

**MAY 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 averagely in this paper having a pass rate of over 50%. Candidates performed poorly in question five (5) which was ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report.

STANDARD OF THE PAPER

The standard of the paper was fairly high compared to the previous sitting. The marks allocation followed the weightings in the current syllabus but some of the syllabus coverages were merged.

In my opinion, none of the questions were too loaded. However, some of the marks allocated were 'over-generous'. For example, question two (2b) should not be more than ten (10) marks. The mark allocated to this question was fifteen (15) which I considered to be too much. No wonder a lot of candidates passed in this question, over 75%. Candidates really took advantage of this generosity.

There were no ambiguities/errors/typing problems that adversely affected performance in the examinations. In my view, 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 about 57.5%. That is, out of a total number of 426 candidates who wrote the paper 245 passed and 181 failed. The performance is therefore, above average.

Unfortunately, students did not answer questions three (3), four (4) and five (5) well even though the topics in questions three and four were within their reach. 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 above average which resulted into 57.5% pass rate and 42.5% failures. Students should prepare well before undertaking the examination in order to pass to boost their confidence.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES

Candidates performed strongly in questions on corporate governance and internal control over the wages system that could lead to misstatements in the financial statements. A whopping 75% of candidates passed in this area. 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 intensify 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 ISA 701, communicating Key Audit Matters in independent Auditors Report.

In this diet, the weakness rate was wide-spread and not concentrated in peculiar places alone. Except question two (2) which recorded a high rate of passes of 75%, all the other four questions recorded pass rates below 50%. To this end, all centres where we have our students must be helped so as to overcome this unwanted weakness in future examinations. We need also to extend this assistance to our Liberia centre, even though no candidate wrote the May, 2018 examination.

The reason for some of these weaknesses 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. These qualified persons are lacking in most of these examination centres. Again, the Institute's learning materials, to me has not penetrated enough amongst most students. All these, when available would enhance the basic foundational knowledge of students to confront the paper in future examinations.

QUESTION ONE

- a) The Finance Manager of Nkran Ltd prepared a comprehensive cash flow forecast for the purpose of securing a Loan from the bank. This was presented to the bank for evaluation and approval. The bank after evaluating the cash flow forecast wrote to Nkran Ltd requesting for a reasonable assurance report. The Managing Director of Nkran Ltd, who was impressed with the Finance Manager's cash flow forecast is now questioning the integrity of the Finance Manager to the extent of considering sacking him. The Managing Director decided to consult you the Auditor before taking the decision.

Required:

- i) Write a letter explaining the need for a *reasonable assurance* and its advantages to Nkran Ltd and the elements of an assurance engagement. **(8 marks)**
- ii) Advise the Managing Director on whether his intended decision is well founded. **(2 marks)**

- b) Atu Emma & Co Chartered Accountants has audited Great Tribulation Ltd for 10 years. In 2017, the Directors found out that the company has been borrowing to finance operating expenses and this has gone on for the past two years. They have advised their Lawyers to commence legal action against the Auditors for misleading the Directors into approving the annual financial statements after they have given an unqualified audit opinion.

Required:

Compare the *responsibilities of the directors and auditors* regarding the annual financial statements of Great Tribulations Ltd. **(10 marks)**

(Total: 20 marks)

QUESTION TWO

- a) Mr. Frimpong Dogbe is the Leader, Founder, Chief Executive Officer and Board Chairman of Awurade Hwe Ltd. He single-handedly appointed a board of five executive and two non-executive directors. No formal performance targets are set for the senior managers in the company and no review of board policies is carried out. Mr. Frimpong Dogbe is the one who sets Board salaries based on his assessment of all the board members, including himself, and not their actual performance.

Internal controls in the company are monitored by the Senior Accountant, although detailed review is assumed to be carried out by the external auditors. Awurade Hwe Ltd does not have an internal audit department.

Required:

Describe **FIVE corporate governance weaknesses** faced by Awurade Hwe Ltd which do not comply with corporate governance principles and for each weakness recommend a solution to overcome the weakness. **(10 marks)**

- b) Third Floor Ltd is a construction company with many contracts being executed concurrently. A large number of workers are on various construction sites. Third Floor Ltd has an internal audit department and the Team is currently reviewing cash wages systems within the company.

The following information is available concerning the wages systems:

- Workers on each site are controlled by a foreman. The foreman has a record of all employee numbers and can issue temporary numbers for new employees.
- Any overtime is calculated by the computerised wages system and added to the standard pay.
- The two staff in the wages department make amendments to the computerised wages system in respect of employee leave, illness, as well as setting up and maintaining all employee records.
- The computerised wages system calculates deductions from gross pay, such as employee taxes (PAYE), and other statutory deductions.
- Finally a list of net cash payments for each employee is produced. Cash is delivered to the wages office by secure courier. The two staff place cash into wages envelopes for each employee along with a handwritten note of gross pay, deductions and net pay. The envelopes are given to the foreman for distribution to the individual employees.

Required:

Identify and explain **FIVE** deficiencies in Third Floor Ltd system of internal control over the wages system that could lead to misstatements in the financial statements, and, for each deficiency, suggest an internal control to overcome that deficiency. **(15 marks)**

(Total: 25 marks)

QUESTION THREE

a)

- i) The external process for the audit of large entities generally involves two or more phases. One phase involves understanding the business and risk assessment, determining the response to assessed risk, testing of controls and a limited amount of substantive procedures. This phase is sometimes known as the interim audit. Another phase involves further tests of controls and substantive procedures and audit finalisation procedures. This phase is sometimes known as the final audit.

Required:

Describe and explain the *main audit procedures and processes* that take place during the interim and final audit of a large entity. **(10 marks)**

- ii) Auditors are required to plan and perform an audit with professional scepticism, to exercise professional judgement and to comply with ethical standards.

Required:

Explain what is meant by '*professional scepticism*' and why it is so important that the auditor maintains professional scepticism throughout the audit. **(5 marks)**

- b)
i) **International Standard on Auditing 560: Subsequent Events** deals with auditor's responsibility towards events that occur after reporting date and especially before the auditor's report is issued.

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in the financial statements have been identified.

Required:

Explain **FIVE** audit procedures to test subsequent events. **(5 marks)**

- ii) **ISA 570 Going Concern** provides guidance to auditors in respect of ensuring that an entity can continue as a going concern.

Required:

Explain the actions that an auditor should carry out to try and ascertain whether an entity can continue as a going concern. **(5 marks)**

(Total: 25 marks)

QUESTION FOUR

- a) BDE Company Limited operates a hotel providing accommodation, leisure facilities and restaurants. Its year ends on 31 March. You are the senior associate of ABC and Associates and are currently preparing the audit programmes for the year-end audit of BDE Company Limited. You are reviewing the notes of last week's meeting between the audit manager and finance director where two material issues were discussed.

Depreciation

BDE Company Limited incurred significant capital expenditure during the year for refurbishing the restaurant facilities for the hotel.

The finance director has proposed that the new leisure equipment should be depreciated over 10 years using the straight-line method.

Food poisoning

BDE's directors received correspondence in January from a group of customers who attended a wedding at the hotel. They have alleged that they suffered severe food poisoning from food eaten at the hotel and are claiming substantial damages. BDE's lawyers have received the claim and believe that the lawsuit against the company is unlikely to be successful.

Required:

- i) Describe **substantive procedures** to obtain **sufficient and appropriate audit evidence** in relation to the above two issues. **(6 marks)**

- ii) List and explain the purpose of three items that should be included on every working paper prepared by the audit team during the audit of depreciation and food poisoning of BDE Company Limited. **(3 marks)**

- b)
 - i) Identify and explain two financial statement assertions relevant to account balances at the year-end; and **(2 marks)**
 - ii) For each identified assertion, describe a substantive procedure relevant to the audit of year-end inventory. **(4 marks)**

(Total: 15 marks)

QUESTION FIVE

In January 2015 the IAASB issued *ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report*. This standard is required to be applied to the audit of all listed entities.

Required:

- a) Explain the term Key Audit Matters as defined in ISA 701. **(2 marks)**

- b) State **TWO** objectives of ISA 701. **(2 marks)**

- c) What are the **THREE** matters that ISA 701 requires the auditor to take into account when making a determination of Key Audit Matters? **(6 marks)**

- d) How should the auditor communicate Key Audit Matters? **(5 marks)**

(Total: 15 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)

- i) **Reasonable assurance** is provided in a report where the auditor has obtained sufficient evidence to feel confident to give reasonable assurance that the information is free from material error. A normal audit opinion (giving reasonable assurance) takes a positive form of words, ie 'In our opinion the financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of...'

The advantages of the reasonable assurance would be:

- The bank will be able to place more reliance on the forecast as it has been subject to review by an independent professional. The level of comfort given will be less than that of an audit but forecast information cannot be verified to the same degree as historical information so the limited assurance is the best that could be expected in the circumstances.
- Reasonable assurance requires a lower level of work than a full scope audit so will be cheaper for the company.

(3 marks each for 2 points = 6 marks)

The elements of assurance engagement are: the three-party relationship; appropriate subject matter; suitable criteria; appropriate evidence; and a conclusion.

(2 marks)

- ii) **Intended decision is not well founded.** The bank by requesting for a reasonable assurance is not questioning the Finance Manager's integrity

(2 marks)

b) **Responsibilities of the directors and auditors regarding annual financial statements**

- **Preparation of financial statements.** The directors have a legal responsibility to prepare financial statements giving a true and fair view. This implies that they have been prepared in accordance with the relevant IASs and IFRSs. The auditor's duty is to carry out an audit (according to the International Standards on Auditing) and to give an opinion on whether a true and fair view is given (or whether the financial statements present fairly, in all material respects, the financial position of the entity). In doing this they will have to consider whether the relevant accounting standards have been properly followed.
- **Estimates and judgements and accounting policies.** The directors have the responsibility for making the estimates and judgements underlying the financial statements and for selecting the appropriate accounting policies. The auditor's responsibility is to assess the appropriateness of the directors' judgements and to

modify the audit opinion in the case of any disagreement causing the auditors to conclude the financial statements are not free from material misstatement.

- **Fraud and error.** The directors have a duty to prevent and detect fraud and error. This is a duty they owe to the shareholders and there is no 'materiality' threshold attached to their duty. The auditor is responsible (under ISA 240) for obtaining reasonable assurance that the financial statements are free from material misstatement including material misstatement caused by fraud. The auditor is responsible for maintaining professional scepticism throughout the audit, considering the possibility of management override of controls. The audit team must discuss how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur.
- **Disclosure.** The directors are responsible for disclosing all information required by law and accounting standards. The auditor's responsibility is to review whether all the disclosure rules have been followed and whether the overall disclosure is adequate. There are certain pieces of information, which, if not disclosed by the directors, must be disclosed by the auditor in his report. Examples of this are related party transactions and transactions with directors.
- **Going concern.** The directors are responsible for assessing whether it is appropriate to treat the business as a going concern. In doing this they should look at forecasts and predictions for at least twelve months from the reporting date. They should also disclose any significant uncertainties over the going concern status of the company. The auditors' responsibility is to consider whether there are any indicators of going concern problems in the company, and assess the forecasts made by directors and decide whether the correct accounting basis has been used and whether there is adequate disclosure of significant uncertainties.

(5 points for 2 marks = 10 marks)

(Total: 20 marks)

QUESTION TWO

a)

- **Weakness**

Mr. Frimpong Dogbe is both the Chief Executive Officer and the Chairman of the Board of Directors. Corporate governance codes indicate that there should be a clear division of responsibilities between running the board of directors and running the company's business so that no individual has unfettered powers of decision.

Recommendation

Awurade Hwe Ltd should appoint a separate chairman who meets the independence criteria set out in the codes. This should ideally be an independent non-executive director.

- **Weakness**

Awurade Hwe Ltd has only two non-executive directors compared with five executive directors. This means that non-executive directors comprise less than half the Board. This is clearly not an appropriate balance to ensure that board decisions are questioned and ultimately taken in the interests of the shareholders, and to prevent executives pursuing their own interests.

Recommendation

Awurade Hwe Ltd should appoint three more non-executive directors so that there is an equal number of executive and non-executive directors.

- **Weakness**

At present there are no formal targets or reviews of board policies/performance carried out. This means that Awurade Hwe Ltd does not have any means by which to appraise directors' performance and to identify training needs or poorly performing directors.

Recommendation

The board should set performance targets for each director and undertake a formal and rigorous review of its own performance and that of individual directors on an annual basis. The performance evaluation of the chairman should be undertaken by the non-executive directors. The fact that the review takes place should also be stated in the annual report.

- **Weakness**

Mr. Frimpong Dogbe decides the remuneration for all directors including himself. Furthermore remuneration is not based on performance. Directors should not set their own remuneration due to them having a clear self-interest which may prompt them to award themselves excessive pay packages.

Recommendation

A remuneration committee comprising at least three non-executive directors should be set up to determine the level of directors' remuneration. The remuneration of non-executive directors should be determined by the board itself

(or the shareholders if required by the articles of association of the company). The remuneration policy should be fair and transparent.

- **Weakness**

Mr. Frimpong Dogbe does not have an internal audit department. This may mean that there are weaknesses in the way in which Awurade Hwe Ltd is directed and controlled as the internal audit department forms an important part of the entity's internal control system.

Recommendation

Awurade Hwe Ltd, should review the need for an internal audit department at least annually. Given the lack of formal controls at the company, an internal audit department should be established as soon as possible. It is not clear whether Awurade Hwe Ltd has an audit committee. If there is no audit committee then one should be established immediately and comprise at least three non-executive directors. The head of internal audit should report to the audit committee.

(5 points for 10 marks)

b)

- **Deficiency**

The foreman is in a position to set up fictitious employees onto the wages system as he has authority to issue temporary employee numbers. This would allow him to collect cash wages for such ghost employees.

Recommendation

The issue of new employee numbers should be authorised by a manager and supported by employee contract letters etc.

- **Deficiency**

The two wages clerks are responsible for the set up and maintenance of all employee records. They could therefore, in collusion, set up ghost employees and collect cash wages from them.

Recommendation

The list of personnel should be matched with the payroll by a manager and all new employee records should be authorised before being set up on the system.

- **Deficiency**

The wages clerks are responsible for making amendments to holidays and illness etc. They could make unauthorised amendments which affect individual staff members' pay.

Recommendation

Any amendments to standing data on the wages system should be done by an authorised manager so that unauthorised amendments are not made. A log of amendments should be regularly reviewed.

- **Deficiency**
The computer system calculates gross pay and any deductions but these are hand-written by the wages clerks for the staff pay packets, so errors could be made and incorrect wages issued.

Recommendations
A payslip should be generated by the computer system and included in the wage envelopes to reduce the chance of errors in deductions and gross pay being made.
- **Deficiency**
The computer automatically calculates gross pay and deductions, however there is no check to ensure the calculations are accurate.

Recommendations
One of the wages clerks should check the gross pay and deductions for a sample of employees to gain assurance that the computer is calculating amounts correctly.
- **Deficiency**
The foreman distributes cash wages to the employees. He could therefore misappropriate any wages not claimed.

Recommendation
The distribution of wages should be overseen by another manager. Unclaimed wages should be noted on a form and returned to the wages department.
- **Deficiency**
Cash is delivered by secure courier but there is no mention of a check to verify the amount delivered. Less cash than stated was delivered may actually be delivered.

Recommendation
The amount of cash delivered should be verified and signed for by the receiving Third Floor officers and the courier.

(Any 5 points for 15 marks)

(Total: 25 marks)

QUESTION THREE

a)

Main audit procedures and practices during the interim audit

- The auditor will obtain a thorough knowledge of the business by discussion with client management and reading relevant trade publications.
- Preliminary analytical procedures will be performed on interim accounts in order to identify any major changes in the business or unexpected trends.
- The client's accounting systems will be documented, or documentation prepared in prior year audits will be updated.
- An assessment will be made of inherent risk and control risk
- Appropriate materiality levels will be estimated.
- The information obtained during the planning stage will be documented along with an outline of the audit strategy to be followed.
- If control risk has been assessed as high in particular areas, then control testing will need to be performed on the controls to confirm the initial assessment of the risk. These tests of controls will be started at the interim audit although they will generally need to be performed on a sample of items extending rights over the accounting period so may need to be completed at the final audit.
- The detailed audit approach should be prepared. Programmes of audit procedures, both tests of controls and substantive procedures, will be designed to show the work that needs to be done and to enable subsequent review of audit completion.
- If substantive procedures are to be performed that involve auditing a sample of transactions selected to cover the whole accounting period, it is likely that some of these procedures will also be started at the interim audit, but these will again be completed at the final audit.

(Any 5 points for 5 marks)

Main audit procedures and practices during the final audit

- The tests that were started at the interim visit, both tests of controls and substantive procedures should be completed.
- Year-end balances may be verified through confirmations obtained from third parties such as: receivables, payables, banks.
- If the client has carried out a year-end inventory count, detailed procedures will be carried out to verify the accuracy of the compilation of the year-end inventory listing and also to follow up any evidence gathered by the auditor when attending the inventory count.
- Detailed calculations will need to be obtained of any estimates the client has made at the year-end such as allowances for receivables, depreciation and provisions. Procedures will need to be performed to:
 - Assess the reasonableness of the methods used to make the estimates.
 - Re-perform the calculations; or
 - Develop point estimates to evaluate management's point estimates.

- Analytical procedures will be performed on the draft accounts to consider whether the view given by the financial statements is in line with the auditors understanding of the business.
- The auditors must review the directors' assessment of whether the business is a going concern. The auditor must consider whether the assumptions made by the directors are reasonable and whether it is appropriate to prepare the accounts on the going concern basis.
- A review of events after the reporting period must be performed in order to assess whether any appropriate adjustments or disclosures as required by IAS 10 have been dealt with correctly.

(Any 5 points for 5 marks)

ii)

Professional scepticism is an attitude that includes having a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and subjecting audit evidence to a critical assessment rather than just taking it at face value. **(2 marks)**

It is important that professional scepticism is maintained throughout the audit to reduce the risks of overlooking unusual transactions, of over generalising when drawing conclusions and of using inappropriate assumptions in determining the nature, timing and extent of audit procedures and evaluating the results of them. **(1.5 marks)**

Professional scepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses from management and those charged with governance. **(1.5 marks)**

b)

i)

- Audit Procedures to Test Subsequent Events
- Inquiries of management
- Status of items involving subjective judgment
- Status of items accounted for using preliminary or inconclusive data
- Whether there are any new commitments, borrowings or guarantees
- Whether there have been any:
 - Sales or destruction of assets
 - Issues of share/debentures or changes in business structure
 - Developments involving risk areas, provisions and contingencies
 - Unusual accounting adjustments
- Major events (eg going concern problems) affecting appropriateness of accounting policies for estimates
- Litigations or claims

Other Procedures

- Review management procedures for identifying subsequent events to ensure that such events are identified.
- Read minutes of general board/committee meetings and enquire about unusual items.
- Review latest available interim financial statement and budgets, cash flow forecast and other management reports.
- Obtain evidence concerning any litigation or claims from the company's solicitors (only with client permission).
- Obtain written representation that all events occurring subsequent to the period-end which need adjustment or disclosure have been adjusted or disclosed.

(1 mark each for any five valid point made)

ii)

Audit actions to ascertain whether an entity is a going concern

When planning the audit the auditor must:

- Consider in particular whether there are any events, conditions and business risks which might cast doubt on the entity's ability to continue as a going concern.
- Evaluate management's assessment of the entity's ability to continue as a going concern.
- When events or conditions have been identified which cast significant doubts on the viability of the business the following additional actions should be taken:
- Review management's plans for future actions based on its going concern assessment and ensure that these are feasible and that the outcome of these plans will improve the situation. (Specific procedures might include analysing and discussing cash flow, reviewing the terms of debentures and loan agreements).
- Gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists regarding going concern. This will involve considering any additional facts or information which has become available since management's going concern assessment.
- Seek written representations from management regarding its plans for future actions and the feasibility of these plans.
- Obtain information regarding the continuance of loan facilities from the company's bankers.
- Identify indications of cash flow problems eg. determine whether there has been an increase in receivables days by reviewing the receivables ageing analysis.

(Any 5 points for 5 marks)

(Total: 25 marks)

QUESTION FOUR

a)

i) **Substantive procedures**

Depreciation

- Review the reasonableness of the depreciation rates applied to the new capital expenditure and compare to industry averages.
- Review the capital expenditure plans of any plans by management to refurbish the restaurant facilities in less than 50 years which means the useful life is less than 50 years.
- Select a sample of building facilities and recalculate the depreciation charge to ensure that the non-current asset register is correct.
- Perform a proof in total calculation for the depreciation charged on the restaurant building facilities, discuss with management if significant fluctuations arise.
- Review the disclosure of the depreciation charges and policies in the draft financial statements.

(3 points for 3 marks)

Food poisoning

- Review the correspondence from the customers claiming food poisoning to assess whether BDE Co has a present obligation as a result of a past event.
- Send an enquiry letter to the lawyers of BDE Co to obtain their view as to the probability of the claim being successful.
- Review board minutes to understand whether the directors believe that the claim will be successful or not.
- Review the post year-end period to assess whether any payments have been made to any of the claimants.
- Discuss with management as to whether they propose to include a contingent liability disclosure or not, consider the reasonableness of this.
- Obtain a written management representation confirming management's view that the lawsuit is unlikely to be successful and hence no provision is required.
- Review the adequacy of any disclosures made in the financial statements for any material contingent liabilities.

(Any 3 points 3 marks)

ii) **Working papers for the audit of BDE Company Limited**

- **Name of client** – identifies the client being audited.
- **Year-end date** – identifies the year end to which the audit working papers relate.
- **Subject** – identifies the area of the financial statements that is being audited, the topic area of the working paper, such as receivables circularisation.
- **Working paper reference** – provides a clear reference to identify the number of the working paper, for example, K5 being the 5th working paper in the audit of cash and cash equivalents (from PCAS).
- **Preparer** – identifies the name of the audit team member who prepared the working paper, so any queries can be directed to the relevant person.

- **Date prepared** – the date that the audit work was performed by the team member; this helps to identify what was known at the time and what issues may have occurred subsequently.
 - **Reviewer** – the name of the audit team member who reviewed the working paper; this provides evidence that the audit work was reviewed by an appropriate member of the team.
 - **Date of review** – the date the audit work was reviewed by the senior member of the team; this should be prior to the date that the audit report was signed
- (Any 3 points for 3 marks)**

b) Financial Statements Assertion

(i) Existence

Assets, liabilities and equity interests exist.

Substantive procedures

During the inventory count select a sample of assets recorded in the inventory records and agree to the warehouse to confirm the assets exist.

Obtain a sample of pre year-end goods dispatch notes and agree that these finished goods are excluded from the inventory records.

(ii) Rights and obligations

The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

Substantive procedures

Confirm during the inventory count that any goods belonging to third parties are excluded from the inventory records and count.

For year-end raw materials and finished goods confirm title belongs to the company by agreeing goods to a recent purchase invoice in the company name.

(iii) Completeness

All assets, liabilities and equity interests that should have been recorded have been recorded.

Substantive procedures

Obtain a copy of the inventory listing and agree the total to the general ledger and the financial statements.

During the inventory count select a sample of goods physically present in the warehouse and confirm recorded in the inventory records.

(iv) Valuation and allocation

Assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Substantive procedures

Select a sample of goods in inventory at the year end, agree the cost per the records to a recent purchase invoice and ensure that the cost is correctly stated.

Select a sample of year-end goods and review post year-end sales invoices to ascertain if net realisable value is above cost or if an adjustment is required.

(6 marks)

(Total: 15 marks)

QUESTION FIVE

a) The term '**key audit matters**' (KAM) is defined in ISA 701 as:

'Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.'

(2 marks)

b) The objectives of ISA 701 are for the auditor to:

- determine those matters which are to be regarded as KAM; and
- communicate those matters in the auditor's report.

(2 points for 2 marks)

c) **Determination of Key Audit Matters (KAM)**

The definition in paragraph 8 of ISA 701 states that KAM are selected from matters which are communicated with those charged with governance. Matters which are discussed with those charged with governance are then evaluated by the auditor who then determines those matters which required significant auditor attention during the course of the audit.

There are three matters which the ISA requires the auditor to take into account when making this determination:

- Areas which were considered to be susceptible to higher risks of material misstatement or which were deemed to be 'significant risks' in accordance with ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
- Significant auditor judgments in relation to areas of the financial statements that involved significant management judgment. This might include accounting estimates which have been identified by the auditor as having a high degree of estimation uncertainty.
- The effect on the audit of significant events or transactions that have taken place during the period. The auditor must determine which matters are of most significance in the audit of the financial statements and these will be regarded as KAM.

(Any 3 points for 6 marks)

d) Communicating Key Audit Matters

Once the auditor has determined which matters will be included as KAM, the auditor must ensure that each matter is appropriately described in the auditor's report including a description of:

- Why the matter was determined to be one of most significance and therefore a key audit matter, and
- How the matter was addressed in the audit (which may include a description of the auditor's approach, a brief overview of procedures performed with an indication of their outcome and any other key observations in respect of the matter).

(5 marks)

(Total: 15 marks)

DETAILED QUESTION-BY-QUESTION ANALYSES OF PERFORMANCE

| | | |
|--------------------|---|-------|
| Question One (1) | - | 40% |
| Question Two (2) | - | 75% |
| Question Three (3) | - | 32.5% |
| Question Four (4) | - | 25% |
| Question Five (5) | - | 5% |

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

Our group thinks that the areas covered by question one (1), question three (3), question four (4) and question five (5) should be critically looked at by both teachers and students. The Institute should also play a pivotal role to assist students to overcome their weaknesses.

Most candidates appreciated some of the questions that appeared in the examination, especially questions one (1) and two (2). Question three (3), four (4) and five (5) were not properly understood. This resulted in most candidates providing inappropriate answers, hence their abysmal performance in those questions.

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