaving it unable to operate.

(ii) *Conditions of exclusive right.* The MOA requires Citilink Airlines' aircraft engines be overhauled biannually. There is a risk that Citilink Airlines will be unable to meet this condition, if the lessor company does not agree to regular overhaul or that it will be too expensive for Citilink Airlines to meet this requirement and it could lose the right to operate, or its exclusivity, opening it up to competition. There may be other conditions which Citilink Airlines has to meet, such as the two weekly flights being a minimum.

(iii) *Necessary service suspension.* As Citilink Airlines is required to overhaul its engines every two years, there will be a significant period every two years where Citilink Airlines will either have to incur the cost of leasing other planes (assuming this is possible) or will have to suspend services. The cost of leasing other planes might be prohibitively expensive or the disruption to service might mean that conditions relating to the right to operate might not be met. As Citilink Airlines only has one plane, service would also be interrupted if there was an emergency relating to the plane, such as fire or a crash.

(iv) *Age of aircraft.* The aircraft being leased is old. This raises operational risks (it may not always be able to fly due to necessary maintenance), finance risks (it may require regular repair) and compliance risks (it may not meet environmental or safety standards, now or in the future).

(v) *High proportion of expensive seats.* The plane leased by Citilink Airlines has a high proportion of unrequired expensive seats and therefore insufficient (overbooked) cheaper seats. Although Citilink Airlines can appease customers by upgrading them, this means the airline is operating well below capacity.

(vi) *Cargo.* The flight route results in the airline carrying a large amount of horticultural produce. This raises various risks – that Citilink Airlines might be liable to passengers if their cargo degrades in transit, that the airline might be liable for any breaches of law by its passengers (for example, if prohibited items are transferred into or from each country. Many countries prohibit the importation of animals or meat products or plants).

(vii) *On-board services.* Customers are currently dissatisfied with the food provision on the flight and there is a risk that food prepared in Accra may become less appealing and even dangerous when served on a Johannesburg to Accra flight (when it has been prepared a substantial time earlier, given a six hour flight, at least an hour's

turnaround time, and time for getting to the airline in the first place). If the food makes customers ill, Citilink Airlines might be faced with compensation claims.

(viii) **Pricing.** There is a complex system of pricing and a large number of sales agents, and Citilink Airlines is at risk of operating at a sales value less than required to cover costs (for example, if too many of the cheapest tickets are sold).

(ix) **Safety.** The airline industry has stringent safety conditions and Citilink Airlines may face customer boycott or difficulty in recruiting staff if safety requirements are not met.

(x) **Fuel.** The aircraft cannot fly without fuel, which can be a scarce or high-cost resource. If fuel prices escalate due to world conditions, the company might not be able to meet the costs of operating.

(b) Managing risks

(i) **Lease.** Citilink Airlines must ensure that the terms of the contract with the international airline ensure that aircraft and staff cannot be withdrawn without reasonable notice, and that in the event of withdrawal, substitutes will be given.

(ii) **Conditions.** Citilink Airlines must ensure that all staff are aware of any conditions and the importance of meeting them. However, this risk must simply be accepted as there is little Citilink Airlines can do about conditions imposed on them by the governing body of their industry.

(iii) **Service suspension.** Citilink Airlines must have contingency plans for service suspension, such as ensuring their contract with the international airline ensures alternative aircraft will be made available to them in the event of maintenance or damage to the aircraft, or by making arrangements to lease from a different airline in the event of emergency. As a minimum, Citilink Airlines must ensure that the airline they lease from would give them financial compensation in the event of aircraft or staff not being available so that Citilink Airlines's customers could be compensated.

(iv) **Age of aircraft.** Citilink Airlines should have plans in place to be able to lease/afford newer planes if required to by law. Again, this could be written into their contract with the airline. Citilink Airlines should manage cash flow and borrowing facilities so as to be able to afford ongoing maintenance when required.

(v) **High proportion of expensive seats.** Citilink Airlines should negotiate a reconfiguration of the plane with the lessor so that business and first class seating could be reduced and more economy seats made available. If this is not possible with the current lessor, Citilink Airlines should investigate leasing differently configured planes from another company. If it is not feasible to adjust the plane seating, Citilink Airlines should consider its pricing and on-board facilities policies to make business and first class seats more attractive to customers. As the seats are not being sold

anyway, it is probable that a reduction in prices would increase overall revenue, although this might reduce potential profit.

(vi) **Cargo.** Citilink Airlines should publish a cargo policy to ensure that customers are aware of their legal obligations. They should ensure that staff are sufficiently trained to discuss the contents of baggage with customers and are aware what items Citilink Airlines should not carry. They should insure against lost and damaged cargo.

(vii) **On-board services.** Citilink Airlines should consider entering into a contract with a company in Johannesburg to provide food for the Johannesburg to Accra journey. Obviously they must not breach any existing contract with the Accra company and so in the meantime should review the type of food provided. For example, it might be safer to only offer cold food, for example sandwiches and cake until an Johannesburg contract can be set up. Even if a new contract is set up, it might still be best to offer cold food as there is less chance of health problems arising as a result of serving cold food rather than hot food.

(viii) **Pricing.** As discussed above, Citilink Airlines should review the pricing policy. They should also establish limits on how many of certain types of tickets (non-refundable/single etc) can be issued for one flight and they should institute a centralised system to ensure that each agent is aware when limits have been reached. As the agents must be linked to a similar system already (to be aware of whether tickets are available for sale) this should not be too difficult to achieve.

(ix) **Safety.** The company should appoint a member of staff to be specifically responsible for safety operations (such as training, updating for legal requirements, educating passengers) and should ensure that staff are regularly appraised about safety issues.

(x) **Fuel.** The company could take out hedging contracts against the cost of fuel. Other than this, there is little they can do about this matter, and it is another risk that has to be accepted.

(Any 5 points for 5 marks)

b)

Suitability of the auditor's report

Unmodified report

From the information in the disclosure notes it is apparent that the company is not a going concern. However it is not clear on which basis the financial statements have been prepared. They may have been prepared:

- On the going concern basis: or
- On an alternative basis.

An unmodified auditor's report means that:

- The accounts give a true and fair view
- They have been prepared in accordance with statute

If the accounts have been prepared on a going concern basis, an unmodified opinion would not be appropriate as this does not reflect the true position of the company. The results would be misleading as the readers would make assumptions about the company's ability to continue, which are clearly not the case. In addition to the inappropriate basis of preparation, disclosure is inadequate as the notes to the accounts do not highlight the significant problems the company is facing. In this respect they are not properly prepared.

If the accounts have been prepared on an alternative basis an unmodified opinion would still not be valid. This is due to the inadequacy of disclosure. The going concern assumption is a fundamental principle. Readers of accounts assume the company is viable unless it is clearly stated otherwise. In this case even though the basis of preparation is correct the lack of disclosure means that they are not properly prepared.

(5 marks)

Alternative opinions

The 'except for' or disclaimer of opinion would not be appropriate irrespective of the basis of preparation as the issue is not one of uncertainty. The company has liquidated assets and we are told that the company has ceased to trade in October.

If the financial statements have been prepared on a going concern basis an adverse opinion should be expressed. This would be due to a material and pervasive misstatement as a result of the basis of preparation. For example assets and liabilities are likely to be misclassified as non-current, when they should be classified as current. The opinion would be adverse as the misstatement is pervasive to the overall true and fair view.

If the accounts have been prepared on an alternative basis reflecting that the company is not a going concern, for example the break-up basis, provided that this has been applied correctly the auditor would agree with this treatment. However a qualified 'except for' auditor's opinion should be issued on the grounds of a material misstatement in respect of the adequacy of the disclosure regarding the basis of preparation.

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

a. (i and ii)

Candidate were to identify and explain five business risks affecting an airline company as stated in the scenario and describe how the risks identified could be managed and maintained at an acceptable levels by the airline. Even though all the risked are contained in the preamble to the question not all candidates could identify them. Most candidates were able to provide the right answers. Again performance was mixed.

b. This question is on reporting. Candidates were given two notes which they were to use to determine whether an unmodified opinion given by the auditor was suitable. While some candidate agreed that the opinion given was proper others rightly disagreed and were able to state the reasons for the disagreement. Further, the alternative opinions required were correctly given by some candidates while others were unable to do so. Again performance was mixed.

CONCLUSION

The pass rate is lower than what was achieved in the previous session. However, the good thing that would be said about this session relates to good handwriting by many candidates which made marking very easy and much improvement in the use of the English language. Answers provided indicated individual effort and no attempts at copying one another's work.