

**NOVEMBER 2020 PROFESSIONAL EXAMINATIONS
AUDIT AND ASSURANCE (PAPER 2.3)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

CHIEF EXAMINER'S GENERAL COMMENTS

Candidates performed well in this paper, having a pass rate of 60%, which however was below that of May 2020 pass rate of 69%. Candidates performed very well in questions one, four and five having pass rates above 50%. Questions two and three scored pass rates less than 50%.

Lecturers and candidates are encouraged to look critically at the topics that featured in questions two and three since the topics would continue to be examined by the Institute.

STANDARD OF THE PAPER

The standard of the paper continues to be higher compared with previous years. The marks allocation followed the weightings in the syllabus. The questions were not overloaded and marks allocations were not over-generous. There were no ambiguities, errors and typing mistakes that adversely affected performance in the examinations. All the five questions were of high standard at the level of examination.

PERFORMANCE OF THE CANDIDATES

The overall performance was good. The general performance of candidates in the paper was 60% thus, the performance was, more than average.

Teaching and learning should continue to be enhanced so that candidates would be able to perform better at subsequent examinations. Unfortunately, candidates performance in questions two and three was below average.

Low performance was not concentrated in a particular centre. High performance was found in most of the centres.

The level of preparedness of most candidates in most of the topics were good and this resulted in high pass rates in three of the questions during the examinations.

STRENGTHS & WEAKNESS OF CANDIDATES

Strength

Candidates who attempted questions 1, 4 and 5 scored higher marks from these three questions. Most of the candidates who attempted these three questions surprisingly scored higher marks ranging from 12% and 18%.

The above shows specific area in which candidates demonstrated strengths. The strengths were widespread 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 candidates.

Weakness

Some candidates demonstrated a lack of in-depth knowledge on Question 2 and 3.

These recorded a pass rate below 50%. To this end, candidates in the various centres must be assisted to overcome their weakness in the topics that featured in questions 2 & 3 so as to improve performance in future examinations.

We continue to advise that qualified instructors be engaged to teach the student to remove the myth surrounding the subject.

The Institute's learning materials should be made readily available for students' usage.

QUESTION ONE

- a) In recent years, some well-publicized corporate failures and its subsequent implication of the reporting auditors have highlighted the audit expectation gap. Public misperceptions are a major cause of the threat of legal challenges facing the accounting profession. One of the key challenges facing assurance providers is understanding and tackling the expectation gap in assurance.

Required:

Discuss what factors account for the *expectation gap*. (5 marks)

- b) Audit planning is a vital area of the audit primarily conducted at the beginning of an audit process to ensure that appropriate attention is devoted to important areas, potential risk are promptly identified, work is completed expeditiously and work is properly coordinated.

Required:

- i) State **FIVE (5)** benefits of audit planning. (5 marks)
ii) Explain what an auditor should do to secure the benefits. (10 marks)

(Total: 20 marks)

QUESTION TWO

- a) *ISA 315: Identifying and assessing risks of material misstatement through understanding the entity and its environment*, requires auditors to assess the risks of material misstatement of the financial statements whether due to fraud or error, through obtaining an understanding of the entity and its environment, including internal controls, in order to be able to design and perform further audit procedures.

Required:

Discuss **FOUR (4)** procedures that should be carried out to obtain an understanding of an entity in the conduct of a first time audit. (6 marks)

- b) *ISA 300: Planning an audit of financial statements* requires auditors to establish the overall strategy for an audit. An auditor is required to plan the audit by developing an audit strategy to guide the plan itself. Audit planning is necessary for a number of reasons of which the foremost is to achieve audit efficiency and effectiveness. Audit planning involves risk assessment procedures, further audit procedures and other audit procedures to obtain sufficient appropriate audit evidence. During the audit, if an auditor concludes that the initial plan requires alteration, then the auditor shall consider revising the audit strategy.

Required:

Explain with justification **FOUR (4)** key items which should be included in an audit strategy document. (4 marks)

- c) You are an audit manager with Kwabotwe & Co, a firm of Chartered Accountants. You have been assigned to handle the firm's quality control in the first quarter. In your first meeting, you invited staff to raise matters from their experience relating to their compliance with IFAC's code of ethics. The following issues came up:

- i) In its management letter to another audit client, Kwabotwe & Co warned the company that its computer system lacked essential controls. The company, subsequently decided to install a totally new system and Kwabotwe & Co's management consultancy department was appointed to design the new system. **(5 marks)**
- ii) Kwabotwe & Co was recently approached by a large company that was not, then, an audit client, for a second opinion with reference to the audit of the financial statements. The company was in dispute with its existing auditors who were proposing to issue a qualified audit opinion because of disagreement over inventory valuation. Kwabotwe & Co's technical partner reviewed the evidence provided by the company and advised the company that its accounting treatment was in order. Shortly afterwards, Kwabotwe & Co was invited to accept nomination as auditors. The reply to the letter of enquiry to the existing auditors made it clear that the inventory valuation dispute was not as straightforward as the company had made it out to be. **(5 marks)**

Required:

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

(Total: 20 marks)

QUESTION THREE

Future Prospects Company Ltd is a multinational company operating in Ghana. Its core operations include management of pension funds and real estate development. In preparing the financial statements, they carry out an appraisal of the pension funds to assess its ability to pay benefits to contributors. Periodic revaluation of lands and building was also carried out.

Required:

- a) In respect of valuation of pension funds, future payments to beneficiaries and revaluation of properties, name two auditor's experts on whom possible reliance will be placed on during your audit of the company and the work each may perform. **(4 marks)**
- b) Outline **FOUR (4)** factors you will consider when deciding to appoint an auditor's expert. **(8 marks)**
- c) Outline **FOUR (4)** procedures you will follow to determine whether you can place reliance on work performed by an auditor's expert. **(8 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) The audit engagement team of which you are a member, for the audit of Survival Ltd has almost completed the audit of the financial statements for the year ended 31 October, 2019. You have been told that your firm will need to obtain a letter of representation from

management as part of the audit evidence needed to form an opinion on the financial statement.

Required:

- i) Outline **FOUR (4)** reasons why your audit firm needs to obtain a letter of representation before the audit report is signed. **(6 marks)**
 - ii) Outline **TWO (2)** factors you will consider to determine the adequacy of management representation as audit evidence. **(4 marks)**
- b) You have responded to an advertisement by a reputable company for the appointment of an internal auditor. You realized the need to prepare well for the interview.

Required:

In anticipation of the questions you may be asked at the interview discuss the role of internal audit in corporate governance and risk management. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) *ISA 210: Agreeing the terms of audit engagements* requires that auditors should issue a letter of engagement before commencement of the audit.

Required:

- i) What is the purpose of an engagement letter? **(1 mark)**
 - ii) Identify **FOUR (4)** important information that the engagement letter should contain. **(4 marks)**
- b) The objective of the auditor per *ISA 210: Agreeing the terms of audit engagements* is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed. One way to do this is to establish whether the *preconditions* for an audit are present.

Required:

What are the preconditions to be assessed? **(5 marks)**

- c) You have completed the audit engagement for ABC Company Ltd and the engagement partner has asked the audit manager to bring the draft communication with those charged with governance for discussion. You were among the audit field staff who performed the audit and prepared the working papers and documented issues for management's considerations.

Required:

Discuss the main matters that should be included in the communication with those charged with governance. **(10 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) The expectation gap results from the public's wrong perception of what they think auditors should do as opposed to what the auditor actually does in accordance with legal and professional requirement. Factors that account for expectation gap are:

- Performance gap
- Some auditors may perform below the expectations of users.
- Liability gap
- Many users do not know to whom the auditor owes a responsibility and therefore may want to sue the auditor when they are not supposed to do so.

(5 marks)

b)

i) Planning helps the auditor to:

- Focus on important audit areas
- Identify and resolve potential problems
- Organize and manage audit engagements
- Assess and select audit team
- Enhance direction of audit
- Enhance supervision of audit

(1 mark for each point-5 marks)

ii) **To secure benefits from planning, the Auditor should;**

• **Involve the staff**

Audit team should be involved in the discussion of the assignment. They should be briefed of the nature of the assignment, the risk involved, areas to be given special attention, timelines etc.

• **Understand the audit engagement**

Should understand the engagement; the objective, the structure, the legal framework, the laws governing the entity, the operations, the industry etc.

• **Establish audit strategy**

The scope, nature, timing and direction of the audit

• **Develop a plan**

Detail actions to undertake the audit.

Document the audit planning

• **Determine the staff to undertake the work**

Establish the level of staff taking into consideration their qualification, experience, independence etc.

• **Establish budget for the audit work**

Quantifying the cost to be incurred on the audit by considering hours to be put in by trainees and partners and other resources to be used.

(2 marks for each point explained to a maximum of 5points - 10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Question one a) required candidates to discuss what factors account for the expectation gap. All the candidates attempted this question. Overall performance was very good.

Question one b) i) required candidates to state five (5) benefits of audit planning. Candidates did well by scoring all the marks allocated to this question. This was one of the questions which were well attempted by candidates. The overall performance was good.

Question one b) ii) required candidates to explain what an auditor should do to secure the benefit above. This question was also well answered.

QUESTION TWO

a) Procedures the auditors should:

- Talk to key management and those charged with governance about the entity in order to obtain knowledge about how the business operates so that they know what its main risks and issues are and what has happened to and in the company during the year under review.
- Visit the entity and observe the types of assets it possesses and the systems in place which allow it to function. This will enable them to build up an understanding of the types of issues and balances the auditors would expect to see in the financial statements and the quality of the control systems.
- Obtain any available accounts, for example, draft financial statements and management accounts. Perform analytical procedures on current and past accounts to identify risk areas so that audit work can be focused on the more risky areas.
- Obtain budgets for the year under review and compare them to draft financial statements to identify any risk areas, perhaps where there have been major variances between intentions and actual results and discuss the results with key management.
- Review any internal control systems manuals and assess whether they are capable of preventing or detecting and correcting errors. If so, carry out tests of controls to determine whether they have operated as intended during the year.

(Any 4 points @ 1.5 mark = 6 marks)

b) **Audit planning/strategy document**

The following matters should be included in an audit strategy document:

- Calculated planning materiality
- Identified risk areas
- Key dates and deadlines, such as directors' meetings, shareholders' meetings
- Specific reporting requirements, particularly if more than the statutory audit opinion is required
- Locations of the entity and where auditors will attend and when
- Audit approach planned, including:

- Extent of reliance on controls
 - Extent of reliance on internal audit (if any)
 - Extent of reliance on experts
 - Specific client/industry developments relevant to the audit
- (Any 4 points for 4 marks)**

c)

i) **Advice on controls**

- This raises a controversial area in auditor independence. While the reporting of control weaknesses discovered during the audit is a required procedure, advising on the development of new systems to overcome those weaknesses is seen by some critics as a possible threat to independence. There is both a general and a specific issue. The general issue is that audit firms generate revenues from clients for both audit and non-audit work.
 - However, contracts for non-audit work are given by management. In performing the audit, the auditors may be reluctant to disagree with management for fear of losing non-audit contracts.
 - The specific issue is that known as self-review. Since the firm designed the new internal control system, there is a presumption, when evaluating control effectiveness at the next audit, that there will be no weaknesses in the system.
 - While providing non-audit services by auditors is not prohibited, the firm should ensure that they should not exceed the overall fee limit of 15% from any one client.
 - However, they do stress that, in advising the client, the audit firm must not make executive decisions. The implementation of advice is the responsibility of management over which the auditor has no control. At the next audit the auditor must check that the system has been properly put into operation and that it is being operated effectively.
- (5 marks)**

ii) **Advice to non-audit clients**

- Although Kwabotwe & Co are not threatening their own independence their action is in breach of professional rules. By offering advice they are prejudicing the independence of the auditors of the company they are advising. This practice is sometimes referred to as 'opinion shopping' and is carried out by companies in order to exert pressure on their existing auditors.
- When invited to provide such advice, professional rules require Kwabotwe & Co to communicate directly with the company's auditors to ensure that their advice is based on all available facts relevant to the judgement.
- Kwabotwe & Co are under an ethical responsibility to decline to be nominated as auditors and to write to the company retracting the advice previously given in the light of further information.

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- a) Candidates were asked to discuss four (4) procedures that should be carried out to obtain an understanding of an entity in the conduct of a first time audit. This was one of the questions which was least attempted by candidates. The overall performance was not encouraging.
- b) Candidates were asked to explain with justification four (4) key items which should be included in an audit strategy document. This was also not well answered by candidates. The overall performance was not good
- c) Candidates were asked to evaluate whether Kwabotwe & Co had complied with the IFAC's Code of Ethics or had acted unprofessionally (Case study). This was the least answered question by candidates. The overall performance was not good

QUESTION THREE

- a) Two auditors experts on whom reliance can be placed on in the scenario above are:
Valuation of Pension Funds: The auditor may have to rely on an actuary to generate audit evidence as to the viability of the pension scheme.
Valuation of Landed Properties: The auditors may rely on the work of valuers in the audit of revaluation of non-current assets. **(4 marks)**
- b) The relevant factors to consider in deciding to appoint an auditors expert during an audit are as follows:
 - Lack of proper knowledge about the items being audited if it is material to the view given by the financial statements.
 - The qualification and competence of expert and his reputation in the field in which audit evidence is required.
 - The independence and objectivity of the expert. The expert relationship with client by way of financial dependence and possibility of bias.
 - The scope of the work of the auditor's expert. These will involve written instructions covering the terms of reference for the experts:
 - ✓ The objective and scope of work
 - ✓ The general outline as the specific matters the expert's report should cover
 - ✓ Intended use of the experts work etc.**(4 points @ 2 marks each = 8 marks)**
- c) **Procedures to determine reliance on the work of auditor's expert.**
 - The auditor will evaluate the adequacy of the work of the experts for the auditor's purposes of including the relevance and reasonableness of the expert's findings and conclusion.
 - The auditor should assess whether the substance of the expert findings is properly reflected in the financial statements
 - The auditor should consider;
 - ✓ The source of data used.
 - ✓ The assumptions and the methods used

- ✓ When the expert carried out the work
- ✓ The reasons for any changes in assumptions and methods used
- ✓ The results of the expert work in the light of the auditors overall knowledge of the business and the results of other audit procedures.
- The auditors do not have the expertise to judge the assumptions and methods used. However, the auditors should seek to obtain an understanding of these assumptions to consider their reasonableness based on other audit evidence and knowledge of the business.
- The relevant factors when evaluating the relevance and reasonableness of the findings and conclusion of the expert may include whether they are;
 - ✓ Presented in a manner that is consistent with industry standards
 - ✓ Clearly expressed including references to the objectives agreed and the standards used.
 - ✓ Based on an appropriate period and taken into account any subsequent events.
 - ✓ Subject to any reservations or restriction on use
 - ✓ Based on appropriate consideration of errors or deviation encountered by the auditor.

(4 points @ 2 marks each = 8 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

- a) Candidates were asked to in respect of valuation of pension fund, and revaluation of properties, name two auditor's experts on whom possible reliance will be placed. This was another question that was least attempted. Candidates did not do well at all and the performance was very poor.
- b) Candidates were asked to outline four (4) factors you will consider when deciding to appoint an auditor's expert. This was another question just like question 3 (a) was least attempted by candidates and poorly answered.
- c) Candidates were asked to outline four (4) procedures you will follow to determine whether you can place reliance on work performed by an auditor's expert. Just like the above, this question too was very poorly answered.

QUESTION FOUR

- a)
 - i) Obtaining a letter of representation:
 - The reason why we need to obtain a letter of representation before signing the audit report is because the information in the letter of representation forms part of the sufficient and appropriate audit evidence needed to form an opinion that the financial statements give a true and fair view.
 - It's a requirement under ISA 580 that the auditor must obtain letter of representation in respect of management responsibility for preparation of the financial statements and giving the auditor all the information they require for the purpose of the audit

- There are various auditing standards which require the auditor to obtain letter of representation from management. Examples include ISA:240,250,450,501,540,550,560,570,710
- The auditor may also find out during the audit that evidence on some items are confined to management or are matters of management judgement. In this case the auditor is required under auditing standards to request representation on those items as audit evidence. Even though this does not absolve the auditor from performing procedures to substantiate the items.

(4 points @ 1.5 marks each =6 marks)

ii) To determine the adequacy of letter of representation the auditor has to consider the following factors:

- Competence, integrity, ethical values or diligence of management.
- Inconsistency of written representation with other evidence obtained by the auditor. The auditor will seek to resolve the latter by performing audit procedures. If it remains unresolved, particularly in addition to the first point the auditor will have to take appropriate actions including modifying the audit report in accordance with ISA 705

(4 marks)

b) Internal Audit and Corporate Governance. Established codes of corporate governance highlight the need for business to maintain good systems of internal control to manage risks the company faces. Internal audit can play a key role in assessing and monitoring control policies and procedures. The internal audit function can assist the board in other ways as well:

In effect, acting as auditors for the board

By being the experts in fields such as auditing and accounting standards in the company and assisting in implementing new standards

By liaising with external auditors, particularly, where external auditors can use internal audit work and reduce the time and therefore cost of the external audit.

(5 marks)

Internal Audit and Risk Management: Internal auditors have two roles to play in relation to organisational risk management. One is to ensure the company's risk management system operates effectively. And secondly to ensure that strategies implemented in respect of business risks operate effectively.

As a significant risk management policy is to implement internal controls, internal audit has a key role in assessing systems and testing controls.

Internal audit may assist in the development of systems, however its key role will be in monitoring the overall process and providing assurance that the systems which the departments have designed meet objectives and operate effectively.

It is important that the internal audit department retains its objectivity towards these aspects of its role, which is a reason why internal audit would generally not be involved in the assessment of risks and the design of the systems.

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

ai) Candidates were asked to outline four (4) reasons why an audit firm needs to obtain a letter of representation before the audit report is signed. This was one question well attempted by candidates. Overall performance was good.

aii) Candidates were asked to outline two(2) factors to consider to determine the adequacy of management representation as audit evidence. This was one question like Q4ai) above well attempted by candidates. Overall performance was good

b) Candidates were asked to discuss the role of internal audit in corporate governance and risk management. Most candidates scored the highest mark from this question. The performance was very good.

QUESTION FIVE

a)

i) The purpose of an engagement letter is to set expectations on both sides (the client and the audit firm) of the agreement. **(1 mark)**

ii) A letter of engagement is supposed to contain the following:

- The objective of the audit
- The responsibility of the auditor
- Management's responsibility for the financial statements.
- The scope of the audit, including reference to applicable legislation, regulations or pronouncements of professional bodies to which the auditor adheres.
- The form of any reports or other communication of results of the engagement.
- The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered.
- Unrestricted access to records, documents and other information requested in connection with the audit
- Management's responsibility for establishing and maintaining effective internal control.

(Any 4 points for 4 marks)

b) **The following are the preconditions for audit:**

- Establish if the financial reporting framework to be used in the preparation of the financial statement is acceptable.
- Obtain from management that it acknowledges and understand its responsibility for the preparation of the financial statements. and
- Obtain from management that it acknowledges and understand its responsibility for internal controls to ensure that the financial statements are not materially misstated.
- To provide the auditor with all relevant and requested information and unrestricted access to all documents and records.

- Where there is evidence that there will be some limitation on the scope of the auditor's work which will result in a disclaimer of opinion unless it is an engagement governed by law, the engagement should not be accepted.

(5 marks)

c) ISA 260 communicating with those charged with governance requires the following matters to be included in the communication:

- The auditor's responsibility in relation to the financial statements:
- The auditor is responsible for forming and expressing an opinion on the financial statements.
- The audit does not relieve management or those charged with governance of their responsibilities
- Planned Scope and timing of the audit includes:
 - ✓ How the audit proposes to address the significant risks of material misstatement from fraud and error.
 - ✓ The auditor's approach to internal control
 - ✓ Application of materiality
 - ✓ The extent to which the auditor will use the work of internal audit
 - ✓ Matters which those charged with governance consider warrant particular attention
- Significant findings from the audit including:
 - ✓ The selection of , or changes in, significant accounting policies
 - ✓ The potential effect on the financial statements of any significant risks and exposures, for example pending litigation that are required to be disclosed in the accounts
 - ✓ Significant difficulties, if any encountered during the audit, (e.g. delays in provision of required information, brief time in which to complete audit, unavailability of expected information)
- Auditor's independence. In the case of listed entities matters include:
 - ✓ A statement that relevant ethical requirements regarding independence have been complied with
 - ✓ All relationships (including total fees for audit and non-audit services) which may be thought to bear on independence.
 - ✓ The related safeguards that have been applied to eliminate/reduce identified threats to independence

(10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Candidates were asked in question a) (i&ii), the purpose of an engagement letter and to identify four (4) important information that the engagement letter should contain. All the candidates attempt this question. Most of the marks were scored from this question. On a whole, performance was very good.

The b) part asked candidates to explain the precondition to be assessed in relation to agreeing the terms of an engagements. This was not well answered by candidates. The performance was average.

Finally, the c) part asked candidates to discuss the main matters that should be included in the communication with those charged with governance. All the candidates attempted this question. It was the best answered question in the examination. Most candidates scored all the marks allocated to this question. Very good performance.

CONCLUSION

In conclusion, the following points would assist to strengthen our examination: More and intensified teaching and learning by lecturers and candidates should continue.

A lot of mock test should be conducted on-line prior to the main examinations so that all rough edges could be smoothed.

Candidates should practice solving more past questions on their own prior to the examinations.

The Institute's school should be opened in most of the big towns including some districts where the examinations take place to prepare candidates adequately for the examination. Other private tuition institutions must be empowered by the Institute including on-line portals to assist our candidates.

The distance learning concept must be encouraged by the Institute to help candidates to prepare adequately for the examinations.

Examiners of questions should continue to set questions from the Institute's recommended texts and to a limited extent from current issues on Audit and Assurance.

LOOKING AHEAD OF FUTURE EXAMINATIONS

Some candidates do not carry forward, their answered question onto continued pages in the answer packets and this action create problems for examiners and moderators. Some candidates still do not follow the details directions to candidates, legibly stated at the cover of the answer booklet.

Some candidates do not write legibly at all thus making reading of solutions by examiners extremely difficult.