

**NOVEMBER 2016 PROFESSIONAL EXAMINATIONS
AUDIT & ASSURANCE (PAPER 2.3)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME**

EXAMINER'S GENERAL COMMENTS

The standard of the paper for November, 2016 was high like the past diets. There were no ambiguities and typographical errors in the paper that was administered in November, 2016 and there were no ambiguities/errors that adversely affected performance in the examinations. In my candid view, all the five (5) questions were of high standard at the level of examination.

Generally, marks allocation followed the weightings in the syllabus was fairly allocated to each sub-question. My only problem was however, with the marks allocated to the Regulatory Framework of Auditing under which the Ghana's Companies Act falls. Instead of a total of ten (10) marks for this section, the marks allocated for the November, 2016 examinations was a whopping eighteen (18) marks. This disfavoured most examinees. Selection of questions in future must be done with the syllabus coverage in mind.

GENERAL PERFORMANCE

The general performance of candidates in the subject is about 73%. That is, out of a total number of 456 candidates who wrote the paper 336 passed and only 120 failed. Incredible performance. The reason could be that teaching and learning are improving at the moment. In fact, questions one (1), two (2), three (3) and five (5) were well answered by candidates and this propelled more candidates to pass the paper. The pass rates for the above questions were 67%, 87% and 53% respectively.

High performers for this paper was evenly spread across majority of the centres. This indicates that candidates are attending classes in most of the centres. Availability of learning materials has contributed greatly to this superlative performance. Low performers were not concentrated in a particular centre. They could be found in most of the centres. Teaching and learning in these centres are to be intensified and sustained. The level of preparedness of most of the candidates were adequate which culminated into about 73% pass rate.

NOTABLE STRENGTHS & WEAKNESSES

Specific areas in which strengths were demonstrated were in questions one(1), two(2), three(3) and five (5) where candidates pass rates were 67%,87% ,87% and 53% respectively. The strengths was found to be widespread in the centres of the examination, including Liberia.

Candidates were well prepared in most topics that featured in questions one (1), two (2), three (3) and five (5). Some candidates however, fumbled with part of question one (1b) specifically the duties of an auditor of a company in line with the provisions of the Ghana Companies Act 1963 (Act 179).

AUDIT & ASSURANCE QUESTIONS

QUESTION ONE

- a) An assurance engagement is an evaluation or measurement of a subject matter by a professional accountant that is the responsibility of another party, against identified suitable criteria to express a conclusion that provides the intended user with a level of assurance about that subject. Both audit and review work are assurance engagements.

Required:

Describe **FIVE** differences between an *audit* and a *review engagement*. (5 marks)

- b) Explain what your duties and rights are as an auditor of a company in line with the provisions of the Ghana Companies Act 1963 (Act 179). (10 marks)
- c) Distinguish between *interim audit* and *final audit*, identifying **TWO** advantages and disadvantages each. (5 marks)

(Total: 20 marks)

QUESTION TWO

- a) Discuss **THREE** functions of an internal audit department. (3 marks)
- b) Computer-Assisted Audit Techniques (CAATs) are the use of computers for audit work and comprise mainly audit software and test data.

Required:

Explain the terms '*audit software*' and '*test data*' and list the advantages of using CAATs in an audit. (3 marks)

- c) There are a number of key procedures which auditors should perform if they wish to rely on internal controls and reduce the level of substantive testing they perform. These include:
- i) Walk-through tests;
 - ii) Audit Sampling;

Required:

Briefly explain each of the procedures listed above. (4 marks)

- d) Compare and contrast the role of internal auditors and external auditors (4 marks)
- e) *ISA 520 Analytical procedures* provides guidance to auditors on the use of analytical procedures during the course of the external audit.

Required:

When using analytical procedures as substantive audit procedures, list and briefly explain with examples **THREE** factors to consider when determining the extent of reliance that can be placed on the results of such procedures. (6 marks)

(Total: 20 marks)

QUESTION THREE

- a) It has become necessary that Audit firms plan their activities well in order to avoid risk and other litigation issues. *ISA 300 Planning an Audit of financial statements*, states that the auditor must plan the audit.

Required:

Briefly define **audit planning** (2 marks)

- b) Enumerate **EIGHT** benefits or importance of audit planning (8 marks)
- c) Demonstrate the use of *Preliminary Analytical Review* as a planning tool in an audit. (5 marks)
- d) *ISA 530 Audit Sampling* states that the objective of the auditor, when using audit sampling, is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Required:

Explain the difference between *statistical sampling* and *non-statistical sampling*. (5 marks)

(Total: 20 marks)

QUESTION FOUR

- a) List and explain **FOUR** factors that will influence the auditor's judgement regarding the sufficiency of the evidence obtained. (6 marks)
- b) *ISA 700 Forming an opinion and reporting on financial statements* indicates the basic elements that will ordinarily be included in the audit report.

Required:

List **SIX** basic elements of an auditor's report. Briefly explain why each element is included in the report. (6 marks)

- c) Outline the procedures for the appointment of auditors in accordance with the Companies Act 1963 (Act 179). (8 marks)

(Total: 20 marks)

QUESTION FIVE

- a) *ISA 265 Communicating deficiencies in internal control with those charged with Governance and Management*. Auditors must report deficiencies in internal control with those charged with governance and management.

Required:

Explain clearly what is *management letter*, indicating the contents of such a letter.

(5 marks)

- b) Briefly explain what is meant by the '*Going Concern Concept*' and describe the test and procedures that the auditor needs to perform to form an opinion on management's conclusion that the company is a going concern. **(6 marks)**
- c) Distinguish the three types of modified opinions that the auditor may issue on financial statements audited by him. **(6 marks)**
- d) State with details **TWO** circumstances under which an auditor may issue a qualified opinion. **(3 marks)**

(Total: 20 marks)

MARKING SCHEME

QUESTION ONE

a) Differences between Audit and Review

	Audit	Review
Scope of Work	Determine by Statue (law)	Whoever or anybody can commissioned a review work
Amount of work done	Determined by the Auditor as he/she deems necessary to give positive opinion	Determined by the Reviewer as he/she deems necessary to give negative opinion
Type of Assurance provided	Reasonable Assurance	Limited Assurance
Level of Assurance provided	High level	Moderate level
Type of opinion provided	Positive assurance "the financial statement show true and fair" (Opinion)	Negative assurance "Nothing has come to our attention" (Conclusion)

(5 marks)

b) Duties and Rights of the Auditor

My duties as an auditor of a company as set out in the Companies Code are as follows:

- To make a report to the members on all Accounts laid before them at annual general meeting, Stating whether the Accounts – give a true and fair view and have been properly prepared in accordance with the provisions of the Companies Code.
- To investigate, and form an opinion on, whether: (a) Proper accounting records and returns have been kept and (b) the Accounts are in agreement with the accounting records and returns
- To modify any opinion on the financial statements if I cannot report affirmatively in respect of the requirements in the 5th schedule to the companies code.
- The Companies Code requires that the auditors gives certain information on the remuneration of and other transaction of the company's directors, if these are not given in the accounts

My rights as auditor as mentioned in the Companies Code are:

- Right of Access at all times to the books, accounts and vouchers of the company
- Right to such information and explanation as I think necessary for the performance of my duties
- Right to receive notice of, attend and speak at meetings of the members
- Right to apply to the court for direction on any aspect of his work.

- Right to communicate with the previous auditor in the case of an initial audit and request any information I may need for my assignment.
- Right to ensure that before being removed, the provisions in the Companies Code have been followed.

(10 marks)

c) **Interim audit:**

In case of larger client the auditor will often find it necessary to proceed with the audit on an interim basis in view of the volume of testing to be undertaken in order to reach an opinion on the reliability of the records. Interim audit as arranged with the co-operation of the client may be biannual, quarterly or even monthly, depending on the volume of audit work considering necessary. In this case the auditor decides to conduct an audit to a particular period within the accounting period.

Advantages

1. It is possible to produce interim accounts for dividend payment.
2. Interim Accounts can be used for application for extra finance (overdraft or Short term loan)

Disadvantages

1. Figures may be altered after the audit work. (2.5 marks)

Final and Completed audit applies to smaller concerns where the volume of transaction and complexity of records do not require the auditor's attendance more than once each year. This visit normally takes place as soon as the business's financial year ends and continues until it has been completed and the audit report signed.

Advantages

- It enables the audit to be planned more efficiently in that audit staff can follow the audit program or the timetable without interruption.
- The work is done at a go thus avoid the need to return to uncompleted work
- Alteration of figures may be avoided

Disadvantages

- There may be difficulty in allocating staff if the Audit Firm has many clients who have the same accounting period.
- Delay may occur if the client does not have competent staff and there are problems with the schedules or the internal controls. This may affect the completion of the accounts to be presented to shareholders. (2.5 marks)

(Total: 20 marks)

QUESTION TWO

a) Functions of an internal audit department

1. To review the control system and to identify weaknesses, breakdown and to report to management with recommendations.
2. To design checks to reveal the existence of frauds or to prevent frauds.
3. To rationalize accounting policies within a group and to design and implement new accounting systems.
4. To conduct management efficiency audits and post implementation audits of capital projects.
5. To describe key risks facing the business activities within scope of audit and to identify control procedures used to ensure each key risk is properly controlled and monitored
6. To develop and execute risk based sampling and testing approach to determine whether most important controls are operating as intended
7. To report issues/make recommendations/negotiate action plans with Management to address issues
8. To follow up on reported findings periodically

(Any 3 points for 3 marks)

b) '**Audit software**' consists of computer programs used by auditors to process data of audit significance from the client's accounting system. It may comprise generalised audit software or custom audit software. It is used for substantive procedures.

'**Test data**' involves entering data such as a sample of transactions into the client's accounting system and comparing the results obtained with pre-determined results. Test data is used for tests of controls.

Advantages of CAATs

- Auditors can test program controls as well as general computer controls.
- A greater number of items can be tested more quickly and accurately.
- Transactions can be tested, rather than paper records that could be incorrect.
- CAATs are cost-effective in the long-term if the client does not change its systems.
- Results can be compared to results from traditional testing and if correlation exists, overall confidence is increased.

(3 marks)

c)

(i) Walk-through tests

Walk through tests are performed by the auditors to confirm that their recording and understanding of the system is correct. They are often performed as the recording of the system takes place or in conjunction with the tests of controls.

The process involves the tracing of a sample of transactions from the start of the operating cycle to the end and vice versa. For example a sales transaction could be traced from the initial order through to the entry in the nominal ledger accounts.

(2 marks)

(ii) **Audit Sampling**

Audit sampling involves the application of audit procedures to a selection of transactions with a population (ie, rather than applying the procedures to 100%). The auditor then obtains and evaluates the evidence in order to form a conclusion about the population as a whole.

Sampling is normally adopted for practical reasons as in most cases it would be too time consuming to audit the whole population. A number of different techniques can be used in order to select the sampling including random, systematic or haphazard selection. When designing the size and the structures of the audit sample the auditor will need to consider sampling risk – the risk that the sample is not representative of the population as a whole, meaning that results cannot be extrapolated.

(2 marks)

d)

Internal and external auditors' roles contrasted

	Internal Auditors	External Auditors
1. Objective	To add value and improve an organisations operations	To express an opinion on the truth and fairness of financial statements.
2. Reporting	Reporting to the board of directors, or other people charged with governance, such as the audit committee, Reports are confidential between the auditors and the directors and management of the organisation.	Reports to the shareholders or members of a company on the truth and fairness of the accounts. Audit report is publicly available to the shareholders and other interested parties.
3. Scope	Work relates to the operations of the organisation.	Work relates to the financial statements.
4. Relationship with the company.	Often employees of the organisation, although sometimes outsourced.	Independent of the company and its management. Usually appointed by the shareholders.

(4 marks)

e)

Factors to consider when assessing the reliance that can be placed on the results of analytical procedures.

(1) Materiality of the items involved

If inventory balances are material, then auditors should not rely solely on analytical procedures.

(2) Other audit procedures

In the audit of receivables, other audit procedures such as the review of subsequent cash receipts may confirm or dispel questions arising from the application of analytical procedures to an aged profile of customers' accounts.

(3) Accuracy of predictions

Auditors would expect greater consistency in comparing the relationship between gross profit and sales from one period to the next than in comparing discretionary expenses such as research costs or advertising expenditure.

(4) Frequency with which relationship is observed

A pattern repeated monthly as opposed to annually (for example, payroll costs).

(5) Assessments of inherent and control risks

If internal controls over sales order processing are weak, and control risk is assessed as high, the auditors may rely more on test of individual transactions or balances than on analytical procedures.

(Any 3 points for 6 marks)

(Total: 20 marks)

QUESTION THREE

- a) Audit planning is defined as the process in which the strategy is designed or conducts to achieve the expected result, which also defines the scope of audit inside the company. The size, nature and the time for the audit plan may vary. Is a vital area of the audit primarily conducted at the beginning of audit process to ensure that appropriate attention is devoted to important areas, potential problems are promptly identified, work is completed expeditiously and work is properly coordinated.

The audit plan converts the audit strategy into a more detailed plan and includes the nature, timing and extent of audit procedures to be performed by engagement team members in order to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.

b) Importance or benefits of audit planning

1. Audit planning helps the auditor to devote appropriate attention to important areas of the audit.
2. Audit planning helps the auditor to identify and resolve potential problems on a timely basis.
3. Audit planning helps the auditor to properly organize and manage the audit so it is performed in an effective manner.

4. Audit planning assists in the selection of appropriate team members and assignment of work to them
5. Audit planning facilitates the direction, supervision and review of work
6. Audit planning assists in coordination of work done by other auditors and experts.
7. Audit planning establishes the means of achieving the objectives of the audit in efficient and effective manner.
8. Setting of materiality levels
9. Determination of audit time table
10. Reliance on internal audit and client staff to provide schedules.

(Any 8 points for 8 marks)

c) Preliminary analytical review is used at the planning stage of an audit to help the auditor to obtain an understanding of the financial circumstance of the client, e.g. a reduction in gross profits percentage may indicate that the company may eventually make a net loss or increase in the debt collection period may indicate risk of uncollectible receivables.

Identify potential risk areas to which an attention should be paid during the audit. For example liquidity and profitability ratios can point to going concern problems which may need to be evaluated.

Determine the nature, timing and extent of audit procedures. For example evidence obtained from preliminary analytical procedures may enable the auditor to determine what audit procedures to perform to respond to the risks identified.

(5 marks)

d)

Statistical sampling: - is any approach to sampling that involves random selection of a sample, and the use of probability theory to evaluate sample results, including measurement of sampling risk.

Non-statistical sampling: - is where the auditor does not use statistical methods and draws a judgmental opinion about the population.

(5 marks)

(Total: 20 marks)

QUESTION FOUR

a) Factors that will influence the auditor's judgement regarding the sufficiency of the evidence obtained

- **Materiality**

Material items will require more evidence to support them than immaterial items, which might be tested by comparative analytical review only.

- **Risk**

The sufficiency of audit evidence required is affected by the level of risk in the area being audited.

- **Source and quality of evidence**

If the evidence is high quality, then less may be required than if it were of poorer quality. In general, audit evidence from external third parties is more reliable than that from the client's record because it is independent. Similarly evidence generated by the auditor is more reliable than that from the client. Original documents are more reliable than copies which can be tampered with.

- **Internal control system**

Evidence obtained from the client's records is more reliable when the related control system is operating effectively (as tested by the auditor).

(6 marks)

b) Basic elements of an Audit report

- **Title**

The audit report should have a title which includes the wording 'independent auditor' to distinguish this report from others that may be prepared internally by the company.

- **Addressee**

The report should be appropriately addressed as required by the engagement and local regulations. This is normally to the shareholders of the company or to those charged with governance.

- **Introductory paragraph/ Report on Financial statement**

This section identifies the financial statements being audited, including the date and period covered. It also identifies the title of each statement that comprises the financial statements being audited.

- **Management's responsibility for the financial statements**

This part of the report is included to describe the responsibilities of those who are responsible for the preparation of the financial statements including those in respect of internal control.

- **Auditors responsibility**

This section describes the auditor's responsibility for expressing an opinion, notifies users that the audit was carried out in accordance with ISAs and explains what an audit involves.

- **Opinion**

This indicates the financial reporting framework used to prepare the accounts and states the auditor's opinion as to whether the financial statements present fairly, in

all material respects (or show a true and fair view of) the financial position of the audited entity in accordance with that framework.

- **Date**
The audit report should be dated as at the completion of the audit, to show that the auditor has considered any events after the reporting period date up to the date of completion and how these might affect the financial statements. The report should not be dated earlier than the date on which the accounts are signed or approved by management.
- **Auditor's address**
The audit report should name a specific location, which is normally the city or town where the auditor maintains the office that has responsibility for the audit.
- **Auditor's signature**
The audit report should be signed in the name of the audit firm, the personal name of the auditor, or both, as appropriate. It is usually signed in the name of the firm because the firm assumes responsibility for the audit.
- Report on Legal and other requirement

(Any 6 points for 6 marks)

(d) Procedures for Appointment of Auditors in accordance with the Companies Act 1963 (Act 179)

- At any time before the first annual general meeting of a company, the directors of the company may appoint, or (if the directors do not make an appointment) the company at a general meeting may appoint, a person to be the auditor of the company, and any auditor so appointed shall, subject to this section, hold office until the conclusion of the first annual general meeting.
- A company shall at each annual general meeting of the company appoint a person to be the auditor of the company, and any auditors so appointed shall, subject to this section, hold office until the conclusion of the next annual general meeting of the company.
- Subject to subsections (7) and (8), the directors of a company may appoint an approved company auditor to fill any casual vacancy in the office of auditor of the company, but while such a vacancy continues the surviving or continuing auditor, if any, may act.
- An auditor of a company may be removed from office by resolution of the company at a general meeting of which special notice has been given, but not otherwise.
An auditor appointed in pursuance of subsection (7) or (8) shall, subject to this section, hold office until the conclusion of the next annual general meeting of the company.
- If a company does not appoint an auditor as required by this section, the Registrar may on the application in writing of any member of the company make the appointment.

- Subject to subsection (7), a person shall not be capable of being appointed auditor of a company at an annual general unless he held office as auditor of the company immediately before the meeting or notice of his nomination as auditor was given to the company by a member of the company not less than twenty-one days before the meeting.
- Where notice of nomination of a person as an auditor of a company is received by the company whether for appointment at an adjourned meeting under subsection (7) or at an annual general meeting, the company shall, not less than seven days before the adjourned meeting or the annual general meeting, send a copy of the notice to the person nominated, to each auditor, if any, of the company and to each person entitled to receive notice of general meetings of the company.
- If, after notice of nomination of a person as an auditor of a company has been given to the company, the annual general meeting of the company is called for a date twenty-one days or less after the notice has been given, subsection (11) shall not apply in relation to the person and, if the annual general meeting is called for a date not more than seven days after the notice has been given and a copy of the notice is, at the time notice of the meeting is given, sent to each person to whom, under subsection (12), it is required to be sent, the company shall be deemed to have complied with that subsection in relation to the notice.

(8 marks)

(Total: 20 marks)

QUESTION FIVE

a) Management Letter

ISA 265 requires that communication of deficiencies on internal control to management must be in written form by way of a letter. It is this letter that is referred to as the management letter.

Contents

- The list of weakness in the structure of accounting system and internal controls eg. there may be no serial numbering of sales invoice so that it is possible for a sales invoices to be lost and not be entered in the records.
- A list of deficiencies in operation of the records or controls.
- Unsuitable accounting policies and practices
- Non-compliance with accounting standards or legislations
- Explanations of the risks arising from each weakness.
- Comments on inefficiencies as well as weaknesses
- Recommendations for improvement

(5 marks)

b) Going Concern

Going Concern – This assumes that the entity will continue to operate for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulation.

The following are tests and procedures the auditor needs to perform to form an opinion on management's conclusion that the company is a going concern:

- Check whether management has carried out going concern assessment and evaluate the assessment done by management.
- Perform further processes as follows:
- Review the cash flow forecast in the subsequent accounting period for improvement
- Review management accounts and the financial records in the subsequent accounting period
- Review correspondence with creditors/suppliers so as to ensure that pressures are not being mounting by them
- Review the client profit forecast prepared for the subsequent accounting period
- Where financial assistance is to be given by banks and other sister companies, review their degree of commitment
- Review minutes of meeting of directors and management
- Review management rescue plans and ensure that they are consistent with facts already known to the auditor.

(6 marks)

c) The three types of modified opinions are

- **Qualified opinion** where effect of misstatements in the financial statements or inability to obtain sufficient appropriate audit evidence is only material but not pervasive.
- **Adverse opinion** where the effect of misstatements in the financial statements is both material and pervasive.
- **Disclaimer of opinion** is where the effect of reliability to obtain sufficient appropriate audit evidence is both material and pervasive

(6 marks)

d) **Circumstances under which an auditor may issue a qualified opinion are:**

- Misstatements in the financial statements where the effect is only material but not pervasive. The misstatement may be done to
- Selection of accounting policies used in the preparation of the financial statements
- The application of the accounting policies in the preparation of the financial statements
- Presentation and disclosure of information in the financial statements
- Inability to obtain sufficient appropriate audit evidence. This may be due to
- Circumstances beyond the control of both management and the auditors, for example timing of the appointment of the auditors which makes it impossible for them to attend stock –taking

- Management imposed scope limitations. For example prohibiting the auditor from carrying out circularisation of debtors
- Auditors own inability to perform necessary audit procedures to obtain the evidence due to time constraints as cost of doing it.

(Any 2 points for 3 marks)

(Total: 20 marks)

EXAMINER'S QUESTIONS ANALYSIS

Question-by-question analysis of performance are as detailed below:

Question one (1)	-	67%
Question Two (2)	-	87%
Question Three (3)	-	87%
Question Four (4)	-	33%
Question Five (5)	-	53%

From the above analyses, it could be observed that questions four (4) was badly answered by candidates whilst question five (5) was averagely answered. Candidates however, answered questions one(1), two(2) and three (3) very well.

For us as a group, we think that the areas covered by questions four (4) and five (5) should be critically looked at by both teachers and students. Most candidates appreciate some of the questions that appeared in the examination, especially questions one (1) two (2), three (3) and five (5).

Some candidates deviated in their answers to the questions and as a result provided wrong answers to some of the questions they answered. Example, question one (1b) which required students to explain the auditor's duties in line with the provisions of the Ghana companies Act 1963 (Act 179). Students were answering the question in relation to the code of ethics rather.

As already stated above, candidates were ill-prepared in the areas of questions four (4) and five (5).

CONCLUSION

Instructors of the subject are to ensure that students grasp the basic principles of the subject. Students should be made to do a lot of class tests before they go in for the examination. Students should do a lot of reading and practice more past questions for teachers to mark and discuss with candidates prior to the examination. Students must be told that whatever hard work they do in Level 2 will carry them to Level 3 since the principles are the same, no matter the level.