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

EXAMINER'S GENERAL COMMENTS
Candidates performed averagely in this paper having a pass rate of 57.32%. It however, fell short of that of the previous diet's pass rate of over 68%.Candidates strangely performed poorly in questions three (3), four (4) and five (5). The worse performance was in question five (5) which only 25% passed.

Lecturers and students are encouraged to look critically at all the topics that featured in those three questions since they will 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. There were no ambiguities/ errors/typing problems that adversely affected performance in the examinations.

The marks allocation followed the weightings in the syllabus except that some of the syllabus coverages were merged. In my opinion some of the questions were fairly loaded, especially questions one (1), two (2), three (3) and four (4). Also some of the marks allocated were 'over-generous'. For example, question two (2(a) (ii)) should attract at least five (5) marks and not the ten (10) marks that was allocated. Marks allocated to question three (3b) was too much.

PERFORMANCE OF CANDIDATES
The general performance of candidates in the subject was 57.32% that is out of a total number of 396 candidates who wrote the paper, 227 passed and 169 failed. The performance is therefore, average. It must be noted that the May,2019 candidates who wrote the examination fell short by 5 candidates when compared with November,2018 candidates who wrote the paper.

Teaching and learning should continue to be intensified so that candidates would be able to perform better at subsequent examinations. Unfortunately, students performance in questions three (3), four (4) and five (5) were below 50%. Students once again did not answer question five (5) well at all. Only 25% of candidates passed this question. Surprisingly all five (5) question topics were 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 some of the candidates to me, was average which resulted into 57.32% pass rate and 42.68% failures. Students should be encouraged to prepare well before undertaking the examination in order to increase the pass rate to boost the confidence of others.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES

Candidates performed well in questions on internal audit and controls systems in line with ISA 315. The pass rate recorded by candidates on this topic is a whopping 60%.

The above depicts 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.

Students are obliged to do more exercises for instructors to mark and discuss those assignments in class. Students on their own should do a lot of readings around the subject, including current issues in Auditing, such as ISA's and Independent Auditors Reports. Strangely, students are losing grasp of some fundamentals of auditing such as analytical procedures, substantive procedures, verification of assets, etc.

WEAKNESSES

In May 2019 diet, the weakness rate was wide-spread and not concentrated in peculiar places alone. Except questions two(2) and one (1) which recorded pass rate of 60% and 52.5% respectively, all the other three questions recorded pass rate below 50%.

To this end, all centres where we have our students must be helped so as to overcome this weakness in future examinations. The reason for some of these weakness comes from lack of qualified and experienced professionals to assist students on these areas. It must be made clear that Auditing is a technical subject which could be competently handled by qualified technical professionals.

QUESTION ONE

a) J.K. Asenso is a member of a team auditing the financial statement of Sascraku Co. Ltd for the year ended 31 December 2017. Shortly after the end of the audit, the media made an allegation of fraudulent activities with the aim of reducing tax liability against the company. A committee was appointed by Ghana Revenue Authority (GRA) to examine the books of the company to substantiate the allegations.

The committee discovered the following anomalies:

- Diverting receipts to private bank accounts;
- Stealing physical assets or intellectual property;
- The entity paid for goods that had not been received;
- Assets had been used for personal purposes.

The directors were not happy with the work of the auditors due to their inability to discover the above anomalies.

Required:

i) Explain the responsibility of the Auditor with respect to detection and prevention of fraud. **(5 marks)**

ii) Outline the audit procedures that the auditors should have adopted to detect the above anomalies. **(5 marks)**

b) The Institute of Chartered Accountants (Ghana) is organizing a continuous professional development program on the code of conduct for members and other relevant issues pertaining to audit. You are the audit partner of Lankai and Co, a firm of Chartered Accountants, and you are to present a paper on the independence of the auditor and the inherent limitations of auditing.

Required:

Your presentation should explain:

i) **TWO (2)** advantages of independent audit**.** **(3 marks)**

ii) The phrase ***"the auditor must be seen to be independent both in fact and appearance".*** **(3 marks)**

iii) Inherent limitations of audit. **(4 marks)**

(Total: 20 marks)

QUESTION TWO

a) You are the Audit Manager in charge of the audit of Adepaye Ltd (Adepaye) for the year ended 30 April 2016 and you are currently planning the year-end audit. Adepaye specialises in the sale of provisions at its head office. The company has opened branches in Ofankor Barrier, Makola, Nanakrom, Kasoa and Kanda within ten years of incorporation. During the interim audit you noted that due to the present economic challenges in Ghana, the company has suffered increases in cost. Also, the presence of competitors are driving the sales prices of the company downward affecting the profitability of the company.

Furthermore, the company has not recorded profit for over five years thus threatening the going concern of the company. Due to the consistent cash flow challenges, the company has financed its operations with bank overdraft and huge long term loans as part of its capital structure.

In a discussion with management and those charged with governance during the interim audit, you were informed that the company plans to improve the customer relationship management of its operations to maintain its market share. The company has asked its bank for a loan to finance its working capital. This they believe would improve the liquidity of the company.

The company has prepared a cash flow forecast for five years from the end of the reporting year 30 April 2016 to support its bank loan request. The internal audit department has reported on the forecast to the board of directors. However, the bank has said it would like a report from the external auditors to confirm the reasonability of the forecast amidst the current challenges in Ghana after their final audit.

The company has approached your firm to examine the cash flow forecast and then to report to the bank.

Required:

i) Explain **TWO (2)** differences in audit approach that the Audit Manager would adopt during the ***interim audit*** and the ***final audit.*** **(6 marks)**

ii) Explain **FIVE (5)** factors you will consider before placing reliance on the work of the internal auditors of Adepaye Ltd. **(10 marks)**

b) For many firms, the audit evidence that they obtain does not focus on a client's internal systems and controls, rather the work is focused on the substantive testing of the transactions and balances which make up the entity's accounts. Consequently many practitioners do not believe that they are required to spend much time documenting a client's internal systems and controls or indeed to test whether any of the controls actually operate in practice in any detail. However, to ignore this area will mean that the requirements of ***ISA 315: Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*** are not complied with.

Required:

i) Explain the components of an internal control systems in line with **ISA 315.** **(5 marks)**

ii) Why is the work on internal controls necessary when auditors take the substantive approach? **(4 marks)**

(Total: 25 marks)

QUESTION THREE

Damongo Ltd (Damongo) is a computer hardware specialist and has been trading for over ten years. Damongo is the only hardware specialist listed on the Ghana Stock Exchange within five years after incorporation.

The company is funded partly through overdrafts and loans and also by several large shareholders. The year end is 31 December 2017. Damongo has experienced significant growth in previous years. However, in the current year a new competitor, HardWare Specialist Co (HardWare), has entered the market and through competitive pricing has gained considerable market share from Damongo. One of Damongo's large customers has stopped trading with them and has moved its business to HardWare. In addition, a number of Damongo's specialist developers have left the company and joined HardWare. Damongo has found it difficult to replace these employees due to the level of their skills and knowledge. Damongo has just received notification that its main supplier who provides the company with specialist electrical equipment has ceased trading.

Damongo is looking to develop new products to differentiate itself from the rest of its competitors. It has approached its shareholders to finance this development, however, they declined to invest further in Damongo. Damongo's loan is long term and it has met all repayments on time. The overdraft has increased significantly over the year and the directors have informed you that the overdraft facility is due for renewal next month, and they are confident it will be renewed.

The directors have produced a cash flow forecast which shows a significantly worsening position in the coming 12 months. They are confident that the new products being developed is viable. Damongo has trading history of significant growth and they believe it is unnecessary to make any disclosures in the financial statements regarding going concern.

At the year end, Damongo received notification from one of its customers that the hardware installed for the customers' online ordering system has not been operating correctly. As a result, the customer has lost significant revenue and has informed Damongo that they intend to take legal action against them for loss of earnings. Damongo has investigated the problem post year end and discovered that other work-in-progress is similarly affected and inventory should be written down. The Finance Director believes that as this misstatement was identified after the year end, it can be amended in the 2017 financial statements.

Required:

a) Describe **THREE (3)** procedures the auditors of Damongo Ltd should undertake in relation to the uncorrected inventory misstatement identified above. **(6 marks)**

b) Explain **FIVE (5)** going concern ***potential indicators*** of Damongo Ltd. **(10 marks)**

c) Identify **SIX (6)** going concern ***audit procedures*** which you should perform for Damongo Ltd. **(6 marks)**

d) The auditors have been informed that Damongo's bankers will not take a decision on the overdraft facility until after the audit report is completed. The directors have now agreed to include some going concern disclosures. Describe the impact on the audit report of

Damongo Ltd if the auditor believes the company is a ***going concern*** but that this is subject to a material uncertainty. **(3 marks)**

(Total: 25 marks)

QUESTION FOUR

You are the external auditor of Paa Willy Ltd (PW) for the year ended 31 March 2019. PW operates 12 convenience stores in the Greater Accra region:

- Each store sells food.
- Each store is responsible for its own inventory procurement and produces monthly management accounts which are sent to the centralised accounting department at PW head office.

PW is financed by a GH¢250,000 bank loan which is repayable at a rate of GH¢50,000 per annum over each of the next 5 years starting on 31 October 2019. It also has an overdraft facility of GH¢100,000 which it uses in full. The bank overdraft facility is due for renewal on 1 May 2020.

The bank has already told the company that it will need a cash flow forecast for two years from 1 February 2020 in order for the bank to decide whether or not the overdraft facility will be renewed. The bank has also said it will require a report from the external auditors to confirm the accuracy of the forecast.

Required:

a) Define the term ***analytical procedures***. **(2 marks)**

b) In relation to the work of an external auditor:

i) Describe **THREE (3)** analytical procedures that should be performed to confirm PW's revenue and profit. **(3 marks)**

ii) Outline **THREE (3**) substantive procedures that should be adopted to verify each of the following assertions:

- The valuation of inventory. **(3 marks)**
- The completeness of payables. **(3 marks)**

c) Recommend **FOUR (4)** appropriate substantive procedures that should be performed to confirm PW's bank loan. **(4 marks)**

(Total: 15 marks)

QUESTION FIVE

a) When there is a material disagreement between the Auditor and management of a client, this could lead to the Auditor expressing a qualified opinion or an adverse opinion.

Required:
Evaluate the circumstances, when due to disagreement between Management and the auditor, an audit firm may express a ***qualified opinion*** or an ***adverse opinion*** in its report on the financial statements of a company. **(5 marks)**

b) Due to increased workload, your firm has just recruited a new junior audit staff member, George Ansong, who has joined the practice directly from University and so has no previous work experience. You have been assigned as his training manager.

George is now looking at summarised material given to him by the audit partner on ISA 260. ***ISA 260: Communication with those charged with governance*** deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. It focuses primarily on communications from the auditor to those charged with governance.

George would like you to explain in more detail what he has read.

Required:
In relation to George's request, detail the provisions set out in ISA 260 in relation to the following:

i) The main objectives of the auditor in communicating with those charged with governance. **(4 marks)**

ii) **SIX (6)** ***significant matters*** the auditor should communicate with those charged with governance about the responsibilities of the auditor in relation to the audit of the financial statements. **(6 marks)**

(Total: 15 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)
i)
- The primary responsibility for prevention or discovering of anomalies is of those charged with governance and the management of the entity.
- The management designs and operates accounting and internal control systems to discharge this responsibility.
- The responsibility of those charged with governance will be to ensure the integrity of the entity's accounting and financial reporting system and appropriateness of established controls.

Responsibilities of Auditor

- **Obtain reasonable assurance** – a financial audit is conducted by the auditor to obtain reasonable (not absolute) assurance that the financial statement are free from material misstatement caused by fraud and error.
- **Cleverly concealed frauds are difficult to detect** -Due to certain inherent limitations, even an audit which is properly planned and performed in accordance with generally accepted auditing standards, may fail to detect a cleverly concealed fraud.
  This particularly happens in cases of fraud involving forgery or collusions among employees or management or those charged with governance. The auditor, thus, cannot be held responsible for the prevention and detection of those anomalies.
- **Consider risk of material misstatements**- The term reasonable assurance implies that some risk of material misstatement could be present in the financial statement and the auditor will fail to detect it. Therefore, he should consider the risk of material misstatement resulting from fraud or error during all the stages of audit process.

(1 mark each for any 5 valid point made)

ii) **Procedures the auditors should have adopted to detect the anomalies:**
- **Examining journal entries and other adjustments**
  The auditor's understanding of the entity's financial reporting process, including automated and manual procedures used to prepare financial statements and related disclosures, and how misstatements may occur.

- **Reviewing accounting estimates for bias**
  The auditor must perform a retrospective review of significant prior-year estimates for any potential bias that might signal inappropriate earnings management (for example, recorded estimates clustered at one end of an acceptable range in the prior year and at the other end of an acceptable range in the current year).

- **Evaluating the business rationale for significant unusual transactions**
  Although the auditor typically gains an understanding of significant transactions, the auditor should place a greater focus on understanding the underlying business rationale for significant unusual transactions. In this context, unusual transactions are those that come to the auditor's attention that are outside the normal course of business for the company or that otherwise appear unusual.

(Any 2 points well explained @ 2.5 marks each = 5 marks)

b)

i) Advantages of independent audit

- Independent audits are important for inspiring and maintaining donor trust because they demonstrate that the non-profit is committed to financial transparency and accountability.
- It helps the management in detection of errors and frauds.
- It helps the management in obtaining loans from banks and other financial institutions as the audited statements are relied upon.
- It builds up the reputation of the business.
- Auditors can give concrete suggestion regarding improvement of business on the basis of their findings in records.
- Audited financial statements help the board of director have more confidence in the organization's finances because they are based on an analysis by an objective third-party.
- Some private foundations require that potential grantees submit audited financial statements, or similarly certified financial statements, in order to be eligible for funding.

(Any 2 points for 3 marks)

ii) The phrase ***"the auditor must be seen to be independent both in fact and appearance"***

- **Independent in fact** – This is the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- **Independence in appearance** – This is the avoidance of facts and circumstances that are so significant that a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firms, or a member of the assurance team's integrity, objectivity or professional skepticism had been compromised. This refers to how independent observers perceive the auditors behavior in relation to performance of his professional duty.

(2 points for 3 marks)

iii) The inherent limitations of auditing are:

- **Minimization and not elimination of errors** – Due to time and cost constraints, the auditor uses selective testing to examine the transactions. Consequently, there may be material misstatements resulting in errors and fraud that remain undetected. It is also not possible for the auditor to uncover a carefully laid scheme of fraud. Thus auditing only reduces and does not eliminate the possibility of existence of errors and fraud in books of account and financial statements.

- **Inconclusiveness of evidence-** The evidence obtained by an auditor is persuasive rather than conclusive. Therefore, an auditor can only draw reasonable conclusions from such evidence.
- **Exercise of judgement** – The nature, timing and extent of audit procedures to be performed is a matter of professional judgment of the auditor. In addition, the auditor exercises judgment to ascertain the reasonableness of various estimates made by the management in the financial statements. As a result, audit conclusions are based on judgement and not reached through the scientific process
- **Inherent limitations of internal control systems** – These also contribute to the inherent limitations of audit. This arises due to:
  - ✓ Potential human error
  - ✓ Possibility of collusion
  - ✓ Manipulation by management
  - ✓ Possibility that a person responsible for exercising control could abuse the authority and
  - ✓ Possibility that procedures may become inadequate due to changes in entity's business and economic environment

(1 mark each for any four valid points = 4 marks)

(Total: 20 marks)

QUESTION TWO

a)

i) Difference between interim audit and final audit

- **Interim audit,** as its name suggests, is that part of the whole audit that takes place before the year-end. The auditor uses the interim audit to carry out procedures that would be difficult to perform at the year-end because of time pressure. **The final audit**, on the other hand, will take place after the year-end and concludes with the auditor forming and expressing an opinion on the financial statements for the whole year subject to audit. It is important to note that the final opinion takes account of conclusions formed at both the interim and final audit.

- **Typical work carried out at the interim audit includes:**
  - ✓ Consideration of inherent risks facing the company. (risk would be initially considered at the planning stage, but is, in fact, reassessed at all audit stages.)
  - ✓ Recording the system of internal control.
  - ✓ Carrying out tests of control on the company's internal control system and evaluating its effectiveness to determine the level of control risk.
  - ✓ Performing sufficient substantive testing of transactions and balances to be satisfied that the books and records are a reliable basis for the preparation of financial statements.
  - ✓ Identification of potential problems that may affect the final audit work. A basic aim is to ensure as far as possible that there are no undetected problems at the year-end.

  Typical work carried out at the final examination includes:
  - ✓ Confirmations from third parties, such as bankers and lawyers.
  - ✓ Analytical reviews of figures in the financial statements.
  - ✓ Reviews of events after the reporting period.
  - ✓ Consideration of the going concern status of the organisation.

(2 points well explained for 6 marks)

ii) Factors to consider before placing reliance on the work of internal auditors

The external auditors would normally be able to use the work of the internal auditors of Adepaye Ltd provided that:

- **They are independent** (in this case, of the accounting department and finance director to whom the accounting department reports). It appears that they have reported to the whole board, which would be a factor increasing their independence. It would be even better if they had strong links with the audit committee (if applicable).
- **They are competent.** Your firm would have formed a view in past years of their reliability by considering the background (including qualifications and experience, particularly as regards forecasting) of the internal audit staff and by examining their reports and working papers. You may also have reviewed some aspects of their work in the current year to the same end.

- **Effective communication**, whether there is likely to be effective communication between the internal auditors and the external auditor.
- Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
- The internal audit function does not have managerial or operational duties that are outside of the internal audit function.
- **They have exercised due professional care**, the work would need to have been properly planned including detailed work programmes, supervised, documented and reviewed. The company is experiencing difficulties due to the economic down turn and it requires the loan in order to expand. Management might place pressure upon the internal auditors to present the cash flow forecast in a more favourable light.

  This would impact the independence of the internal auditors.
  You would still take full responsibility for any report that you issue.

(5 points @ 2 marks each = 10 marks)

b)

i) The Components of internal control systems in line with ISA 315 are:

The Control Environment

Control environment is the attitude toward internal control and control consciousness established and maintained by the management and the employees of an organization. It is a product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity, and morale of the organization's people. The organization structure and accountability relationships are key factors in the control environment.

Elements of the Control Environment

- Ethical Values and Integrity
- Management's Operating Style and Philosophy
- Competence
- Morale
- Supportive Attitude
- Mission
- Structure

Risk Assessment

Risks are events that threaten the accomplishment of objectives. They ultimately impact an organization's ability to accomplish its mission. Risk assessment is the process of identifying, evaluating and determining how to manage these events. At every level within an organization there are both internal and external risks that could prevent the accomplishment of established objectives. Ideally, management should seek to prevent these risks. However, sometimes management cannot prevent the risk from occurring. In such cases, management should decide whether to accept the risk, reduce the risk to acceptable levels, or avoid the risk. To have reasonable assurance that the organization will achieve its objectives, management should ensure each risk is assessed and handled properly.

- Assessing Risk (Ask the questions…)
  - What obstacles could stand in the way of achieving your objective?
  - What can go wrong?
  - What is the worst thing that could happen?
  - What is the worst thing that has happened?
  - Are there new Processes?
  - Are there processes that have changed?
  - Are there new goals and legislation?
  - Are there staffing changes?
  - What keeps you awake at night?
- Impact – Is generally beyond the organization's control in the short-to-medium term.
  Likelihood – Is the main focus of an organization's internal control
- What are the possible risks in your area of operations and what is the likely impact of each?
- How to Deal With Risk
- Managing Risk
  - Accept the risk: Do not establish control activities
  - Prevent or reduce the risk: Establish control activities
  - Avoid the risk: Do not carry out the function
- Preventing or Reducing Risk
  - What is the cause of the risk?
  - What is the cost of control vs. the cost of the unfavourable event?
  - What is the priority of this risk?

Control Activities

Control activities are tools - both manual and automated - that help prevent or reduce the risks that can impede accomplishment of the organization's objectives and mission. Management should establish control activities to effectively and efficiently accomplish the organization's objectives and mission.

Examples of Control Activities

- Documentation
- Approval and Authorization
- Verification
- Supervision
- Separation of Duties
- Safeguarding Assets
- Reporting
- Computer Systems Controls
  - o Backup and Disaster Recovery
  - o Input Controls
  - o Output Controls

Information and Communication Systems

Communication is the exchange of useful information between and among people and organizations to support decisions and coordinate activities. Within an organization, information should be communicated to management and other employees who need it in a form and within a time frame that helps them to carry out their responsibilities. Communication also takes place with outside parties such as customers, suppliers and regulators.

Elements of Communication

- Timeliness
- Sufficient but not excessive detail
- Appropriate to user
- Clear and open horizontal and vertical

Monitoring

Monitoring is the review of an organization's activities and transactions to assess the quality of performance over time and to determine whether controls are effective. Management should focus monitoring efforts on internal control and achievement of organization objectives. For monitoring to be most effective, all employees need to understand the organization's mission, objectives, and responsibilities and risk tolerance levels.

Major Areas for Monitoring

- Control Activities
- Mission
- Control Environment
- Communication
- Risks and Opportunities
- Results

(5 points for 5 marks)

ii)

Why is work on internal control necessary when auditors take a substantive approach?

Some auditors question the value of the work ISAs require on evaluating the design and implementation of controls. The purpose of this work is to help auditors properly understand the business and, very specifically, to deal with any risks arising from poor internal controls. Performing the same substantive procedures, regardless of whether controls are designed, implemented and operated properly, poorly or not at all, ignores the following:

- ISAs require substantive procedures to be tailored to the assessed risks;
- a substantive approach often involves analytical procedures and if auditors ignore controls, they risk placing undue reliance on the information on which they perform the procedures, if it is produced by a poorly-controlled system;
- auditors may well miss something important in a key area if they do not understand that the controls over them are poor, and they may not be auditing in

the most efficient manner possible if they do not understand that controls are good; and

- ISAs require auditors to obtain an understanding of the internal controls relevant to the audit by evaluating the design and implementation of those controls irrespective of the size and complexity of the client and regardless of the audit strategy.

(Any 2 points @ 2 marks each = 4 marks)

(Total: 25 marks)

QUESTION THREE

a) Procedures to undertake in relation to the uncorrected misstatement

- The extent of the potential misstatement should be considered and therefore a large sample of inventory items should be tested to identify the possible size of the misstatement.
- The potential misstatement should be discussed with Damongo Ltd's management in order to understand why these inventory differences are occurring.
- The misstatement should be compared to materiality to assess if the error is material individually.
- If not, then it should be added to other errors noted during the audit to assess if in aggregate the uncorrected errors are now material.
- If material, the auditors should ask the directors to adjust the inventory balances to correct the misstatements identified in the 2017 year end.
- Request a written representation from the directors about the uncorrected misstatements including the inventory errors.
- Consider the implication for the audit report if the inventory errors are material and the directors refuses to make adjustments.

(Any 3 points @ 2 marks each = 6 marks)

b) Going concern indicators

- A new competitor, HardWare Specialist Co (Hardwares), has entered the market and gained considerable market share from Damongo through competitive pricing. There is a risk that if Damongo continues to lose market share this will impact on future cash flows. In addition, there may be pressure on Damongo to drop their prices in order to compete, which will impact profits and cash flows.
- A significant customer has stopped trading with Damongo and moved its business to Hardwares. This could result in a significant loss of future revenues and profit, and unless this customer can be replaced, there will be a reduction of future cash flows.
- A number of Damongo's specialist developers have left the company and joined Hardwares and the company has found it difficult to replace these employees due to their experience and skills. The company is looking to develop new products and in order to do this, it needs sufficiently trained staff. If it cannot recruit enough staff, then it could hold up the product development and stop the company from increasing revenue.
- Damongo's main supplier who provides specialist equipment has just stopped trading. If the equipment is highly specialised, there is a risk that Damongo may not be able to obtain these products from other suppliers which would impact on their ability to trade. More likely, there are other suppliers available but they may be more expensive which will increase the outflows of Damongo and worsen the cash flow forecast.
- Damongo needs to raise finance to develop new products in order to gain market share; they approached their shareholders for further finance but they declined to invest further. If Damongo is unable to obtain suitable finance, then it may be that the shareholders deem Damongo to be too risky to invest in further. They may be concerned that Damongo will not be able to offer them a suitable return on their

investment, suggesting cash flow problems. In addition, if Damongo cannot obtain alternative finance, then it will not be able to develop the products it needs to.

- Damongo's overdraft has grown significantly during the year. If the bank does not renew the overdraft and the company is unable to obtain alternative finance, then it may not be able to continue to trade.
- Damongo's cash flow forecast shows a significantly worsening position for the coming 12 months. If the company continues to have cash outflows, then it will increase its overdraft further and will start to run out of available cash.
- One of Damongo's customers is planning to sue the company for loss of revenue due to hardware being installed by Damongo in the customer's online ordering system not operating correctly. If the customer is successful, then Damongo may have to pay a significant settlement which will put further pressure on cash flows. In addition, it is unlikely that this customer will continue to trade with Damongo and if the problems become known to other customers, this may lead to a further loss of revenue and cash flows as well as impact on Damongo's reputation.

(5 points @ 2 marks each = 10 marks)

c) Going concern procedures

- Obtain the company's cash flow forecast and review the cash in and outflows. Assess the assumptions for reasonableness and discuss the findings with management to understand if the company will have sufficient cash flows.
- Perform a sensitivity analysis on the cash flows to understand the margin of safety the company has in terms of its net cash in/outflow.
- Discuss with the finance director whether any new customers have been obtained to replace the one lost.
- Review the company's post year-end sales and order book to assess if the levels of trade are likely to increase in light of the increased competition from Hardware and if the revenue figures in the cash flow forecast are reasonable.
- Discuss with the directors whether replacement specialist developers have been recruited to replace those lost to Hardware.
- Review any agreements with the bank to determine whether any covenants have been breached, especially in relation to the overdraft.
- Review any bank correspondence to assess the likelihood of the bank renewing the overdraft facility.
- Review the correspondence with shareholders to assess whether any of these are likely to reconsider increasing their investment in the company.
- Discuss with the directors whether they have contacted any banks for finance to help with the new product development.
- Enquire of the lawyers of Damongo as to the existence of any additional litigation and request their assessment of the likelihood of Damongo having to make payment to their customer who intends to sue for loss of revenue.
- Perform audit tests in relation to subsequent events to identify any items which might indicate or mitigate the risk of going concern not being appropriate.
- Review the post year-end board minutes to identify any other issues which might indicate further financial difficulties for the company.

- Review post year-end management accounts to assess if in line with cash flow forecast.
- Consider whether any additional disclosures as required by IAS 1 Presentation of Financial Statements in relation to material uncertainties over going concern should be made in the financial statements.
- Consider whether the going concern basis is appropriate for the preparation of the financial statements.
- Obtain a written representation confirming the directors' view that Damongo is a going concern.

(6 points for 6 marks)

d) Audit report

- The directors of Damongo have agreed to make going concern disclosures; however, the impact on the audit report will be dependent on the adequacy of these disclosures. If the disclosures are adequate, then the audit report will be modified as an emphasis of matter paragraph would be required.
- The paragraph will state that the audit opinion is not modified, indicate that there is a material uncertainty and will cross reference to the disclosure note made by management. It would be included immediately after the opinion paragraph.
- If the disclosures made by management are not adequate, the audit opinion will need to be modified as there is a material misstatement. Depending on the materiality of the issue, this will be either qualified or an adverse opinion.
- A paragraph describing the matter giving rise to the modification will be included just before the opinion paragraph and this will clearly identify the lack of disclosure over the going concern uncertainty. The opinion paragraph will be amended to state 'except for' or the financial statements are not fairly presented.

(Any 3 points for 3 marks)

(Total: 25 marks)

QUESTION FOUR

a) Analytical procedures involve evaluating financial and non-financial information and comparing actual results to expectations. They also involve identifying significant fluctuations and relationships that deviate from expectations. Expectations should be developed based on the auditor's knowledge of the operations of the entity during the period under review and information obtained through performance of other audit tests. **(2 marks)**

b)

i) Analytical procedures to confirm revenue and profit

- Review monthly sales per outlet broken down per food products.
- Compare profit margins for sales across shops.
- Review sales mark up on cost and compare to revenue.
- Review average level of shop inventory wastage per outlet.
- Compare actual levels of sale per shop to budget.

(Any 3 points for 3 marks)

ii) **Substantive procedures (1 mark for each properly explained procedure)**

- **Valuation of inventory**

✓ Verify sample to supplier invoices to ascertain cost.
✓ Discuss method of cost approximation with management and compare to current prices across the three areas of food products.
✓ Examine sales prices after year end to confirm NRV > cost for shop inventory
✓ Vouch a sample items held in shop inventory to purchase invoices to verify cost
✓ Consider the level of perishable inventory held at the inventory count and review the year end valuation

(Any 3 points for 3 marks)

- **Completeness of payables**

✓ Analytically review the level of payables this year to prior year
✓ Circularise suppliers, review supplier statements
✓ Review cash book for payments made to suppliers post year end
✓ Calculate payables days and investigate significant differences

(Any 3 points for 3 marks)

iii) Bank loan

✓ Inspect loan agreement for sum borrowed and evidence of any covenants/ conditions.
✓ Direct confirmation from the lender and unpaid loan and interest/ security.
✓ Ensure proper split between current and non-current liability.
✓ Ensure interest charge and any accrued interest accurately recorded.

(4 points for 4 marks)

(Total: 15 marks)

QUESTION FIVE

a) Expressing qualified opinion and adverse opinion

- A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. A qualified opinion should be expressed as being 'except for' the effects of the matter to which the qualification relates. **(2.5 marks)**
- An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that an 'except for' qualification of the report, is not adequate to disclose the misleading or incomplete nature of the financial statements. **(2.5 marks)**

b)

i) The objectives of the auditor in communicating with those charged with governance are:

- To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- To obtain from those charged with governance information relevant to the audit;
- To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
- To promote effective two-way communication between the auditor and those charged with governance.

(4 points for 4 marks)

ii) **The significant matters the auditor shall communicate with those charged with governance about the auditor's responsibilities in relation to the financial statement audit include**:

- The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
- The audit of the financial statements does not relieve management or those charged with governance of their responsibilities,
- The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit,
- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures,
- Significant difficulties, if any, encountered during the audit,
- Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

(6 points for 6 marks)
(Total: 15 marks)

DETAILED QUESTION-BY-QUESTION ANALYSIS OF PERFORMANCE

Question One (1)	-	52.5%
Question Two (2)	-	60%
Question Three (3)	-	32.5%
Question Four (4)	-	32.5%
Question Five (5)	-	25%

From the above analysis, it could be observed that question five (5) was poorly answered by candidates whilst questions three (3) and four (4) were also not answered well. Candidates however, answered questions one (1) and two (2) well.
Few students were able to answer question three (3)(a) well. Most of candidates were writing the audit procedures for verifying and valuing inventory. It was a clear deviation from the requirement. Question three (3)(b) was well answered by most candidates. Students were able to clearly identify the going concern indicators in the case study given, and maximum scores were attained by most of the examinees.

Question three (3) (c) was averagely answered by the students. They were able to identify the going concern audit procedures. Some candidates were however, stating the generic audit procedures. Most candidates did not answer question three (3)(d) well due to lack of understanding.

Question four (4)(a) was poorly handled by students. Quite a number of candidates seemed to struggle with the requirement of the question which demanded that candidates define the term "analytical procedure".
Question four (4) (b)(i) asked candidates to describe three analytical procedures that should be performed to confirm revenue and profit. Candidates' inability to define the term 'analytical procedure' fed into their responses to this part of the question. A significant number of candidates failed to answer the question appropriately. Most candidates used the descriptions of other procedures other than analytical procedure that auditors use to obtain evidence to answer the question. Candidates mentioned procedures such as: Inspection, observation, confirmation or Inquiry as procedures to confirm revenue and profit.
Questions 4(c) was poorly answered by most candidates. Majority of the candidates confused Bank Loan with Bank Overdraft and therefore recommended wrong procedures to verify bank loan as required by the question. Most candidates centred their answers on the preparation of cash flow statement instead of describing procedures to verify bank loan.

Question five (5) (a) was answered well by most candidates scoring four (4) out of the five (5) marks. Most candidates did not answer question five (5)(b)(i) properly. No wonder most students who attempted scored low marks. Candidates also deviated in their answers to question five (5)(b)(ii). Most candidates interchanged answers for (b)(i) with that of (b)(ii)

Candidates were ill-prepared in areas where questions three (3), four (4) and five (5) covered in the examination.