

**NOVEMBER 2019 PROFESSIONAL EXAMINATIONS
AUDIT & ASSURANCE (PAPER 2.3)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

EXAMINER'S GENERAL COMMENTS

In my opinion, candidates performed well in this paper having a pass rate of 68% which is better than May, 2019 pass rate which stood at 57.32%.

Candidates performed well in questions one (1) to four (4) having pass rates of over 50%. The worse performance was in question five (5) which only 30% passed.

Lecturers and students are encouraged to look critically at the topics that featured in question five (5) and others since the topics would continue to be examined by Examiners.

STANDARD OF THE PAPER

The standard of the paper continues to be very high and very comparative with the previously examined papers at this level.

The mark allocation followed the weightings in the syllabus but during this diet I realised some of the syllabus coverages were merged. Some mark allocations were contrary to the syllabus weightings. I observed that mark allocation for Regulatory Framework of Auditing which is 10% was given higher allocation.

In my opinion, questions were not overloaded and marks allocations were not over-generous. There were no ambiguities/errors/ typing problems that adversely affected performance in the examinations. All the five (5) questions were of high standard at the level of examination.

PERFORMANCE OF CANDIDATES

The general performance of candidates in the subject is 69% that is out of a total number of 280 candidates who wrote the paper, 192 passed and 88 failed. The performance is therefore, more than average.

High performers for this examination was evenly spread across all centres.

Teaching and learning should continue to be enhanced so that candidates would be able to perform better at subsequent examinations. Unfortunately, students' performance in question five (5) was below 50%. Only 30% of candidates passed this question. Surprisingly question five (5) topic was within the reach of students.

Low performance were not concentrated in a particular centre. The above performance was found in most of the centres. Teaching and learning in these centres are to be seriously looked at by all stakeholders.

The level of preparedness of most candidates in most of the topics were good and this inured to the high rate of passes in four (four) of the questions during the examinations.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES

Candidates performed well in questions on Audit strategy and plan in line with ISA 200 and 300 as well as ISA 505 External Confirmation. The pass rates recorded by candidates on these topics were 62.5% each which are above average.

The above shows specific area in which strengths were demonstrated by students. The strengths were wide spread amongst candidates in various centres.

The probable reason why the above strengths were obtained may be due to the fact that teaching and learning of those topics were seriously intensified and appreciated by students.

The areas where the above strengths can be enhanced should be that both teachers and students should continue to perform their roles properly.

Below are some of the identified weaknesses of candidates:

- Some candidates do not write answered question numbers at the appropriate columns provided for that purpose. The Institute should educate candidates on this simple issue.
- Some candidates do not follow the details of directions to candidates legibly stated at the back of the answer booklet.

QUESTION ONE

- a) Accounting firms offer a wide range of professional services to their clients, including audit, other assurance and related services. These services are regulated, with many jurisdictions requiring compliance with international standards and local regulations. The type of service delivered depends both on the statutory requirements and what will provide the most value to the client and users of the financial information.

Required:

Explain the difference between *audit* and *assurance engagements*. (5 marks)

- b) *ISA 200: Overall Objectives of Independent Auditor and the Conduct of an Audit* and *ISA 300 - Planning an Audit of Financial Statements* requires that auditors should plan in order to conduct the audit in an effective, efficient and timely manner. The plan should include overall audit strategy and detailed audit plan.

Required:

- i) Distinguish between *audit strategy* and *audit plan*. (5 marks)
ii) Identify the contents of audit strategy and audit plan. (10 marks)

(Total: 20 marks)

QUESTION TWO

- a) *ISA: 505 External Confirmations* states that ‘the auditor should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level’. An Auditor may obtain external confirmations from third parties to corroborate the audit evidence already available with the auditor. The Auditor shall determine whether positive or negative request is appropriate given the condition.

Responses or events of non-responses are required to be evaluated. Responses may be unreliable if they are served indirectly to the auditor, not served by the intended person or transmission is compromised and the auditor may have to perform additional procedures to resolve doubts and suspicion. In events of non-responses or management refusal to permit the auditor to seek confirmations, the auditor shall assess if modification in the auditor’s report is necessary.

Required:

Explain **FOUR (4)** examples of external confirmations and for each one identify:

- i) an audit assertion that the external confirmation supports; and
ii) an audit assertion that the external confirmation does NOT support.

(10 marks)

- b) Sowah Quartey & Co., a firm of Auditors with a number of clients listed on the Ghana Stock Exchange, recently held a staff training session on quality control. During the session, staff raised matters from their experience relating to the ethical code on independence. Some of these matters are outlined below:
- i) Shortly before commencing the final audit of a large listed company, a Junior Staff member on the audit team inherited a substantial number of shares in that company. No action was taken because, although representing a large investment for the staff member concerned, the number of shares was totally immaterial with respect to the company. Moreover, the partner knew that if the company's results is announced, there will be a rise in the share price and he did not think it was fair to require the staff member to sell them beforehand. **(5 marks)**
- ii) The Management Accountant of another listed client company had an accident and was away from work for three months. At the time of the accident, the audit senior was winding up the prior year's audit. Given his familiarity with the company's management accounting system, it was agreed that he would take over as Management Accountant for the three months. **(5 marks)**

Required:

Discuss whether Sowah Quartey & Co had complied with the IFAC's Code of Ethics or had acted unprofessionally in any other way with respect to each of the above scenarios.

(Total: 20 marks)

QUESTION THREE

The information in the financial statements of your client, Honesty Company Limited, represents claims by management in relation to its responsibility to prepare financial statements which gives a true and fair view of the company's state of affairs and results of operations for the year under review. These claims are referred to as financial statements assertions.

Required:

As a member of the engagement team charged with the audit of the client's financial statements for the year ended October 31, 2019:

- a) Outline the audit objectives for the audit of stock (inventories) in the financial statements. Your answer should relate to the financial statement assertions. **(8 marks)**
- b) Discuss **FOUR (4)** sources from which evidence can be obtained to confirm the quantities and value of stocks. **(8 marks)**
- c) Explain why stocks present high audit risk **(4 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) During the audit of Die Hard Company Limited the following items were listed on the file divider under subsequent events.
- i) Kodjo Armah, a major debtor for GH¢400,000 has been found to be insolvent.
 - ii) Large quantities of stocks were destroyed by fire in the first month after the reporting date.
 - iii) Judgement in respect of litigation that was ongoing before the year end has been given against the company shortly after the end of the financial year. The judgement debt was GH¢ 5 million.
 - iv) Two customers had put in a claim in respect of goods sold to them under warranty before the year end of GH¢300,000 and GH¢450,000 respectively. No provision was made for warranty claims in the financial statements.
 - v) The company issued fresh equity shares after the year end. The number of shares was 2.5 million which generated GH¢5 million.

Required:

Classify the above items and indicate the treatment required in the financial statements.

(10 marks)

- b) The management of your company is carrying out major restructuring of the operations of the company for more effective and efficient achievement of objectives and targets. One of the major decisions taken was the outsourcing of the Internal Audit Function.

Required:

- i) Define *outsourcing*. **(2 marks)**
- ii) Identify **FOUR (4)** advantages and **FOUR (4)** disadvantages of outsourcing the internal audit function. **(8 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) You have been assigned as the training manager in your audit firm. The Partners of your firm tasked you to take the newly recruited trainees through *ISA 210: Agreeing the Terms of Audit Engagement*. This deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and those charged with governance.

The ISA states that the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate, and these terms can be recorded in an audit engagement letter or other suitable form of written agreement.

Required:

Prepare briefing notes:

- i) Describing the main actions an Auditor should take in order to establish whether the pre-conditions for an audit are present. **(6 marks)**
- ii) Outlining when an auditor should change the terms of the audit engagement in relation to a recurring audit. **(4 marks)**

- b) The basic objective of an audit is to form and express an opinion on the financial statements. The tangible means by which the auditor achieves this objective is the Auditors Report that is issued to members of the company after the completion of the audit.

Required:

- i) Discuss **TWO (2)** authoritative sources which govern the form and content of the auditor's report to members. **(4 marks)**
- ii) Explain the essence or importance of *Management responsibility* and *Auditors responsibility* paragraph in the auditor's report. **(6 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)

- An **audit** of financial statements is the examination of historical financial statements to enable the auditor to express an opinion whether the financial statements are prepared fairly, in all material respects or give a true and fair view, in accordance with an applicable financial reporting framework. An audit is a higher form of an assurance engagement performed only on historical financial information or statements.
- **An audit of financial statements is an assurance engagement.**
- **Assurance engagement** – means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. Here, a professional accountant evaluates a subject matter which is the responsibility of a third party and to form a conclusion about the subject matter conformity with an identified criteria in order to provide the intended user a level of confidence about the subject matter.
- Not all assurance engagements are audits. An example of non-audit assurance engagements is Review assignment.
- Audit engagement gives reasonable assurance- low level of risk.
- Non-audit assurance gives limited assurance - the risk is limited to the circumstance surrounding the engagement.
- More time is spent on audit assurance than other non-audit assurance and more costly too.

(5 points for 5 marks)

b)

- i) Audit strategy sets the overall scope, timing and direction of an audit and guides the development of the more detailed audit plan.
Audit plan is more detailed process which set out the work to be done in order to achieve the audit strategy.

(2.5 marks)

While audit strategy are audit assessments done by the senior audit personnel to determine the overall audit approach and risk nature of the audit, audit plan is a set of instructions to audit team specifying the audit procedures that should be performed in each area of the audit

(2.5 marks)

ii) **Audit strategy entails the following:**

- Determines the characteristics of the engagement that define its scope such as:
- The reporting standards applying to the audit
- Industry specific reporting requirement
- Reporting objectives of the engagement
- Reporting deadlines
- Nature of communications and reports required
- Factors which will determine the focus of the audit
- Materiality
- Risk assessment
- The audit approach – whether relying on internal control. The extent of test to perform etc.
- Any recent developments in relation to the entity, the industry or financial reporting requirements
- Determining the nature, the extent and timing of the resources from the results of the above
- Which staff and how many to use
- Which areas of the audit to use them
- How are they to be managed supervised and directed

(Any 5 points for 5 marks)

Audit plan on the other hand deals with

- Procedures to be used in order to assess the risk of misstatement in the entity's records and financial statement etc.
- Materiality assessment
- Preliminary analytical procedures
- Detailed risk assessment
- Audit procedures in response to assessed risks
- Audit plan is set in a series of instructions to audit team to address the concerns of audit strategy.

(Any 5 points for 5 marks)

(Total: 20 marks)

QUESTION TWO

a) **Four examples of external confirmations are:**

- Debtor's confirmation letter
- Solicitor letter
- Bank report letter
- Certificate on stock held by third parties.

one example of each assertion only required.

Debtor's confirmation letter

This letter provides evidence of the existence of the debtor when a reply is returned from that debtor direct to the auditor.

The letter provides evidence on cut-off because sales or cash receipts recorded in the incorrect accounting period will have to be reconciled to the balance provided by the debtor.

The letter does not provide evidence of completeness of the debtor balance because debtors may not query balances which are understated.

The letter does not provide evidence of the valuation of the debtor balance because the debtor cannot be expected to list all outstanding balances and confirmation of the debt does not mean it will be paid.

Solicitor letter

A solicitor letter provides evidence as to the existence of claims at the period end as the solicitor will confirm specific claims.

However, the letter does not necessarily confirm the valuation of claims due to uncertainty about the future or the completeness of any legal claims as solicitors do not normally provide a list of all claims – they prefer to comment only on claims they are actually asked about.

Bank report letter

A bank confirmation letter provides good evidence on the existence of the company's bank accounts as the bank has confirmed this information in writing.

A bank letter cannot necessarily be relied on to provide complete or accurate information. Most banks place a disclaimer on the letter of 'errors and omission excepted' indicating that the auditor must review this evidence against other cash and bank evidence obtained.

Certificate on stock held by third parties

A letter from the third party holding the stock will provide evidence of the existence of that stock because the third party has confirmed this in writing.

However, the letter does not provide evidence regarding the valuation of the stock; confirming something exists does not necessarily mean it is in good condition.

(4 points well explained @ 2.5 marks each=10 marks)

b)

i) Shareholding by staff member

- While partners are not allowed to hold shares in client companies there is no specific prohibition in the Code of Ethics on the holding of shares in audit clients by audit staff providing the staff members concerned are not personally involved in the audit of such clients?
- However, some audit firms have adopted a prohibition on the holding of shares in audit clients by audit staff as an in-house rule. The argument that independence is not impaired because the holding is insignificant is incorrect.
- If the holding is of such a size as is likely to influence the behaviour of the audit staff member, then it is material.
- If the staff member was allowed to retain the shares then he or she should not have been included in the audit team.
- If the partner advised the staff member not to sell the shares until after the audit was completed, then this would have been unethical and possibly illegal in that it constitutes insider dealing – the use of privileged information to secure a personal advantage in the trading of shares- which is criminal offence.

(5 points for 5 marks)

ii) Management accounting services

- Preparation of accounting records on behalf of a listed or public interest company is normally prohibited. An exception to this Rule allows such work to be performed in an emergency situation which does not extend beyond the minimum period necessary and where every care was taken that management accepted full responsibility for the work of the audit firm's staff member.
- It is more reasonable, however, to argue that the assignment of a staff member to the position of management accountant is likely to breach the rules on independence.
- It amounts to a staff member of the firm being engaged in making management decisions on behalf of the client.
- The firm will thus be reporting on a statement of financial performance in which one of its own employees had played an active part.
- A user of the financial statements might conclude that the audit firm might have an incentive to conspire with management in concealing poor performance attributable, in part, to the actions of its own staff member.

(5 points for 5 marks)

(Total: 20 marks)

QUESTION THREE

- a) The audit objectives of the audit of stocks(inventories) are to ensure:
- **Completeness:** That all stocks belonging to the client at the balance sheet date have been reported or included in the financial statements
 - **Existence:** That the stocks were in existence at the balance sheet date
 - **Rights and Obligation:** That the client has title to the stocks or the entity hold or controls the rights to the stocks
 - **Valuations and allocation:** That stocks are included in the financial statements at appropriate amounts and any resulting valuation or allocation and adjustments are appropriately recorded.
 - **Presentation and disclosure:** That stocks are properly classified, presented and adequately disclosed in the financial statements.

(2 marks each for 4 points = 8 marks)

- b) Sources of evidence on quantity and value of stocks: Evidence on quantity and value of stocks can be obtained from:
- **Observation of stock taking:** Careful observation of client stock taking may enable the auditor to form opinion about the quantity and value of client stocks.
 - **Stock summary sheets and valuation:** Examination of the stock summary sheets prepared by the client and comparison with sample evidence taken during stock taking will provide evidence on the stock quantities.
 - Checking of the extensions and summary of the stock valuation will provide evidence of the value of stocks.
 - **Client stock systems:** Where the client has an adequate stock system which is maintained on perpetual inventory system, evidence can be obtained from it to substantiate stock quantities and valuation.
 - **Third party confirmation:** Evidence about quantity and value of client stock can also be obtain from confirmation replies from third parties holding client stock.

(2 marks each for 4 points = 8 marks)

- c) **Stocks present high audit risk because of the following reasons:**
- **Lack of double entry records:** For most clients the stock quantities and value are not obtained from double entry book keeping but through physical stock count and valuation which can be manipulated by management that intends to engage in fraudulent financial reporting
 - **Materiality of stocks:** For most entities stocks represent large proportion of the assets of the company. Materiality of this magnitude is bound to increase audit risk.

(2 points @ 2 marks each: 4 marks)

(Total: 20 marks)

QUESTION FOUR

a)

Events	Classification	Treatment
Insolvent Debtor Kodjo Armah GH¢400,000.00	Adjusting events	Write off as bad debt
Large quantities of stock destroyed by fire	Non-adjusting events	Put a note on the F/S
Judgement debt in respect of litigation	Adjusting events	Provide for the amount in the financial statements as well as the notes on F/S
Warranty claims of GH¢300,000 and GH¢400,000	Adjusting events	Provision in the F/S and a note on the F/S
Issue of fresh 2.5 million equity shares for GH¢5 million	Non-Adjusting event	Note on F/S

(2 marks for each event = 10 marks)

b) **Outsourcing** is the process of purchasing key functions from an outside supplier. In order words it is contracting out certain functions for example internal audit or information technology. (2 marks)

ii)

Advantages:

- **Cost:** A key advantage of outsourcing is that it is often cheaper to contract a service out than it is to conduct it in house. It may also significantly improve cost control.
- **Specialist Service:** Outsourcing results in specialist being used to provide the service when that would not have been the case if the function was performed in the house.
- **Indemnity:** The service organisation may provide indemnity in the event of problems arising. If problems arose in house, there is no such comfort zone.
- **Cash flow:** Obtaining the service through a contract may assist with cash flow, as the contract will represent a flat rate fee, whereas the cost of providing the service in house might have led to fluctuating cost. Example if temporary staff are required in a busy period.
- No need to recruit additional staff.
- Can be used on short term basis.
- A team of staff can be provided if required.

(4 points for 4 marks)

Disadvantages

- **Loss of control:** The single biggest disadvantage of outsourcing is the extent to which the company loses control over the function itself, although not over cost control.

- Time demand on management: The contract has to be managed and ensure that the service being provided is appropriate and is in accordance with the contract. This may take a disproportionate amount of time
- Possibility of Litigation: The contract might limit the liability of the contractor, leading to problems if the contract is not performed well. This may results in court action being required.
- Disadvantage may outweigh advantages: Should these disadvantages be realised, the cost of outsourcing could outweigh the benefit, even though in theory outsourcing should reduce cost.
- Independent and objectivity issues.
- High cost of outsourcing.
- Company staff may oppose outsourcing if it result in redundancy.
- High turn over of Internal Audit staff.
- Outsource staff may have a limited knowledge of the company.

(4 points for 4 marks)

(Total: 20 marks)

QUESTION FIVE

a)

(i) Preconditions for an Audit.

In order to establish whether the preconditions for an audit are present, the auditor shall firstly:

(a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility for:

- the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
- such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

• providing the auditor with:

➤ Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

➤ Additional information that the auditor may request from management for the purpose of the audit; and

➤ Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

(c) The auditor should establish if the management or those charged with governance have imposed a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

(d) If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

(4 points @ 1.5 marks each = 6 marks)

ii) Changing the terms of recurring audits

In the event of a recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

When accessing the rationale to agree to a change in the terms of the audit engagement the following should be considered:

- The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

- If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
- If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.
- If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
 - ✓ Withdraw from the audit engagement where possible under applicable law or regulation; and
 - ✓ Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

(4 points for 4 marks)

b)

- (i) The two authoritative sources which govern the auditor's report to members are
- **Professional Standards or Requirement:** International Standards on Auditing (700/701) specified both the form or structure and the contents of the auditor's report to members. The standards specify the structure or form of the report that is how the information should be arranged in a systematic manner, allowing the information to flow in a coherent manner from title to date. They also specify the content that is the information that must be stated in the report, for example what the title must be- Independent Auditors Report etc.
 - **The other authoritative source for the auditor's report is statutory or legal requirements.** While the legal or statutory requirement does not prescribe the format of the report (that is left to the professional requirements) they specify the information that must be included in the report. Eg whether the auditor have received all the information and explanations they require for the purposes of their audit etc.

(2 points @ 2 marks each =4 marks)

- (ii) There is a phenomenon known as 'an expectation gap' which represents the misconception in the minds of the public as to what auditors do and the meaning of the auditor's report. For example members of public think it is the auditor who is responsible for the preparation of the financial statements. Another misconception is that the main objective of an audit is to detect fraud.

To minimise this expectation gap, if not to completely eliminate it, there is the need for the Accountancy profession to educate the general public in attempt at this education is the inclusion of the paragraphs under management responsibility and auditor's responsibility in the auditor's report.

Management Responsibility Paragraph. The essence of this paragraph explains briefly but succinctly, the responsibility of management for preparation of the financial statements that are free from material misstatements whether due to fraud or error. It also explain management responsibility to operate internal controls to ensure the reliability of the financial statements, making significant judgements and estimates in the preparation of the financial statements. It also touches on the prevention and detection of fraud and errors. **(3 marks)**

Auditors Responsibility Paragraph: The essence of this paragraph spelt out the auditor's responsibility for the audit of the financial statements and the expression of an opinion on the view given by the financial statements. This is in sharp contrast to management responsibility to prepare the financial statements. This paragraph also states the procedure followed by the auditor in the conduct of the audit to be able to obtain the evidence needed to form the opinion on the true and fairness of the view given by the financial statements but not certify the correctness of the accounts or prevent and /or detect fraud.

(3 marks)

(Total: 20 marks)

DETAILED REPORT ON WEAKNESS DEMONSTRATED BY CANDIDATES IN ANSWERING THE QUESTIONS.

In November, 2019 diet, the minor weakness rate was wide- spread and not concentrated in peculiar places alone. Questions one (1), two (2), three (3) and four (4) recorded 62.5%, 52.5%, 62.5% and 57.5% pass rates respectively. Only question five (5) recorded a pass rate below 50%.

To this end, students in the various centres must be helped to overcome their weakness in the topics that featured in question five (5) so as to perform excellently in future examinations.

We continue to advice that qualified teachers are attracted to teach the subject to demystify the myth surrounding the subject Auditing.

DETAILED QUESTION-BY -QUESTION ANALYSIS OF PERFORMANCE

Question One (1)	-	62.5%
Question Two (2)	-	52.5%
Question Three (3)	-	62.5%
Question Four (4)	-	57.5%
Question Five (5)	-	30%

From the above analysis, it could be observed that question five (5) was poorly answered by candidates. Candidates however, performed well in questions one, two, three and four since they were all above 50% pass rates.

CONCLUSION

In conclusion, the following points would assist to strengthen our examinations.

- More and intensified teaching and learning by teachers and students should be continued.
- A lot of mock tests should be conducted prior to the main examinations so that all rough edges could be smoothened.
- Students should practice more past and other auditing questions on their own prior to the examinations proper.