

**MAY 2016 PROFESSIONAL EXAMINATION
AUDIT & ASSURANCE (2.3)
EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

EXAMINER'S REPORT

EXAMINER'S GENERAL COMMENTS & STANDARD OF PAPER

The standard of the paper for May, 2016 was as high as that of November, 2015. The syllabus coverage of the paper was excellent with no material ambiguities or errors. In my view all the five (5) questions were of high standard at the level of examination. No questions were 'too loaded'. In my view however, question two (2b) marks are 'over-generous'. That question should not attract more than five (5) marks. This contributed in no small measure for candidates to score 80% in the examination. Marks allocation followed the weightings in the syllabus was fairly allocated to each sub-question. There were no questions or sub-questions in which mark allocation was contrary to syllabus weightings.

GENERAL PERFORMANCE OF CANDIDATES

The general performance or pass rate of candidates in the subject is 55%. That is, out of a total number of 418 candidates who wrote the paper 234 passed and 184 failed.

The performance was above average. The reason could be that teaching and learning are improving at the moment. Performance or pass rate was higher this diet than that of November, 2015

High performers for this paper were evenly spread across majority of the centres. It is an indication that candidates are attending classes in most of the centres. Availability of learning materials has also contributed greatly to this 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. There were situations or scenarios of copying in any of the centres where the examinations were conducted. The level of preparedness of most of the candidates was adequate which culminated into over 55% pass rate.

NOTABLE STRENGTHS & WEAKNESSES OF CANDIDATES

In fact question two (2) was well answered by candidates and this propelled more candidates to pass the paper. The pass rate for this question was over 80%. Specific areas in which strengths were demonstrated were in questions two (2) and three (3) where candidates pass rate was 80% and 52.5% respectively. Question five (5) also recorded a pass rate of 42.5% which was not bad at all. Candidates were well prepared in those topics that featured in questions two (2), three (3) and five (5).

Most of the candidates demonstrated tremendous weakness in answering some of the questions. There were a lot of deviations in their answers, especially question five (5). Candidates did not understand some of the questions before attempting to answer them. The weakness was peculiar to a few candidates considering the failure rate of 45%.

The reason for the weakness to our group of Examiners is that most candidates lacked the understanding of basic principles under pinning the subject.

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

Question one (1)	-	22.5%
Question Two (2)	-	80.0%
Question Three (3)	-	52.5%
Question Four (4)	-	12.5%
Question Five (5)	-	42.5%

From the above analyses, it could be observed that questions one (1) and four (4) were badly answered by candidates whilst question five (5) was averagely answered. Candidates, however, answered questions two (2) and three (3) very well. For us as a group, we think that the areas covered by questions one (1), four (4) and five (5) should be critically looked at by both teachers and students.

Most candidates did not appreciate some of the questions that appeared in the examination, especially question one (1) four (4) 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. Eg . question five (5a) which says "Explain the purpose of value for money audit". Most students were defining VFM audit instead.

AUDIT & ASSURANCE QUESTIONS

QUESTION ONE

- a) '*Audit evidence* must be reviewed critically with respect to its validity and pertinence as evidence before it is permitted to influence the mind of the auditor with respect to the assertion at issue'.
- i) An Auditor is considering using a copy of credit sale invoices on a file as evidence for the credit sales figure in the accounts. How would he assess the validity and pertinence of this file as audit evidence? **(3 marks)**
- ii) A mail order company invoices its customers with up to five ladies' dresses. Most customers accept and pay for one or two dresses and return the rest. A credit note is then issued. The accounts incorporate a provision for returnable dresses at the year end. The audit is completed very quickly and post-balance sheet events are not usable by the auditor as evidence. What evidence would the auditor regard as valid and pertinent in respect of the provision? **(3 marks)**
- iii) What factors would influence an auditor in considering the acceptability as evidence of certificates received from third parties? **(3 marks)**
- iv) A building contracting company has constructed an office block on its own land for its own use. State the evidence the auditor would require on the cost of the building. **(3 marks)**
- v) Discuss the different forms of audit evidence that would be available to auditors of very small companies and of very large companies. **(3 marks)**
- b) Discuss the advantages and disadvantages of *auditing standards* to auditors and the consequences of them being enforceable by statute. **(5 marks)**

(Total: 20 marks)

QUESTION TWO

- a) You are a manager in the audit firm of ABC & Co; and this is your first time you have worked on one of the firm's established clients, Tark Co. The main activity of Tark Co is providing investment advice to individuals regarding saving for retirement, purchase of shares and securities and investing in tax efficient savings schemes. Tark is regulated by the relevant financial services authority.

You have been asked to start the audit planning for Tark Co, by Mr. Soon, a partner in ABC & Co. Mr. Soon has been the engagement partner for Tark Co, for the past nine years and so has excellent knowledge of the client. Mr. Soon

has informed you that he would like his daughter Afi to be part of the audit team this year; Afi is currently studying for her first set of knowledge level papers for her ICAG qualification. Mr. Soon also informs you that Mr. Fac, the audit senior, received investment advice from Tark Co during the year and intends to do the same next year.

In an initial meeting with the finance director of Tark Co, you learnt that the audit team will not be entertained on Tark Co.'s yacht this year as this could appear to be an attempt to influence the opinion of the audit. Instead, he has arranged a balloon flight costing less than one-tenth of the expenses of using the yacht and hopes this will be acceptable. The director also states that the fee for taxation services this year should be based on a percentage of tax saved and trust that your firm will accept a fixed fee for representing Tark Co in a dispute regarding the amount of sales tax payable to the taxation authorities.

Required:

- i) Explain the ethical threats which may affect the auditor of Tark Co. **(6 marks)**
 - ii) For each ethical threat, discuss how the effect of the threat can be mitigated.
(6marks)
- b) Discuss the benefits of Tark Co establishing an Internal Audit Department.
(8marks)

(Total: 20 marks)

QUESTION THREE

- a) An audit is often carried out in more than one sitting, especially when there are tight reporting deadlines. The auditors will carry out an interim audit during the period under review followed by a final audit shortly after the year end. Work at the interim audit will often include obtaining audit evidence about the operating effectiveness of controls.

Required:

- i) Describe the impact on the final audit of performing work on internal controls at an interim audit.
(2 marks)
- ii) Assuming an interim audit has taken place and work on internal controls was carried out, list the factors the auditor should consider when deciding how much more work is needed at the final audit in relation to internal controls.
(4 marks)

- b) Businesses may establish an audit committee to help improve corporate governance within a company. This can provide benefits to both internal and external auditors.

Required:

Explain how an audit committee can benefit both the external auditors and the internal auditors of an entity. **(4 marks)**

- c) There are similarities and differences between the responsibilities of internal and external auditors. Both internal and external auditors have responsibilities relating to the prevention, detection and reporting of fraud, for example, but their responsibilities are not the same.

Required:

Explain the difference between the responsibilities of *internal auditors and external auditors* for the prevention, detection and reporting of fraud and error. **(6 marks)**

- d) *ISA 610 using the work of internal auditors* provides guidance to external auditors on the use of internal audit work.

Required:

List and explain the various criteria that should be considered by external auditors when assessing whether to take reliance from work performed by internal audit.

(4 marks)

(Total: 20 marks)

QUESTION FOUR

- a) Describe external auditor's responsibilities and the work that the auditors must perform in relation to the going concern status of companies.

(5 marks)

- b) Describe the possible audit reports that can be issued where the going concern status of a company is called into question; your answer should describe the circumstances in which they can be issued.

(5 marks)

- c) You have been asked by your client, a garage proprietor, to advise on a system of control for cash sales. Set out the points you would take into consideration before giving your recommendations.

(10 marks)

(Total: 20 marks)

QUESTION FIVE

- a) Explain the purpose of *value for money* audit. **(4 marks)**
- b) Okunka hospital is located in a country where healthcare is free, as the taxpayers funds are used to finance state owned hospitals. Two years ago, management reviewed all aspects of the hospital's operations and instigated a number of measures aimed at improving overall '*value for money*' for the local community. Management have asked you, an audit manager in the hospital's internal audit department, to perform a review over the measures which have been implemented.

Okunka has one centralized procurement department through which all purchase requisition forms are forwarded to. Upon receipt, the procurement team embarks on market research for the lowest price from suppliers after which a purchase order is raised. The purchased order is then submitted to the procurement director, who authorises all orders. The small procurement team receive in excess of 200 forms a day. The human resource department has had difficulties with recruiting suitably trained staff. Overtime rates have been increased to incentivise permanent staff to fill staffing gaps, this has been popular, and reliance on expensive temporary staff has been reduced. Monitoring of staff hours had been difficult but the hospital has implemented time card clocking in and out procedures and these hours are used for overtime payments as well.

The hospital has invested heavily in new surgical equipment, which although very expensive, has meant that more operations could be performed to ensure faster patient recovery. However, there is shortage of well-trained medical staff. A capital expenditure committee has been established, made up of senior managers, and they plan and authorise any significant capital expenditure items.

Required:

- i) Identify and explain **FOUR** strengths within Okunka's operating environment; and **(6 marks)**
- ii) For each strength identified, describe how Okunka might make further improvements to provide best value for money. **(4 marks)**
- c) Describe **TWO** substantive procedures the external auditor of Okunka should adopt to verify **EACH** of the following assertion in relation to an entity's property, plant and equipment:
- i) Valuation
 - ii) Completeness; and
 - iii) Rights and obligations.

(Note: Assume that the hospital adopts International Financial Reporting Standards). **(6marks)**

(Total: 20 marks)

AUDIT & ASSURANCE SCHEME

QUESTION ONE

a)

- i) The file of copy credit sales invoices is the most pertinent evidence which the auditor can obtain of the credit sales figure in the accounts. This is because the sales figure is built up from the individual sales which the copy sales invoices represent.

The auditor's assessment of its validity as evidence will however depend upon the degree to which it is supported by other evidence. It is a general rule that documents created within the organization, such as the copy invoices, form weak audit evidence.

The auditor may for example assess the internal controls designed to ensure the completeness, accuracy and validity of sales invoices in the file or seek evidence from outside the organization such as customers' remittance advices.

- ii) The most pertinent evidence which the auditor could seek would be stock returned and credit notes issued after the year end in relation to the garments in the hands of customers at the year end. However, because of the tight deadline for the audit the auditor will have to rely on calculations of expected returns based on previous experience. In order to accept the validity of this evidence the auditor would check the calculations and confirm that they were made on reasonable assumptions about trends in the numbers of dresses accepted by customers and any problematical styles.

- iii) When considering the acceptability of a certificate from a third party as audit evidence the auditor would be influenced by the following.

- 1) the fact that the evidence is documentary;
- 2) the fact that it has come from a third party, particularly if it has been sent directly to the auditor by the third party;
- 3) the integrity of the third party implied by his status or by his membership of a profession. For example an auditor would place more reliance on a statement from a bank manager than one from a member of the general public;
- 4) the qualification of the third party relating to the subject on which he certifies;
- 5) the independence of the third party from the client;
- 6) any unusual disclaimer made in the certificate;
- 7) the extent to which the certificate is supported by other evidence.

- iv) The evidence required would include ÷

- 1) the controls operating over the costing records;
 - 2) documents such as purchase invoices supporting material individual entries in the costing record for the office;
 - 3) the calculation of overheads included in the cost of the office, which must not include any element of profit;
 - 4) an independent valuer's opinion may be obtained if other evidence is not sufficiently reliable;
 - 5) the amount for which the building is insured;
 - 6) confirmation of cost and method of costing in the letter of representation.
- v) **The main differences between the audit evidence which can be obtained from large and small companies are:**

(1) Internal Control

In a large company audit it will normally be possible to rely extensively upon internal controls as a sophisticated internal control system will exist. On the other hand a small company will not need such a complex system so the auditor will not be able to obtain evidence from the operation of internal controls.

(2) Substantive testing

Large companies will have a very large number of transactions, so it will not be practicable to rely entirely on substantive tests. A small company will, however have a small number of transactions and the auditor will be able to rely on the evidence of substantive tests.

(3) Involvement of directors

The directors of a large company will not be involved in the detail of the operation. Therefore in order to assess the reliability of any representations they make the auditor must assess the reliability of the reports they receive from the managers.

In a small company the directors will be involved in the day to day running of their company, so their representation will be based on a detailed knowledge and understanding. It may also be possible to rely to some extent on the supervision they exercise over the company's accounting. An assessment of evidence from the directors of a small company will therefore depend among other things upon an assessment of their integrity, and on supporting evidence from other sources.

b)

The major advantages and disadvantages of auditing standards can be summarized as follows.

Advantages

- (1) They give a framework for all audits around which a particular audit can be developed.
- (2) They help to standardise the approach of all auditors to the common objective of producing an opinion.
- (3) They assist the court in interpretation of the concept of 'due professional care' and may assist auditors when defending their work.
- (4) They increase public awareness of what an audit comprises and the work behind the production of an audit report.
- (5) They provide support for auditors in potential disputes with clients regarding the audit work necessary.

Disadvantages

- (1) It may appear that they impinge on, rather than assist, professional judgement.
- (2) They are considered by some to stifle initiative and developments of new auditing methods.
- (3) They may create additional and unnecessary work and thus raise fees, particularly in the audit of small companies.

Consequences

If auditing standards were to be enforceable by statute it would mean that there would be government intervention in areas currently controlled solely by the profession itself. This might ultimately lead to a diminished role of self-regulation. To be enforceable by statute the standards would have to be applicable to all circumstance and thus need to be very general and broad in their instructions. This might reduce their usefulness to the auditors. Auditors might spend unnecessary time ensuring that they have complied with the law rather than considering the quality of service to their clients.

Finally, it should be considered whether full statutory backing for standards would force auditors into narrow views and approaches

which might gradually impair the quality of accounting and auditing practices.

QUESTION TWO

Scheme

- (a) 1 mark for each ethical threat and 1 mark for explanation of how to mitigate that threat = 2 marks per linked points.

Part (i) therefore is 6 marks total and part (ii) is 6 marks total

Engagement partner - time providing service
Engagement partner's daughter takes part in audit
Payment for investment advice
Gift of balloon flight from client
Contingent fee-taxation work
Representing client in court

Maximum Marks

- (b) 2 marks per well - explained point
Regulation
Reports to the board
Liaison with external auditors
Monitor effectiveness of internal control
Value for money audit
Taxation services
Risk assessment

Maximum Marks

- (a) Threats and safeguards

(i) Ethical threats

(ii) Possible safeguards

<p>(1) <u>Familiarity</u></p> <p>Mr. Soon has been the engagement partner for Tark for the past nine years.</p> <p>This gives rise to a familiarity threat because of his long association with</p>	<p>Mr. Soon should be rotated off the audit. The ICAG code of Ethics and Conduct states that for listed companies, engagement partners should be rotated after no more than</p>
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<p>this one client which could impair his objectivity and independence.</p> <p>Mr. Soon's daughter Afi will be part of the audit team of Tark. This also gives rise to a familiarity threat because her father is the engagement partner and this may impair objectivity.</p> <p>(2) <u>Intimidation</u></p> <p>There may be an intimidation threat from the Finance Director of Tark who has made a statement regarding the calculation of the fees for taxation services. The audit firm may feel that it has to accept this in order to keep Tark as a tax client.</p>	<p>seven years and not return to that client until a further period of two years has elapsed. Although Tark is not stated as listed, partner rotation should be implemented.</p> <p>Whilst Mr. Soon is still the engagement partner for this audit, his daughter should not be part of the audit team of Tark.</p> <p>The engagement partner should explain to the Finance Director that although his firm can provide taxation services to Tark, the fees charged must be based on the time spent on the work.</p>
<p>(3) <u>Advocacy</u></p> <p>An Advocacy threat may arise as the Finance Director is expecting ABC & Co to represent his company in a dispute with the taxation authorities.</p>	<p>There are no safeguards which could be put in place to mitigate this threat and so the firm must decline to represent Tark in this dispute.</p>
<p>(4) <u>Self-review</u></p> <p>The firm also provides taxation services to Tark and this may give rise to self-review threat as staff may end up reviewing their own work. The extent of the threat will depend on the nature of the services and in particular how any matters advised on will be reflected in the financial statements.</p>	<p>Depending on the level of the threat Tark could use separate engagement teams for the audit and tax work to mitigate any threat arising.</p>
<p>(5) <u>Self Interest</u></p> <p>Mr. Fac, the audit senior, received investment advice from the Company and intends to do so in the future. A self-interest threat may arise as a result which could impair his objectivity.</p>	<p>If Mr. Fac paid for the services received from Tark as any other customer would, there is potentially no problem. However, this should be discussed with the engagement and ethics partners and he may be advised not to use the services of Tark in the future.</p>

<p>The client is expecting the tax fee to be based on a % of tax saved- this is a form of contingent fees. This gives rise to a self-interest threat because the firm will want to save as much tax as possible in order to charge as high a tax fee as possible.</p>	<p>There are no safeguards that can be put in place to mitigate this threat and so the firm should not agree to the proposed fee arrangement for taxation services.</p>
<p>The client has arranged a balloon flight for the audit team. This could give rise to a self-interest threat in the form of gifts and hospitality.</p>	<p>The Code of Ethics and Conduct states that gifts and hospitality should only be accepted where the value is trivial and inconsequential. In this case, it would be appropriate to decline the balloon flight so as not to impair the firm's independence.</p>

(b) **Benefits of an internal audit department**

An internal audit department could look at existing procedures and systems in operation at Tark and make lots of useful recommendations to tighten up areas where there are deficiencies in controls.

An internal audit department could carry out value for money audits, looking at the economy, efficiency and effectiveness of processes and activities within the entity.

The internal auditors could examine the IT systems in place and make recommendations regarding these, including looking at the programmed controls.

The internal auditors could undertake financial audits to substantiate information in management and financial reporting.

The internal audit department could make recommendations in respect of good corporate governance, even though the company may not be required to comply with corporate governance guidelines.

The external auditors might be able to rely on work undertaken by the company's internal auditors and this in turn could result in a reduced audit fee.

The company has to comply with financial services regulations so an internal audit department could undertake work to ensure that it is complying with all required legislation and regulations.

The presence of an internal audit department within the company would present a positive image to clients of the company and to shareholders.

QUESTION THREE

Scheme

(a) (i) Impact on final audit of internal control work at interim audit
Up to 1 mark per point to a maximum of 2 marks.

(ii) Extent of work at final audit – factors to consider
Up to 1 mark per point to a maximum of 4 marks.

(b) Audit committee and auditors
Up to 1 mark per explained point to a maximum of 4 marks.

(c) Prevention, detection and reporting of fraud and error
1.5 marks per well explained point to maximum of 6 marks.

(d) Reliance on internal audit work
1 mark per point to maximum of 4 marks.

(a) **Interim audit an internal Controls**

(i) Impact of interim audit work on internal controls on the final audit.

If the auditors are to place reliance on internal controls they must obtain evidence that controls have operated effectively throughout the period.

If the auditor obtains audit evidence about the operating effectiveness of controls at the interim audit, when it comes to the final audit, instead of having to gain evidence over controls covering the whole year the auditor can focus on obtaining audit evidence about significant changes to those controls subsequent to the interim period.

The auditor will need to determine the extent of the additional audit evidence to be obtained for the remaining period.

(ii) Factors to consider when determining the extent of further work on internal controls at the final audit:

At the final audit the auditor will need to gain additional audit evidence about controls that were operating during the period between the interim audit and the year end. When determining the extent of the additional work needed the auditor will take into account:

- The significance of the assessed risks of material misstatement at the assertion level.
- The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel.
- The degree to which audit evidence about the operating effectiveness of those controls was obtained.
- The length of the remaining period
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
- The strength of the control environment.

(b) **Benefits of an audit committee to external auditors**

An audit committee can benefit the external auditor because the committee provides a channel of communication and forum for issues of concern. This acts to strengthen the position of the external auditor and reduces the risk of intimidation threat arising which may occur when providing feedback directly to the board.

The audit committee therefore allows the external auditor to assert his/her independence in the event of a dispute with management.

Benefits of an audit committee to internal auditor

The audit committee will help maintain the quality of the internal audit department since one of its roles will be to monitor and review the effectiveness of the company's internal audit function.

Since the internal auditors are able to report findings to the audit committee rather than directly to the board, as with the external auditors, their independence is strengthened and they should feel more comfortable when reporting irregularities and problems, and making recommendations, in areas where there has been board member involvement.

(c) **Prevention, detection and reporting of fraud and error**

External Auditors

Prevention and detection

The external auditors are bound by the requirements of ISA 240. This requires that auditors recognize that **fraud and error may materially affect the financial statements** and design procedures to ensure that the risk is minimized. The auditors have no specific requirement to prevent or detect fraud. However, they must maintain **professional scepticism** throughout the audit, recognizing that circumstances may exist that cause the financial statements to be materially misstated.

By conducting the audit in accordance with ISAs the auditor obtains reasonable assurance that the financial statements are free from material misstatement caused by fraud or error. However, due to the nature of fraud the risk of not detecting fraud is higher than the risk of not detecting error.

Reporting

ISA 240 also sets out the requirements in relation to reporting fraud. If auditors suspect or detect a fraud, they must report it on a **timely basis** to the **appropriate level of management**.

If management are implicated the matter must be communicated to **those charged with governance**, unless the fraud necessitates immediate reporting to a **third party**.

The matter should only be referred to in the audit report if the opinion is modified on those grounds. It may also be that the matter is one which needs reporting to a relevant authority in the public interest. If the auditors feel that this is so, they should seek **legal advice** before taking any action, and request that the entity reports itself. If the directors refuse to make any disclosure in these circumstances, the auditors should make the disclosure themselves.

Internal auditors

Prevention and detection

It is likely that the internal auditors will have a role both in the prevention and detection of fraud. Indirectly, they play a role in their involvement with the **internal controls** of a business, which are set up to limit risks to the company, one of which is fraud. Directly, they may be engaged by the directors to carry out test when a fraud is suspected, or routinely to discourage such activity.

However, if a serious fraud was suspected, a company might bring in **external experts**, such as forensic accountants or the police.

Reporting

If internal auditors discovered issues which made them suspect fraud, they would **report it immediately** to their superiors, who would report to those charged with governance. In the event that an internal auditor suspected top level fraud, he might make disclosure to the relevant authority in the public interest.

- (d) Criteria to be considered when assessing whether to place reliance on internal audit work include the following:

Objectivity of function

The external auditor should consider whom the internal auditors report to and whether they are subject to any conflicting responsibilities, constraints or restrictions. This will affect the capability of the internal auditors to communicate significant matters openly.

Scope of function

The external auditors should consider the extent and nature of assignments performed by the internal auditors and the action taken by management as a result of internal audit reports.

Technical Competence

The external auditors should consider whether the internal auditors have adequate technical training and proficiency.

Due professional care

The external auditors should consider whether the work of internal audit is properly planned, supervised, reviewed and documented.

QUESTION FOUR

Scheme

- | | | |
|-----|---|---------|
| (a) | External auditor responsibilities – going concern
Up to 1 mark per point to a maximum of | 5 marks |
| (b) | Possible audit reports and circumstances
Up to 1.5 marks per point to a maximum of | 5 marks |

(a) **External auditor's responsibilities and the work that the auditor should perform in relation to going concern**

(i) Responsibilities

According to ISA 570 the auditor must:

- Evaluate management's assessment of the entity's ability to continue as a going concern.
- Consider whether there are, and remain alert throughout the audit for, events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- Enquire of management its knowledge of events or conditions beyond the period of the assessment that may cast significant doubt on the entity's ability to continue as a going concern.
- Obtain sufficient appropriate audit evidence to determine whether a material uncertainty exists if events or conditions are identified that cast significant doubt on the entity's ability to continue as a going concern.

(ii) **Audit work**

- As part of the overall risk assessment the auditor must consider whether there are any events or conditions and related business risks which may cast significant doubt on the company's ability to continue.
- The auditor should evaluate the process by which management has assessed the viability of the company. The auditor should make enquires of those charged with governance and examine supporting documentation such as cash flow forecasts and budgets.
- The auditor must consider whether the period used by management to assess the viability of the company is sufficient. If the period covers less than twelve months from the reporting date the auditor should ask management to extend the period to twelve months from the reporting date.
- The auditor should evaluate the assumptions used by management and determine whether they seem reasonable in the light of other known facts.

- Where events or conditions have been identified which may cast significant doubt on the entity's ability to continue as a going concern the auditor must review management's plans for future actions and gather sufficient appropriate audit evidence to confirm whether a material uncertainty exists. This will include:
 - Analysing and discussing the cash flow and interim financial statements.
 - Reviewing the terms of debentures and loan agreements
 - Reading minutes of the meetings of shareholders and directors for reference to financing difficulties.
 - Inquiring of the company's lawyers regarding litigation and claims.
 - Assessing the possibility of raising additional funds.
 - Reviewing events after the period end.
- The auditor must seek written representations from management regarding its plans for future action.

(b) **Audit reports**

- (i) Where the use of the going concern assumption is appropriate but a material uncertainty exists, provided that the auditor agrees with the basis of preparation of the accounts and the situation is adequately disclosed, an **unmodified opinion** is issued. The audit report will however include an **emphasis of matter paragraph** highlighting the uncertainty to the user and referring them to the details in the disclosure note.
- (ii) Where the material uncertainty exists but the situation is not adequately disclosed the opinion should be **modified on the grounds that there is** insufficient disclosure and the financial statements are materially misstated. Depending on the specific circumstances this may be a qualified 'except for' or adverse opinion.
- (iii) If in the auditor's judgement the company will not be able to continue as a going concern and the financial statements have been prepared on a going concern basis the auditor shall express **an adverse opinion**.
- (iv) If the auditors are unable to form an opinion because they were not able to obtain sufficient appropriate audit evidence they shall issue **an 'except for' qualified opinion or a disclaimer**.
- (v) If management is unwilling to extend its assessment where the period considered is less than twelve months from the reporting date the auditor

shall consider **the need to modify** the opinion as a result of not obtaining this evidence.

- (c) The points which might be taken into consideration before giving recommendations to a garage proprietor on a system of control for cash sales are as follows:
- (i) The type of cash sales which might be made. The garage might, for instance, have cash sales from:
 - 1. Petrol;
 - 2. Sales of spares;
 - 3. Repairs to vehicles;
 - 4. Sale of motor vehicles;
 - 5. Vehicle hire;
 - 6. Sale of items from a shop on the forecourt.
 - (ii) The size of the garage and the number of staff available. This will affect the division of responsibilities and the possibility of one person's work being proved independently by another.
 - (iii) The amount of control exercised by the proprietor over the day-to-day running of the garage.
 - (iv) The type of business (eg. partnership, sole trader or company) and the effect which a breakdown in control may have over the need to publish certain information under statute.
 - (v) The documentation already available in the system and how this can be used to good effect under new recommendations.
 - (vi) The possibility of discounts being given and how this can be controlled and recorded.
 - (vii) The need not to overburden non-administrative staff with time-consuming administrative duties but to keep forms (eg. Showing total cash sales) as simple as possible.
 - (viii) The availability of tills which can accumulate total cash sales during a period.

Scheme

Controls for cash sales for a typical garage
Up to 1.5 marks per point to a maximum of 10 marks.

QUESTION FIVE

Scheme

- (a) Up to 1 mark per valid point
Explain of value for money audit

Economy	-	description	} 4 marks
Efficiency	-	description	
Effectiveness	-	description	

- (b) 0.5 marks for identification and up to 1 mark for explanation of each well explained strength and up to 1 mark per improvements. If not well explained 0.5 marks for each, but overall maximum of 4 points / marks.

Internal audit department

Centralised buying department buys from lowest cost supplier

Authorisation of all purchase orders by purchasing director

Reduction in use of temporary staff

Employee clocking in cards to monitor hours worked

New surgical equipment leading to better recovery rates capital expenditure committee **10 marks**

- (c) Up to 1 mark per substantive procedure

Valuation (i)

Review depreciation policies for reasonableness

Recalculate the depreciation charge

Proof in total calculation of depreciation

For revalued assets, consider reasonableness of valuer

For revalued assets, agree the revalued amounts to valuation report

Surgical equipment additions-vouch the cost to invoice

2 marks

Completeness (ii)

Reconcile PPE schedule to general ledger

Physical inspection of assets

Reconciliation of non-current asset register to the general ledger

Review the repairs and maintenance expense account

2 marks

Rights and obligations (iii)

Verify ownership of property via inspection of title deeds

Additions agree to purchase invoices to verify invoices related to entity

Review any new lease agreements

Inspect vehicle registration documents **2 marks**

Total for (c) **6 marks**

20 marks

(a) **Purpose of a value for money (VFM) audit**

VFM focuses on the best combination of services for the lowest level of resources. The purpose of a VFM audit is to examine the **economy, efficiency** and **effectiveness** of the activity or process in question.

- **Economy** - Attaining the appropriate quantity and quality of physical human and financial resources (inputs) at lowest cost.
- **Efficiency** - The relationship between goods or services produced (outputs) and the resources used to produce them.
- **Effectiveness** - Concerned with how well an activity is achieving its policy objectives or other intended effects.

(b)

Strength (i)	Improvement (ii)
<p>1. The buying department researches the lowest price from suppliers before raising a purchase order. This helps with economy of the process, attaining resources at the lowest cost.</p> <p>2. Overtime rates have been increased and this has incentivized staff to fill staffing gaps. As a result the hospital has saved money by decreasing the level of expensive temporary staff, additionally, the permanent staff may be more effective as they are familiar with the hospitals systems and the level of patient care expected at Okunka.</p> <p>3. The hospital has implemented time card clocking in to ensure employees are only paid for those hours worked. It also provides a means for recording hours worked which is valuable management information. Before this there would have been no definitive record of actual hours worked.</p> <p>4. A capital expenditure committee of senior managers has been set</p>	<p>1. In order to also ensure the goods are of the required quality, an approved list of suppliers could be built up, with purchases only being permitted from those suppliers on the list.</p> <p>2. The increased hours will affect overall efficiency given that the same staff are now carrying out extended shifts, as overtime rates are higher than basic rates, even though overtime cost appears to be lower than temporary staff. There is also an increased risk of mistakes due to tiredness which could have adverse effects on the reputation of the hospital. Ideally the hospital should recruit enough permanent staff of the required level to fill shifts without then working overtime.</p> <p>3. The system appears to allow payable overtime to accumulate simply because an employee clocks out late, even if there is no staff gap to fill. The system should be set to automatically clock out after the normal number of shift hours. Staff will then need to clock back in for their overtime if they have an authorized shift. Overtime hours each month should be reviewed by the department head for consistency with agreed extra shifts.</p> <p>4. In a hospital there will be very expensive equipment purchases,</p>

<p>up to authorize significant capital expenditure items. This will help prevent cash out flows for unnecessary assets, or assets not budgeted for.</p> <p>5. The hospital has an internal audit department monitoring the internal control environment and advising on value for money.</p> <p>6. Orders are authorized by a purchasing director to help ensure expenditure incurred is necessary expenditure.</p> <p>7. New surgical equipment purchased has improved the rate of operations and patient recovery rates. This is an improvement in the effectiveness of the hospital.</p>	<p>such as the recently acquired new surgical equipment. It is better that these are authorized at board level rather than by senior managers. An authorization policy should be drawn up setting out the different levels of authorization needed (the highest being at board level) depending on the amount of expenditure for capital items.</p> <p>5. The remit of internal audit could be extended to advising on implementation.</p> <p>6. The volume of forms (200 per day) will no doubt take valuable time away from the director which could be used on more pressing matters. Orders below a certain monetary level should be authorized by the next level (down) of management. Orders over the specified monetary value should still be reserved for purchase director authorization.</p> <p>7. The equipment is not used as efficiently as it could be due to lack of trained medical staff. The hospital should look at providing targeted training for existing medical staff and look to recruit staff that have the appropriate skills.</p>
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(c) **Substantive procedures - property, plant and equipment (non-current assets)**

(i) Valuation

- Review depreciation rates applied in relation to asset lives, past experience of profits and losses on disposals, and consistency with prior years and disclosed accounting policies.
- If assets have been revalued, consider:
 - Experience and independence of valuer
 - Scope of the valuer's work
 - Methods and assumptions used
 - Whether valuation bases are in line with IFRSs

(ii) Completeness

- Compare non-current assets in the general ledger with the non-current assets register and obtain explanations for differences.
- For a sample of assets which physically exist agree that they are recorded in the non-current asset register.

(iii) Rights and Obligations

- Verify title to land and buildings by inspection of:
 - Title deeds
 - Land registry certificates
 - Leases
- Examine documents of title for other assets (including purchase invoices, contracts, hire purchase or lease agreements).

EXAMINER'S CONCLUSION

The under listed areas on which such strengths can be enhanced:

- Vigorous teaching and learning by both teachers and students should be continued.
- A lot of mock tests should be administered to students prior to the main examinations so that all rough edges could be smoothed.
- More past questions should be practiced by students.
- The Institute's school should be opened in big towns where the examination take place to prepare students for the examination.
- The Institute can also encourage the Distance Learning concept to help students to prepare adequately for the examinations.

- Setters of questions should be made to set questions from the Institute's recommended texts and to a limited extent from current issues on Audit and Assurance.
- 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.