

**NOVEMBER 2018 PROFESSIONAL EXAMINATIONS**  
**AUDIT & ASSURANCE (PAPER 2.3)**  
**CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

**EXAMINER'S GENERAL COMMENTS**

In my opinion, candidates performed above average in this paper having a pass rate of over 68%. It is better than the over 50% pass rate recorded in May, 2018.

Candidates strangely performed poorly in question five (5) which was on Auditor's Report. It looks as if the candidates were tricked with the structure of the question. Lecturers and students are encouraged to look critically at the Auditor's Report in the Auditing Syllabus since it may continue to feature in subsequent examinations.

**STANDARD OF THE PAPER**

The standard of the paper, as usual, was high especially with the coming of question one (1) on IAASB. Introduction of some of these standard topics at this level will encourage our students to do more reading in the Auditing subject.

The mark allocation followed the weightings in the current syllabus but I realised some of the syllabus coverages were merged. The mark allocations were not however, contrary to the syllabus weightings. There were no ambiguities/errors/typing problems that adversely affected performance in the examinations. In my view, and that of my able Examiners, all the five (5) question were of high standard at the level of examination.

**PERFORMANCE OF CANDIDATES**

The general performance of candidates in the subject is about 68%. That is, out of a total number of 401 candidates who wrote the paper 273 passed and 128 failed. The performance is therefore, good.

Teaching and learning should be intensified so that candidates would be able to perform better at subsequent examinations. Unfortunately, students performance in questions one (1), three (3) and four (4) were below 50%. Students did not answer question five (5) well at all. Only 9% of candidates passed this question. Surprisingly all five (5) question topics were within the reach of students.

Higher performers for this paper was evenly spread across majority of the centres where the examination was taken. Low performance were not concentrated in a particular centre. Low performance could also be found in most of the centres. Teaching and learning in these centres are to be intensified and sustained.

The level of preparedness of some of the candidates were good which resulted into 68% pass rate and 32% failures. Students should be encouraged to prepare extra 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 strongly in questions on Internal Audit and Outsourcing. Candidates also performed well in questions on corporate governance. A whopping 60% of candidates passed in this area. It seems to me that students are doing well on the topic of corporate governance. In May, 2018, 75% of candidates passed questions from corporate governance. It however, fell to 60% in November, 2018.

The above depicts specific area in which strengths were demonstrated by students. The strengths were wide spread amongst candidates. The probable reason why the above strengths were obtained may be due to the fact that teaching and learning of those topics were intensified and appreciated by students.

The only 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 teachers 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 IAASB, IAS and Independent Auditors Report. Students are also loosing grasp of verification of assets which is not good enough.

In this diet, the weakness rate was wide-spread and not concentrated in peculiar centres alone. Except question two (2) which recorded a high rate of passes of 60%, all the other four questions recorded pass rate below 50%. The reason for some of these weakness comes from lack of qualified and experienced professionals to assist students in 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) The shareholders of Store and Quarry Ltd namely Obodai and Obosie are residing abroad. They appointed directors to see to the day to day running of the company. The directors produced the financial statements of the company which show a true and fair view. Other relevant information regarding directors' pay and benefits, going concern and management of risk have been provided by the directors. In order to know the accuracy of the information provided, the shareholders engaged your firm Standard and Co. Chartered Accountants to perform an assurance engagements.

**Required:**

- i) Explain an assurance engagement as provided by IAASB. **(2 marks)**
- ii) Explain **FOUR (4)** elements of an assurance engagement. **(4 marks)**
- iii) Describe the differences between *reasonable assurance* engagement and *limited assurance* engagements. **(4 marks)**

b)

- i) Yaw Manu is a Chartered Accountant who has been appointed as an auditor of Level Ltd at the annual general meeting of the company in December 2009 which assignment Yaw Manu accepted. In April 2010, Yaw Manu joined Kwaku Assenso also a Chartered Accountant, who is the Finance Manager of Level Ltd, as a partner.

**Required:**

Discuss the ethical issues raised in the above scenario. **(5 marks)**

- ii) You are the auditor of S.K Ltd. While conducting the audit of the company for the year ended 31 December 2017, you wanted to refer to the minutes book but the Board of Directors refused to give these books to you.

**Required:**

Discuss the implications of the directors' action. **(5 marks)**

**(Total: 20 marks)**

## QUESTION TWO

- a) Proper Banking Limited (PBL) has been trading for 20 years selling banking products and has recently become a listed company. In accordance with corporate governance principles of Bank of Ghana PBL maintains a small internal audit department. The board of directors feel that the authorized business of the Company is banking which is core to the success of PBL. On 20 November, 2017, the Operational and Governance Committee of the Board met to discuss whether to maintain the internal audit department and increase its size and build its expertise or to outsource the whole function to their external auditors, International & Co with headquarters in Accra, Ghana with global presence over ninety-nine (99) countries.

**Required:**

Advise the Board of PBL on the advantages and disadvantages of whether to outsource or maintain their internal audit function. **(10 marks)**

- b) Proper Banking Limited (PBL) is required to comply with corporate governance principles in order to maintain its listed status and banking license due to the current banking crises in Ghana.

The Finance Director, decides on the amount of remuneration each director is paid. Currently all remuneration is in the form of an annual bonus based on profits. Yaw is considering setting up an audit committee, but has not undertaken this task yet as he is very busy. A new sales director was appointed a year ago. She is yet to undertake his board training as this is normally provided by the chief executive officer and this role is currently vacant.

Koffie Quartey is the chairman of PBL. Until last year, he was the Chief Executive Officer. Koffie is unsure if PBL needs more non-executive directors as there are currently four non-executive directors out of the eleven board members. He is considering appointing one of his close friends, who is a retired executive council member of a Non-Governmental Organization (NGO), as a non-executive director.

The shareholders are many and due to their large numbers, the directors believe that it is impractical and too costly to hold an annual general meeting of shareholders. Instead, the board has suggested sending out the financial statements and any voting resolutions by email for shareholders to vote on the resolutions via email.

**Required:**

In respect of the corporate governance of Proper Banking Limited:

- i) Identify and explain **FIVE (5)** corporate governance weaknesses; and **(10 marks)**  
ii) Provide a recommendation to address each weakness. **(5 marks)**

**(Total: 25 marks)**

### QUESTION THREE

International Training Center (ITC) is a large company limited by shares which operates a network of teaching centers in countries across West Africa. The Company was incorporated under the requirements of the Companies Act, 1963 (Act 179) on 19 January 1990 and domiciled in Ghana. Students who register with the Center pay 30% during initial registration and the remaining 70% over the course period. You are the senior Associate of Add Consult. ITC is a new client and you are currently planning the audit with the audit manager to audit the company for the year ended 31 December 2017.

You have been provided with the following planning notes from the audit partner following his meeting with the Finance Director.

- ITC purchases stationery from a supplier in China and these goods are shipped to the company's central warehouse. The goods are usually in transit for a fortnight and the company correctly records the goods when received. ITC does not undertake a year-end inventory count, but carries out monthly continuous (perpetual) inventory counts and any errors identified are adjusted in the inventory system for that month.
- During the year the directors of the Company have each been paid a significant bonus, and they have included this in wages and salaries expenses. Separate disclosure of the bonus is required by the Companies Act.
- ITC has a policy of revaluing its land and buildings and this year has updated the valuations of all land and buildings.
- During the year the company introduced a bonus based scheme on sales for its sales persons. The bonus target was based on increasing the number of students signing up for 6-month courses by the school for individuals running accountancy examinations. This has been successful and revenue has increased by 25%, especially in the last few months of the year. The level of receivables is considerably higher than last year and there are concerns about the creditworthiness of some students.

**Required:**

- a) Describe **FIVE (5)** audit risks, and explain the auditor's response to each risk, in planning the audit of International Training Center. **(10 marks)**
- b) Identify **FIVE (5)** audit procedures Add Consult should perform in order to place reliance on the continuous (perpetual) counts for year-end inventory. **(5 marks)**
- c) Describe *substantive procedures* Add Consult should perform to confirm the directors' bonus payments included in the financial statements. **(5 marks)**
- d) The Finance Director of the Company informed the audit partner that the reason for appointing Add Consult as auditors was because they audit other similar companies, including the Company's main competitor. The Finance Director doubts how Add Consult keeps information (obtained during the audit) confidential.

**Required:**

Explain the safeguards which your firm should implement to ensure that this conflict of interest is properly managed. **(5 marks)**

**(Total: 25 marks)**

**QUESTION FOUR**

- a) All Souls Ltd is the audit client of Objectivity Auditors, a firm of Chartered Accountants. All Souls Ltd has been operating a manual system of accounting for the past 10 years. All Souls Ltd is contemplating the acquisition of a new accounting software to facilitate the preparations of its accounting records.

**Required:**

As an audit senior of Objectivity Auditors, advise your audit team on the problems which are likely to be encountered by auditors while a client is moving from manual based accounting records to computer based accounting records. **(8 marks)**

- b) At a meeting to deliberate with management on the draft financial statement of E.T Company Ltd, the external auditors, Sampson Amarty and Co., a firm of Chartered Accountants demanded that management should explain how an amount of GH¢200,000 for land and building in the financial statements had been arrived at. The Managing Director asked the Director of Finance to explain how the amount of GH¢200,000 was arrived at. The Director of Finance explained that the amount of GH¢200,000 was given to them by an external valuer, S.K. Valuation Experts

**Required:**

Explain the *audit procedures* that would be adopted in verifying the land and building value in the financial statements.

**(7 marks)**

**(Total: 15 marks)**

## QUESTION FIVE

The auditors of ABC Ltd issued an adverse opinion on the financial statements of the company for the year ended 31 December 2017. This was due to the fact that management could not make available the cash book, general ledger and debtors ledger to the auditors for examination.

Some of the engagement team members may not agree to the issue of an adverse opinion and are suggesting an unmodified report with an emphasis of matter paragraph.

**Required:**

- a) Comment on the *action of the auditors* to issue an adverse opinion. **(10 marks)**
- b) Explain to your team members, the *circumstances* that will make auditors include an emphasis of matter paragraph in the Independent Auditor's report. **(5 marks)**

**(Total: 15 marks)**

## SOLUTION TO QUESTIONS

### QUESTION ONE

a)

i) An *assurance engagement* is one 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 subject matter information (that is, the outcome of the evaluation or measurement of a subject matter against criteria). **(2 marks)**

ii) An assurance engagement performed by a practitioner will consist of the following elements:

- **A three party relationship** – The three parties are the intended user, the responsible party and the practitioner.
- **A subject matter:** This is the data to be evaluated that has been prepared by the responsible party. It can take many forms including financial performance (e.g. historical financial information, non-financial performance (e.g. key performance indicators), processes (e.g. internal control) and behavior (e.g. compliance with laws and regulations).
- **Suitable criteria:** The subject matter is evaluated or measured against criteria in order to reach opinion.
- **Evidence:** Sufficient appropriate evidence needs to be gathered to support the required level of assurance.
- **An assurance report:** A written report containing the practitioners' opinion is issued to the intended user, in the form appropriated to a reasonable assurance engagement or a limited assurance engagement.

**(1 mark each for any four valid point made)**

**(4 marks)**

iii) **Reasonable Assurance Vs Limited Assurance**

- Reasonable assurance engagement is where a high, but not absolute level of assurance is given. The object of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the assurance practitioner's conclusion. The conclusion would usually be expressed in a positive form. In order to give reasonable assurance, a significant amount of testing and evaluation is required to support the conclusion. **(2 marks)**

Limited assurance is a lower level of assurance. The nature, timing and extent of the procedures carried out by the practitioner in a limited assurance engagement would be limited compared with what is required in a reasonable assurance engagement. Nevertheless, the procedures performed should be planned to obtain a level of assurance which is meaningful in the practitioner's professional judgment.

- For a limited assurance engagement the conclusion conveys whether, based on the procedures performed and evidence obtained, a matter (s) has come to the practitioner's attention to cause the practitioner to believe the subject matter



information is materially misstated. This would usually be expressed in a negative form of words. (2 marks)

b)

- i) Disqualification of an auditor. In order to ensure the independence of the auditor Section 270 and 296 of the companies' code contain grounds for disqualification of an auditor of a public and private company respectively. According to the section a person who is a partner or who is in the employment of an officer or employee of the company is not qualified for being appointed as the auditor.

In the given case, Yaw Manu has been appointed as an auditor of Level Ltd in the annual general meeting. Subsequently, he has become a partner of Kwaku Assenso who is the Finance manager (employee) of Level Ltd. This is one of the grounds for disqualification. Therefore, Yaw Manu shall be deemed to have vacated office automatically.

The ethical issues that could be raised in the above scenario are:

- Independence
- Self Review
- Confidentiality
- Conflict of interest
- Objectivity
- Collusion

(5 marks)

- ii) **Right of the statutory auditor of access to books, accounts and vouchers of the company.**

- Section 133 (a) confers upon the auditor the right of access to the records, books, of accounts and vouchers of the company. Books include minutes books of general meetings as well as meetings of the board. (1 mark)
- This right has been conferred upon the auditor to enable him to express an opinion on financial statement which are derived from the records, books of accounts and vouchers. Under the 5<sup>th</sup> schedule of the companies' code 1963, Act 179, auditor has a duty to report whether the company's balance sheet and profit and loss account are in agreement with books of accounts and return. (2 marks)
- In the present case, auditors have been denied the access to minute books. The auditors need minutes books of the meetings of the board and shareholders to verify/vouch transactions and decisions. (1 mark)
- Such a denial constitute a limitation on scope of audit. He may extend audit procedures and express a qualified opinion or disclaimer of opinion in his audit report. (1 mark)

(Total: 20 marks)

## QUESTION TWO

### a) Advantages/Disadvantages of outsourcing internal audit department

#### **Proper Banking Limited**

##### **Advantages**

- **Skills and experience**

International & Co is likely to have a large pool of staff available to provide the internal audit service to Proper Banking Limited. In addition, the audit firm is likely to have staff with specialist skills already available.

- **Flexibility**

If the internal audit department is outsourced, Proper Banking Limited will have total flexibility in its internal audit service. Staff can be requested from International & Co to suit the company's workloads and requirements. This will ensure that, when required, extra staff is readily available for as long or short a period as needed.

- **Staffing**

Proper Banking Limited (PBL) wishes to expand its internal audit department in terms of size and specialist skills. If they outsource, then there will be no need to spend money in recruiting further staff as International & Co will provide the staff members.

- **Immediate solution**

As the current internal audit department is small, then outsourcing can provide the number of staff needed straight away.

- **Cost control and management**

Outsourcing can be an efficient means to control the costs of internal audit as any associated costs such as training will be eliminated as International & Co will train its own employees. In addition, the costs for the internal audit service will be agreed in advance. This will ensure that Proper Banking Limited can budget accordingly.

(Any 3 points for 3 marks)

##### **Disadvantages**

- **Confidentiality**

Knowledge of company systems and confidential data will be available to International & Co. Although the engagement letter would provide confidentiality clauses, this may not stop breaches of confidentiality.

- **Loss of Control**

Proper Banking Limited currently has more control over the activities of its internal audit department; however, once outsourced it will need to discuss areas of work and timings well in advance with International & Co.

- **Knowledge of company**

International & Co will allocate available staff members to work on the internal audit assignment; this may mean that each visit the staff members are different and hence they may not fully understand the systems of Proper Banking Limited. This will decrease the quality of the services provided and increase the time spent by Proper Banking Limited's employees in explaining the system to the auditors.

- **Existing internal audit department**

Proper Banking Limited has an existing internal audit department; if they cannot be redeployed elsewhere in the company, then they may need to be made redundant and this could be costly for Proper Banking Limited. Staff may oppose the outsourcing if it results in redundancies.

- **Increased costs**

As well as the cost of potential redundancies, the internal audit fee charged by International & Co may over a period of time increase, proving to be very expensive.

- **Loss of in-house skills**

If the current internal audit team is not deployed elsewhere in the company, valuable internal audit knowledge and experience may be lost. If Proper Banking Limited then decided at a future date to bring the service back in-house, this might prove to be too difficult.

(Any 3 points for 3 marks)

### **International & Co**

#### **Advantages**

- **Additional fees for International & Co**

The audit firm will benefit from the internal audit service being outsourced as this will generate additional fee income. However, the firm will need to monitor the fees to ensure that they do not represent too high a percentage of their total fee income. As a public interest company, fee income should not represent more than 15% of gross practice income for two consecutive years.

(2 marks)

#### **Disadvantages**

- **Independence:** If International & Co provides both external audit and internal audit services, there may be a self-review threat especially where the internal audit work is relied upon by the external audit team. The firm would need to take steps to ensure that separate teams are put in place as well as additional safeguards

(2 marks)

### **b) Corporate Governance weaknesses and recommendations**

<b>Weakness</b>	<b>Recommendation</b>
<p>Koffie Governance is now the chairman; however, until last year he was the chief executive. The chairman is supposed to be an independent non-executive director and hence cannot have previously been the chief executive.</p> <p>The roles of chairman and chief executive are both very important and carry significant responsibilities; hence this prevents too much power residing in the hands of one individual.</p>	<p>Koffie Governance should return to his role as chief executive as this will fill the current vacancy and an independent non-executive director should be recruited to fill the role of chairman.</p>

<p>The board is comprised of eleven members and only four non-executive directors. There should be an appropriate balance of executives and non-executives, to ensure that the board makes the correct objective decisions, which are in the best interest of the stakeholders of the company, and no individual or group of individuals dominates the board's decision-making.</p>	<p>At least half of the board should be comprised of non-executive directors. Hence the board of Proper Banking Limited should consider recruiting and appointing an additional two to three non-executive directors.</p>
<p>Koffie Governance is considering appointing his close friend as a non-executive director; the friend has experience of serving as an executive council member of a non-governmental organisation. Non-executives bring valuable experience to a company, but they must also exercise their independent judgement over the whole board. If this director is a close friend of Koffie Governance, then it is possible that he will not be independent. In addition, other than being a former chief executive, he does not have any relevant experience of the banking industry and so it is questionable what value he will add to Proper Banking Limited.</p>	<p>Only independent non-executives with relevant experience and skills should be appointed to the board of Proper Banking Limited. The close friend of Koffie Governance is unlikely to meet these criteria, as he has no experience in the banking industry, and so should not be appointed.</p>
<p>The remuneration for directors is set by Yaw Addison, the finance director. However, no director should be involved in setting their own remuneration as this may result in excessive levels of pay being set. All directors' remuneration is in the form of an annual bonus. However, the pay should motivate the directors to focus on the long-term growth of the business. Annual targets can encourage short-term strategies rather than maximising shareholder wealth. In addition, non-executive directors' pay should not be based on meeting company targets as their pay should be independent of how the company performs.</p>	<p>There should be a fair and transparent policy in place for setting remuneration levels. The non-executive directors should decide on the remuneration of the executives. The chairman should decide on the pay of the non-executives. The remuneration of executives should be restructured to include a significant proportion aimed at long-term company performance. Perhaps they could be granted share options, as this would help to move the focus to the longer term.</p>
<p>Proper Banking Limited does not currently have an audit committee. Audit committees undertake an important role in that they help</p>	<p>Non-executives should be paid an annual fee for their services, which is unrelated to how Proper Banking Limited performs.</p> <p>Proper Banking Limited should appoint an audit committee as soon as possible. The committee should be comprised of at least</p>

<p>the directors to satisfy their responsibility of accountability with regards to maintaining an appropriate relationship with the company's auditor.</p> <p>A new sales director was appointed a year ago, however, he has not undergone any board training. All directors should receive induction training when they first join the board so that they are fully aware of their responsibilities.</p> <p>Proper Banking Limited is not planning to hold an annual general meeting (AGM) as the number of shareholders are such that it would be too costly and impractical. However, the AGM is an important meeting in that it gives the shareholders an opportunity to raise any concerns, receive an answer and vote on important resolutions. The proposal to send the financial statements and resolutions by email is not appropriate as it does not allow shareholders an opportunity to raise relevant questions.</p>	<p>reasonable independent non-executives, one of whom should have relevant financial experience.</p> <p>The current non-executives should be appointed to the audit committee, assuming they meet the requirements of independence.</p> <p>The new sales director should immediately receive relevant training from Koffie Governance to ensure that he has a full understanding of his role and responsibilities.</p> <p>The company should continue to hold the AGM. Sending information by email in advance of the meeting may be practical and save some costs; however, this should not be seen as a replacement for the AGM</p>
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(5 points of Weakness well explained for 10 marks)  
(5 points of Recommendation for 5 marks)

(Total: 25 marks)

### QUESTION THREE

#### a) Audit risks and response

Audit risk	Auditor's response
<p>International Training Center is a new client for Add Consult. As the team is not so familiar with the accounting policies, transactions and balances of the Company, there will be an increased detection risk on the audit.</p>	<p>Add Consult should ensure they have a suitably experienced team. Also, adequate time should be allocated for team members to obtain an understanding of the company and the risks of material misstatement.</p>
<p>The Company purchases their goods from China and the goods are in transit for forth night. At the year end there is a risk that the cut-off of inventory, purchases and payables may not be accurate. The company correctly accounts for goods when they receive them. Therefore at the year-end only goods which have been received into the warehouse should be included in the inventory balance and a respective payables balance recognised.</p>	<p>The audit team should undertake detailed cut-off testing of goods in transit from the suppliers in China to ensure that the cut-off is complete and accurate.</p>
<p>The company undertakes continuous (perpetual) inventory counts at its central warehouse. Under such a system all inventory must be counted at least once a year with adjustments made to the inventory records. Inventory could be under or overstated if the continuous (perpetual) inventory counts are not complete and the inventory records accurately updated for adjustments.</p>	<p>The completeness of the continuous (perpetual) inventory counts should be reviewed. In addition, the level of adjustments made to inventory should be considered to assess whether reliance on the inventory records at the year-end will be acceptable.</p>
<p>A sales-related bonus scheme has been introduced in the year; this may lead to sales cut-off errors with employees aiming to maximise their current year bonus</p>	<p>Increased sales cut-off testing will be performed along with a review of any post year-end cancellations of contracts as they may indicate cut-off errors.</p>
<p>Receivables are considerably higher than the prior year and there are concerns about the creditworthiness of some students. There is a risk that some receivables may be overvalued as they are not recoverable.</p>	<p>Extended post year-end cash receipts testing and a review of the aged receivables ledger to be performed to assess valuation. Also consider the adequacy of any allowance for receivables.</p>

<p>In addition, receivables could be overstated as a result of the bonus scheme; some of the customers signed up for contracts may not actually exist.</p> <p>The Company has a policy of revaluing its land and buildings and these valuations have been updated during the year.</p> <p>Property, plant and equipment could be under or overvalued if the recent valuation has not been carried out in accordance with IAS 16 Property, Plant and Equipment and adequate disclosures may not have been made in the financial statements.</p> <p>The directors have each been paid a significant bonus and separate disclosure of this in the financial statements is required by the Companies Act, 1963 (Act 179).The directors' remuneration disclosure will not be complete and accurate if the bonus paid is not disclosed in accordance with the Companies Act, 1963 (Act 179)</p>	<p>External confirmation of receivables to confirm that customers exist and represent valid amounts due.</p> <p>Discuss with management the process adopted for undertaking the valuation, including whether the whole class of assets was revalued and if the valuation was undertaken by an expert. This process should be reviewed for compliance with IAS 16.</p> <p>Review the disclosures of the revaluation in the financial statements for compliance with IAS 16.</p> <p>Discuss this matter with management and review the disclosure in the financial statements to ensure compliance with the Companies Act, 1963 Act 179).</p>
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(5 points for Audit risks @ 5 marks)  
(5 points for Recommendations @ 5 marks)

**b) Audit procedures for continuous (perpetual) inventory counts**

- The audit team should attend at least one of the continuous (perpetual) inventory counts to review whether the controls over the inventory count are adequate.
- The audit team should confirm that all of the inventory lines have been counted or are due to be counted at least once a year by reviewing the schedules of counts undertaken/due to be undertaken.
- Review the adjustments made to the inventory records on a monthly basis to gain an understanding of the level of differences arising on a month by month basis.
- If significant differences consistently arise, this could indicate that the inventory records are not adequately maintained.
- Discuss with management how they will ensure that year-end inventory will not be under or overstated.

- Consider attending the inventory count at the year end to undertake test counts of inventory from records to floor and from floor to records in order to confirm the existence and completeness of inventory.

**(5 points for 5 marks)**

**c) Substantive procedures for directors' bonus and remuneration**

- Obtain a schedule of the directors' remuneration including the bonus paid and cast the addition of the schedule.
- Agree the individual bonus payments to the payroll records.
- Confirm the amount of each bonus paid by agreeing to the cash book and bank statements.
- Review the board minutes to confirm whether any additional bonus payments relating to this year have been agreed.
- Obtain a written representation from management confirming the completeness of directors' remuneration including the bonus.
- Review any disclosures made of the bonus and assess whether these are in compliance with local legislation.

**(5 points for 5 marks)**

**d) Safeguards to ensure proper management of conflicts of interest**

- Both International Training Center and its competitor should be notified that Add Consult would be acting as auditors for each company and, if necessary, consent obtained.
- Advising one or both clients to seek additional independent advice.
- The use of separate engagement teams, with different engagement partners and team members; once an employee has worked on one audit, such as International Training Center, then they would be prevented from being on the audit of the competitor for a period of time. This separation of teams is known as building a 'Chinese wall'.
- Procedures to prevent access to information, for example, strict physical separation of both teams, confidential and secure data filing.
- Clear guidelines for members of each engagement team on issues of security and confidentiality. These guidelines could be included within the audit engagement letters.
- Potentially the use of confidentiality agreements signed by employees and partners of the firm.
- Regular monitoring of the application of the above safeguards by a senior individual in Add Consult not involved in either audit.

**(5 points for 5 marks)**

**(Total: 25 marks)**



## QUESTION FOUR

a) **The problems which are encountered by the auditor from shifting from manual based accounting to computer based accounting are:**

- **High speed** – Data processing is carried out at high speed and this requires careful management of data. Tracing of individual vouchers becomes difficult
- **Concentration of duties** – in a computer-based accounting system, internal controls are established by separation of knowledge not duties. Less number of people are required to perform accounting functions. It leads to concentration of duties
- **Impact of poor system** – The consequences of error in a computer system are very serious, For example, an erroneous programme will treat wages and salaries as a revenue item but there might be a need to capitalize these in case of installation of machinery, Errors in EDP system, which the auditor detects, may involve extensive redesign and reprogramming
- **Lack of audit trail** – in a computer based accounting records system audit trail is often missing. Transaction are recorded electronically and thus, source documents are not generated. The auditor should be aware of his problem and design his procedures accordingly
- **Tight scheduling** – Audit computerized accounts or EDP auditing, generally involves tight scheduling. This is because the client has to make arrangements to provide auditor access to computer system and make available various files.
- The auditor should carefully assess the staffing requirements beforehand. The client, too, has to follow the schedule given by the auditor tightly
- **Weakening of internal controls** – The concentration of accounting functions in few hands, possibly no back up data and formulation and implementation of different types of control by non-accountants weaken the internal controls.

**(2 marks each for any 4 valid points made= 8 marks)**

b) **Verification of the Land and Buildings**

- Verify valuation to valuation certificate
- Consider reasonableness of valuation by reviewing
- Experience of the valuer
- The scope of work
- Methods and assumptions used
- The objectivity of the valuer
- Check that valuation surplus has been correctly calculated
- Consider whether permanent diminution in value of assets has occurred
- Consider the adequacy of depreciation
- Ensure that the valuation surplus has been correctly treated
- Verify title to land and building by inspection of
- Title deeds
- Land registration certificate
- Inspect directors minute book to ensure that all title deeds, conveyances, tenancy agreement and lease are properly authorized

- Check sample of entries in the fixed assets register and the trace back to source documentation to ensure they are properly stated
- Review company policies for depreciation and ensure appropriate in the light of the life of the building and ensure that land is not depreciated
- Ensure the assets are properly disclosed in the financial statement
- If freehold or leasehold assets are let to third parties , inspect tenancy agreement and performed analytical procedures on rental income
- Physically inspect a sample of assets
- Ensure that the fixed assets register reconcile with nominal ledger

**(1 mark each for any 7 valid points= 7 marks)**

**(Total: 15 marks)**

## **QUESTION FIVE**

- a) Adverse opinion is issue where there is disagreement between the auditor and the client on issues such as
- Inappropriate accounting policies.
  - Regarding fact or amount (example failure to provide a material bad debt )
  - Compliance with legislation or other requirements.
  - If the above issues are found to be pervasive, then the auditor can give an adverse opinion.
  - In the case under consideration, there is a pervasive uncertainty relating to the scope of the audit. The unavailability of the cash book, general ledger and debtor's ledger will have an impact so great to render the financial statement as a whole meaningless. From the above, the auditors should have given a disclaimer of opinion.
  - The issues at stake led to limitations of scope of the auditors work.
  - Adverse opinion is therefore not appropriate in these circumstances.

**(Any 5 points @ 2 marks each =10 marks)**

- b) An emphasis of matter paragraph is a paragraph included in the auditor's reports that refers to a matter appropriately presented or disclosed in the financial statement that in the auditors judgement, is of such importance that it is fundamental to users ' understanding of the financial statement. Emphasis of matter paragraphs are used to draw readers' attention to a matter already presented or disclosed in the financial statement that the auditor feels is fundamental to their understanding, provided that the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated.

**Example of situations in which the auditor might include an emphasis of matter paragraph in the auditor's report are:**

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action

- Early application of a new accounting standard that has a pervasive effect on the financial statements.
- A major catastrophe that has had or continues to have a significant effect on the entity's financial position.

**(Any 2 points for 5 marks)**

**(Total: 15 marks)**

## **DETAILED QUESTION-BY-QUESTION ANALYSES OF PERFORMANCE**

Question One (1)	-	47%
Question Two (2)	-	60%
Question Three (3)	-	42%
Question Four (4)	-	44%
Question Five (5)	-	9%

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

The Audit and Assurance group thinks that areas covered by question five (5) should be critically looked at by both teachers and students. Candidates in answering question one (1) were writing out all the separate requirements of the question without answering any of those. Question two (2a) required candidates to explain the advantages and disadvantages of outsourcing as against in-house internal audit department. Whereas some students accurately explained the merits and demerits of outsourcing, others went ahead to present the advantages and disadvantages of the internal audits department which was not a requirement of the question. In question two (2b), candidates failed to explain the effects of the identified weaknesses. Most students were just stating the weakness as stipulated in the case. Some few students also ignored the case and were generic with the weaknesses. Overall the performance for question two (2) was encouraging.

Students found it difficult identifying audit risks from the case given in question three (3). Candidates were rather explaining the types of audit risks (that is, Inherent, detection and control risks) and others.

Most students (60%) confused the problems the auditor will face because of the movement from the manual system to the computerized system per question four (4). Students rather chose to explain the problems/disadvantages to the Company (All Souls Ltd) for moving from the manual system of accounting to the computerized system.

Question four (4b) was answered well by candidates. A few (10%) students were explaining the audit procedures in verifying the sale of the land and building.

Candidates were ill-prepared in areas where question five (5) covered in the examination.