

**THE INSTITUTE OF CHARTERED
ACCOUNTANTS (GHANA)**



**MAY 2012 EXAMINATIONS
(PROFESSIONAL)**

PART 2

AUDIT AND INTERNAL REVIEW

(Paper 2.2)

Attempt ALL Questions

TIME ALLOWED:

Reading & Planning - 15 Minutes

Workings - 3 Hours

QUESTION 1

- (a) The International Standard on Auditing ISA 300 *Planning an Audit of Financial Statements* states that ‘.....Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways.....’

Required:

- (i) Explain **six (6)** ways that adequate planning benefits the audit of financial statements. **(6 marks)**
- (ii) State and explain the need for two additional considerations in the planning an audit of financial statements specifically required in an initial (first time) audit engagement. **(4 marks)**
- (b) You are an audit supervisor of the audit firm Adakos Associates, a firm with three partners. You have been delegated to prepare a training programme for newly appointed audit trainees to enable them understand the difference between what they learnt at school in auditing and what they should expect as they start their on-the-job training in the profession.

Required:

Prepare the training material you would use, including examples to explain the following:

- (i) The difference between substantive and compliance audit tests.
- (ii) **Two (2)** advantages of using statistical sampling in choosing items for review.
- (iii) The difference between Systems Based and Risk Based audits.
- (iv) The difference between Directional and Rotational testing.
- (v) Audit risk, listing its **three (3)** components.

(10 marks)

(Total: 20 marks)

QUESTION 2

- (a) Akuafu Company Limited supplies a wide range seeds to commercial farmers in the three northern regions of Ghana. The company has an internal department which provides audit reports to the Audit Committee.

The seeds are offered for sale to the customers via an Internet site. Customers review the product list on the Internet and place orders for packets of seeds using specific product codes, along with their credit card details, onto Akuafu Company Limited’s secure server.

Order quantities are normally between one and three packets for each type of seed. Order details are transferred manually onto the company's internal inventory control and sales system, and a two part packing list is printed in the seed warehouse. Each order and packing list is given a random alphabetical code based on the name of the employee inputting the order, the date, and the products being ordered.

In the seed warehouse, the packets of seeds for each order are taken from specific bins and dispatched to the customer with one copy of the packing list. The second copy of the packing list is sent to the accounts department where inventory and sales in the computer system are updated to show that the order has been dispatched. The customer's credit card is then charged by the inventory control and sales computer system. Bad debts in Akuafu are currently 3% of total sales.

Finally, the computer system checks that for each charge made to a customer's credit card account successfully, the order details are on file to prove that the charge was made correctly. The order file is marked as completed confirming that the order has been dispatched and payment obtained.

Required:

In respect of sales system of Akuafu Company Limited, prepare a report to be sent to the Audit Committee of Akuafu Company Limited which:

- (i) Identifies and explains **four (4)** weaknesses in the sales system;
 - (ii) Explain the possible effect of each weakness; and
 - (iii) Provide a recommendation to alleviate each weakness. *(15 marks)*
- (b) List the issues the external auditor would consider in the decision whether or not to place reliance on the work of the internal audit department. *(5 marks)*

(Total: 20 marks)

QUESTION 3

- (a) 'Auditing is a process, carried out by an appointed qualified person or body, whereby the records and financial statements of an entity are subjected to independent examination in such detail that will enable the auditor to express an opinion on whether or not the financial statement show a true and fair view of the financial affairs of the entity'.

Required:

Answer the following questions in relation to the statement above and the statutory (legal) and professional requirements of the auditing profession in Ghana.

- (i) Explain why the examination of the records and financial statements should be 'independent'. **(2 marks)**

- (ii) Explain **four (4)** of the requirements for the person or body qualified to be appointed as an auditor in Ghana. **(4 marks)**

- (iii) Explain the legal requirements that the auditor must comply with before the auditor can issue a report that expresses an opinion that the financial statements show a true and fair view of the financial affairs of the entity. **(4 marks)**

- (b) The Code of Ethics for Professional Accountants requires that accountants comply with the requirements of the Code.
 - (i) Identify the gifts or hospitality that are acceptable and discuss when they become unacceptable. **(2 marks)**

 - (ii) An audit manager of your firm is the sister to the finance manager of an audit client company of your firm; can your firm continue to provide internal audit services for that client? **(3 marks)**

 - (iii) Can your firm provide internal audit services for an external audit client? **(2 marks)**

 - (iv) The office of the Director General of the Ghana Revenue Authority has requested your firm to provide evidence in their investigation of an audit client for a possible tax fraud. Can your firm do so? **(3 marks)**

Required:

For each of the questions, provide brief answers noting in particular the threats to any requirements of the Code that may arise and the safeguards that should be available to manage them to an acceptable level.

(Total: 20 marks)

QUESTION 4

You are an audit manager in BDR Associates working of the files of one of your audit clients. KonaHene Chemicals Limited for the year ended 31 July 2011. KonaHene is a supplier of agricultural chemicals in the mid-section of the country with over 120,000 customers. The company owns one large warehouse in Kona, a village in Ashanti Region, and approximately the centre of its operational area. Customers place orders for chemicals either over the Internet, by phone or in person.

Orders are dispatched on the day of receipt of the order. No returns are allowed.

Due to the high inventory turnover, and the fact that the chemicals have varying and usually short shelf life before they expire, KonaHene maintains the inventory system using a computer application software that records for each chemical item received. The name and barcode on the label, the quantity, the manufacture date and the expiry date. The system will not allow the user to save any item received if the two dates are not recorded. As the items are sold, the system keeps a perpetual record of the quantity sold and also the quantity still left. The system also sets a Re-Order Level and sends a text message to the manger when the quantity of any item reaches its set minimum level.

BDR Associates has audited the system for the last five years and has found no errors within the software. You are currently reviewing the inventory system with an audit junior, using an audit software for the first time in your firm for this audit. The junior needs experience in the audit of the controls over a computer inventory system and some basic knowledge of substantive tests on the inventory value at year end which is stated in the trial balance at:

Inventory – chemicals for resale: GHC423,000 (2010: GHC256,000).

Required:

- (i) Explain **two (2)** major advantages of using software to test inventory system. **(2 marks)**
- (ii) List **three (3)** of the major issues the auditor would be concerned with in the audit of inventory at KonaHene. **(3 marks)**
- (iii) List the audit procedures you would perform to confirm that the controls in the inventory system at KonaHene are working as required and for each procedure, explain the reason for carrying out that procedure. **(6 marks)**
- (iv) List the audit procedures you would perform to test the value of inventory at 31 July 2011 and for each procedure, explain the reason for carrying out that procedure. **(9 marks)**

(Total: 20 marks)

QUESTION 5

- (a) In recording the system of Internal Controls, an auditor may make use of
- i. Narrative notes
 - ii. Flow Charts
 - iii. Internal Control Questionnaires.

Required:

- (i) Enumerate **two (2)** advantages for each of these forms of recordings (**6 marks**)
- (ii) Enumerate **one (1)** disadvantage for each of these forms of recordings. (**3 marks**)

- (b) In the audit of financial statements of companies, auditors and their clients use many ways to communicate with one another including Representation Letter, Management Letter and Engagement Letters.

Required:

- (i) Distinguish between a representative letter and a management letter. **(2 marks)**
- (ii) List the major issues that would be discussed in an engagement letter for the audit of a financial statement. **(4 marks)**
- (c) An auditor should express an unmodified report when he concludes that the financial statements give a true and fair (or are presented fairly, in all material respects) in accordance with the identified financial reporting framework. Otherwise, the auditor will express a modified opinion.

Required:

State and explain the different types of modified reports and the situations that would lead to each type of modified report.

(5 marks)

(Total: 20 marks)