

MAY 2021 PROFESSIONAL EXAMINATIONS
AUDIT & 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 75.11%, which was above that of the November 2020 pass rate of 60%. Candidates performed very well in questions one (1), two (2) and four (4), having pass rate above 50%. Questions three (3) and five (5) scored pass rates below 50%.

Lecturers and students are encouraged to look critically at the topics featured in questions three (3) and five (5) since these topics would continue to be examined by the Institute.

STANDARD OF THE PAPER

The standard of the paper continues to compare with that of previous years. The mark allocation followed the weightings in the syllabus. Questions were not overloaded, and marks allocations were not over-generous. There were no ambiguities/errors/typing problems that adversely affected performance in the examinations. All five (5) questions were of a high standard at the level of examination.

PERFORMANCE OF THE CANDIDATES

The overall performance was good as compared to the previous setting. Unfortunately, candidates performance in questions three (3) and five (5) were below average.

Low performance was not concentrated in any particular centre. On the contrary, the above performance was found in most of the centres. Our group of Examiners did not see any signs of copying at a particular centre.

The level of preparedness of most candidates in most of the topics was good and this inured to a high rate of passes in three (3) of the questions during the examinations.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

Candidates who attempted questions 1, 2 and 4 scored higher marks from these three questions. Most of the candidates who tried these three questions surprisingly scored higher marks ranging from 12 and 18. The strengths were widespread amongst candidates in various centres. The probable reason why the above strengths were obtained may be because teaching and learning of those topics were seriously intensified and appreciated by candidates.

Some candidates demonstrated a lack of in-depth knowledge on Questions 3 and 5. To this end, candidates in the various centres must be assisted to overcome their weakness in the topics featured in questions 3 & 5 to perform well in future examinations.

QUESTION ONE

- a) An Internal Auditor is part of the management Internal Control System. However, it is possible to list the other work that internal auditors might do under the following broad heading:
- Value for money audit
 - Best value Audit

Required:

Explain the differences between Value for money audit and Best value audit. (5 marks)

- b) To prepare an audit strategy and an audit plan, the Auditor will need to gain an understanding of the entity and its environment in accordance with *ISA 315 "Identifying and assessing the risk and material misstatement through understanding the entity and its environment"*.

Required:

- i) State **FIVE (5)** sources from which the Auditor can obtain knowledge of the industry and the organisation. (5 marks)
- ii) Identify **FIVE (5)** components that together make up internal controls. (5 marks)
- iii) Define the concept of risk-based auditing. (3 marks)

- c) Materiality is a fundamental concept in both auditing and accounting. Framework for the preparation of financial statement states that Information is material if its omission, misstatement or non-disclosure could influence economic decisions of users taken based on the financial statements.

Required:

State **TWO (2)** instances which require the Auditor to apply the concept of materiality. (2 marks)

(Total: 20 marks)

QUESTION TWO

- a) The IFAC Code of ethics governs the practice of auditing to ensure that practitioners will act in the public interest. Furthermore, in an audit, many relevant auditing standards must be followed to perform work that will serve the needs of user's of the Auditor's report.

Required:

Explain each of the **FIVE (5)** fundamental principles of the Code of Ethics and conduct for professional audit practitioners. (5 marks)

- b) *ISA 570: Going Concern* guides auditors to ensure that an entity can continue to operate into the foreseeable future.

Required:

State **TWO (2)** audit tests necessary to ascertain whether an entity is a going concern.

(5 marks)

- c) Auditor appointment, dismissal, and remuneration is regulated by Companies Act 2019, (Act, 992).

Required:

- i) How are auditors of Limited Liability companies:

- Appointed **(3 marks)**
 - Remunerated **(2 marks)**
- ii) What may cause auditors to resign from their appointments? **(5 marks)**

(Total: 20 marks)

QUESTION THREE

Expert Ltd (Expert) is a wholesaler of furniture (such as chairs, tables and cupboards). Expert buys the furniture from six major manufacturers and sells them to over 1,000 customers ranging from large retail chain stores to smaller owner-controlled businesses. The receivables balance includes customers owing up to GH¢200,000 to smaller balances of about GH¢20,000, all with different due dates for payments and credit limits. All information is stored on Expert's computer systems, although previous audits have adopted an 'audit around the computer' approach.

You are the Audit Senior in charge of the audit of the receivables balance. For the first time with this client, you have decided to use an audit software to assist with the audit of the receivables balance. IT staff at Expert are happy to help you the Auditor. However, they cannot confirm the completeness of systems documentation and warn that the systems have very old operating system, limiting file compatibility with modern programs.

To limit the possibility of damage to Expert's computer files, a copy of the files will be provided by Expert's IT staff for the Auditor to use with their own audit software.

Required:

- a) State **SIX (6)** substantive test that should be carried out using audit software on the receivables balance of Expert Ltd. **(9 marks)**
- b) Identify **FOUR (4)** potential problems of using audit software at Expert Ltd. For each problem, explain how it can be resolved. **(8 marks)**
- c) Explain the concept of “*auditing around the computer*” and discuss why this increases audit risk for the Auditor. **(3 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) Fafa Ltd operates a chain of food wholesalers across the Volta Region of Ghana, and its year-end was 30 September, 2019.

The final audit is nearly complete, and it is proposed that the financial statements and audit report will be signed on 13 December, 2019. Revenue for the year is GHS 79 million, and profit before taxation is GHS 8.5 million. The following event occurred after the year-end.

Receivable

A customer of Fafa Ltd has been experiencing cash flow problems, and its year-end balance is GHS 0.8 million. The company has just become aware that its customer is experiencing significant going concern difficulties. Fafa Ltd believes that as the company has been trading for many years, they will receive some, if not full, payment from the customer, hence they have not adjusted the receivable balance.

Required:

For the event above:

- i) Discuss whether the financial statements require amendment. **(1 marks)**
 - ii) Describe **THREE (3)** audit procedures that should be performed to form a conclusion on the amendment. **(3 marks)**
- b) Describe management's responsibility for subsequent events occurring between:
- i) The year-end date and the date the Auditor's report is signed
 - ii) The date the Auditor's report is signed and the date the financial statements are issued. **(6 marks)**
- c) Internal audit is one of the supporting functions within an organisation. This function is set up reluctantly in many entities. It is most of the time denied the recognition and resources it requires to operate. Internal Auditors report administratively to the CEO's of organisations even though they are required to functionally report to the Audit Committees of their respective organisations on professional issues.

Required:

Explain **FIVE (5)** limitations of the Internal Audit Unit and discuss steps that the Internal Audit Unit can initiate to remain independent even though they are employees of a company. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) *ISA 210 deals with the Auditor's responsibility in agreeing the terms of the audit engagement with management and where appropriate, those charged with governance.* This includes establishing certain preconditions for an audit and responsibilities which rests with management and where appropriate those charged with governance.

Required:

- i) What **THREE (3)** preconditions must be established before an audit engagement is accepted? **(6 marks)**
- ii) Under what **TWO (2)** circumstances will an auditor refuse an engagement? **(4 marks)**
- b) Logistics Ltd is a Logistics and Freight Forwarding company based in the port city of Takoradi, and you are the Audit Manager in charge of the year-end audit. The draft financial statements show a profit before tax of GH¢2.6 million and total assets of GH¢18 million.

In your discussion with management, the following issues came up:

- i) Management informed you that due to the ongoing coronavirus pandemic, shipping from China has slowed down considerably, and as a result, many employees have been laid off. A redundancy provision of GH¢220,000 is included in the draft financial statements. The audit review and calculations confirmed that the redundancy provision should be GH¢450,000. The Finance Director is however not willing to adjust the draft financial statements. **(5 marks)**
- ii) An employee has filed a wrongful dismissal lawsuit against Logistics Limited for GH¢ 1.2 million. This case is ongoing and will not be resolved before the Auditor's report is signed. The matter is disclosed as a contingent liability. **(5 marks)**

Required:

Discuss each of the issues i) and ii) above and describe their impact on the Auditor's report, if any, should these issues remain unresolved in terms of *ISA 705 (revised); Modification of the Auditor's Opinion.*

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) **Value for Money Audit**

Value for Money Audit is the type of audit to assess performance as in terms of getting good value from the money that an entity spends. Value for money is obtained by accessing the 3ES (i.e., economy, efficiency, effectiveness). **(2.5 marks)**

Best Value Audit

The fundamental concept of best value is continuous improvement. There is some evidence that some private sector organisations now use the concept of best value to measure improvement. This occurs where organisations attempt to achieve continuous improvement by focusing on the 4Cs (i.e., challenge, compare, consult, and complete). **(2.5 marks)**

b)

i) **Sources of obtaining knowledge**

- Communication with previous Auditors
- The clients most recent annual accounts
- Other business publications of the client.
- Press report on the clients' activities
- Credit rating from client rating agencies.
- Reference from existing clients
- Previous knowledge of the clients' industry
- Interaction with client management and staff

(Any 5 points @ 1 mark each = 5 marks)

ii) **Component of internal controls.**

Five main components of Internal Controls

- Control environment
- Risk assessment
- Information System
- Control Activities
- Monitoring of Controls

(Any 5 points @ 1 mark each = 5 marks)

iii) **Risk-based auditing**

This is where Auditor will then focus his work on balances in the financial statements where he considers a material risk of misstatement. High-risk material items will be audited in detail, but low risk/ immaterial items will receive less attention. **(3 marks)**

c) **Two instances where the concept of materiality is applied:**

- When planning and performing the audit.
- During the testing of items in the course of the audit
- When evaluating the effects of misstatements on the financial statements and therefore on his audit opinion. **(Any 2 points for 2 marks)**

(Total: 20 marks)

CHIEF EXAMINER'S COMMENT

a) Candidates were required to explain the difference between Value for Money audit and Best value audit. All the candidates attempted this question. Overall performance was excellent.

bi) Candidates were required to state five (5) sources from which the Auditor can obtain knowledge of the industry and the organisation. 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.

bii) Candidates were asked to identify five (5) components that together make up an international control system. This question was also well answered.

c) Candidate were required to state two (2) instances that require the Auditor to apply the concept of materiality. – This was also answered well.

QUESTION TWO

a) **Fundamental principles**

- **Integrity:** A professional accountant should be honest and straightforward in performing professional services.
- **Objectivity:** A professional accountant should be fair and not allow personal bias, conflict of interest or influence of others to override objectivity.
- **Professional competence and due care:** When performing professional services, a professional accountant should show competence and duty of care by keeping up-to-date with developments in practice, legislation and techniques.
- **Confidentiality:** A professional accountant should respect the confidentiality of information acquired during the course of providing professional services and should not use or disclose such information without obtaining client permission.
- **Professional behaviour:** A professional accountant should act in a manner consistent with the profession's good reputation and refrain from any conduct that might bring discredit to the profession.

(5 points @ 1 mark each = 5 marks)

b) **Audit work - going concern**

- Review management's plans for future actions based on its going concern assessment.

- Gather additional sufficient and appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists regarding the going concern concept.
- Seek written representations from management regarding its plans for future action.
- Obtain information from company bankers regarding the continuance of loan facilities.
- Review receivables ageing analysis to determine whether there is an increase in days, indicating cash flow problems.

(5 points @ 1 mark each = 5 marks)

c)

i) Per the Company's Act 2019 (Act 992), Auditors are appointed by the following process:

- The first auditors of companies are appointed by the directors who also fill in casual vacancies.
- When a company has no auditor for a continuous period of three months, the Registrar General may appoint an auditor for the company.
- By shareholders at Annual General Meeting when the appointment of existing Auditor ceases.

(3 points @ 1 mark each = 3 marks)

Per the Company's Act 2019 (Act 992), Auditors are remunerated by the following process:

- When directors appoint an auditor the directors fix the fees for the period expiring at the next AGM.
- When the Registrar General appoints an auditor, the fees are fixed by the registrar general.
- By an ordinary resolution of the company or in manner by which the company may direct by an ordinary resolution.

(2 points @ 1 mark each = 2 marks)

ii) **Reasons why an auditor may resign**

- An auditor may resign under the following circumstances:
- In relation to fee matter
- When the management of the auditee and those charged with governance demonstrate a lack of integrity
- When audit firms can no longer maintain independence
- Irreconcilable difference between the client and Auditor
- When the client changes in size and nature and the Auditor no longer have the competency to perform
- When the client is engaging in illegal activities.

(Any 5 points @ 1 mark each = 5 marks)

(Total: 20 marks)

CHIEF EXAMINER'S REPORT

a) Candidates were asked to explain each of the five (5) fundamental principles of the Code of Ethics and conduct for professional audit practitioners. This was one of the questions which was well attempted by candidates. The overall performance was encouraging.

b) Candidates were asked to state two (2) audit tests necessary to ascertain whether an entity is a going concern. This was not well answered by candidates. The overall performance was not good

ci) Candidates were asked to explain how auditors of limited liability companies are: (a) appointed and (b) remunerated. This was one of the questions well answered by candidates. The overall performance was very good

cii) Candidates were asked to explain what may cause an auditor to resign from their appointment. This was also answered well by candidates. The overall performance was very good

QUESTION THREE

a)

Substantive Test	Objective
Cast the receivables ledger to ensure it agrees with the total on the receivables control account.	To ensure the completeness and accuracy of recording of items in the receivables ledger and control account.
Compare the balance on each receivable account with its credit limit to ensure this has not been exceeded	To check for violation of system rules.
Review the balances in the receivables ledger to ensure no balance exceeds total sales to that customer.	To check for unreasonable items in the ledger.
Calculate receivables days for each month end to monitor control of receivables over the year.	To obtaining new/relevant statistical information.
Stratify receivables balances to show all material items and select an appropriate sample for testing.	To select items for audit testing.
Produce an aged receivables analysis to assist with the identification of irrecoverable receivables.	To assist with receivables valuation testing.

(6 points @ 1.5 marks for 9 marks)

b) **Problems of using audit software**

- **Cost**

There may be substantial setup costs to use the software, especially where the client's computer systems have not been fully documented, as is the situation in Expert Ltd. Therefore, a cost-benefit analysis from the audit point-of-view should be carried out prior to deciding to use audit software.

- **Lack of software documentation**

The computer audit department at Expert cannot confirm that all system documentation is available, especially for the older 'legacy' systems currently in use. This again confirms the view that audit software should be deferred until next year to avoid extensive setup costs that cannot be recouped due to system changes.

- **Change to clients' systems**

Changes to clients' computer systems can result in costly amendments to the audit software. Given that Expert's systems will change next year, this is almost certain to result in modifications to the software. Starting to use audit software this year is therefore not advisable.

- **Outputs obtained**

The audit manager must be clear about precisely what audit assertions are to be tested with the audit software and what outputs are expected. Starting testing to obtain knowledge of the system is inappropriate as testing may be too detailed and output produced that is not required, increasing the cost for the client.

- **Use of copy files**

The use of copy files means that the Auditor will not be certain that these are the actual files being used within Expert's computer systems, especially as the provenance of those files will not be checked. To ensure that the files are genuine, either the Auditor should supervise the copying or the 'live' files on Expert's computer systems should be used.

(Any 4 points @ 2 marks each = 8 marks)

c) **Auditing around the computer**

This term means that the 'internal' software of the computer is not documented or audited by the Auditor, but that the inputs to the computer are agreed to the expected outputs from the computer.

This method of auditing increases audit risk because:

First, the actual computer files and programs are not tested; the Auditor has no direct evidence that the programs are working as documented.

Where errors are found in reconciling inputs to outputs, it may be difficult or even impossible to determine why those errors occurred. As a result, constructive amendments to clients' systems cannot be made, and there is an increased likelihood of audit qualifications.

(3 marks)

(Total: 20 marks)

CHIEF EXAMINER'S COMMENT

- a) Candidates were asked to state six (6) substantive tests that should be carried out using audit software on the receivables balances of Expert Ltd. This was one question not well answered by the student. Mixed performance
- b) Candidates were asked to identify four (4) potential problems using audit software at Expert Ltd. For each problem, explain how it can be resolved. This was another question, just like question 3 (a) was not well answered by candidates—mixed performance.
- c) Candidates were asked to explain the concept of "auditing around the computer" and discuss why this increases audit risk for the Auditor. This was another question just like 3 (a&b) not well answered by candidates. Mixed performance

QUESTION FOUR

a) **Receivable**

A customer, owing GH¢ 0.8 million at the year-end, is experiencing significant going concern difficulties. This information was received after the year-end but provided further evidence of the recoverability of the receivable balance at the year-end. However, under IAS 10 Events after the Reporting Period, if the customer is experiencing cash flow difficulties just a few months after the year-end, then it is highly unlikely that the GH¢ 0.8m was recoverable as of 30 September.

The receivables balance is overstated and consideration should be given to adjusting this balance, if material, through the use of an allowance for receivables or by being written off. **(1 mark)**

The following audit procedures should be applied to form a conclusion as to the level of the adjustment:

- The correspondence with the customer should be reviewed to assess whether there is any likelihood of payment.
- Discuss with management as to why they feel an adjustment is not required.
- Review the post year-end period to see if any payments have been received from the customer. **(3 marks)**

b) **ISA 560 Subsequent Events responsibilities**

Management Responsibility

- i) The period between the year-end date and the date the Auditor's report is signed. IAS 10 states that if an entity obtains information about an adjusting event after the reporting period, it should update the financial statements to allow for this new information. Accordingly, an entity shall adjust the amounts recognised in its financial statements to reflect the adjusting events after the reporting period. Non-adjusting events after the reporting period are treated differently. IAS 10 states that an entity shall not adjust the amounts recognised in its financial statement to reflect non-adjusting events after the reporting period. If a non-

adjusting event is a material, it must be disclosed. If it is not disclosed it could influence the economic decisions taken by users of the financial information. The disclosure should include.

- The nature of the event and
 - An estimate of its financial effect or a statement that such an estimate cannot be made.
- ii) After the Auditor's report is signed but before the financial statements are issued after the Auditor's report is signed but before the financial statements are issued, it is the responsibility of management to bring any such events to the attention of the Auditor and make the necessary adjustments or disclosure to the financial statements for the Auditor to validate the amendment and issue a fresh report on the financial statement which will bear a date after the amended financial statement are approved by management. Failure to amend the financial statements may result in the Auditor withdrawing the audit report and issuing a new report or prevent further reliance on the report depending on whether the report is still with the Auditor or has been released to management.

(6 marks)

c) Limitations of the Internal Audit

- Internal auditors may be employees of the company they are reporting on and therefore may not wish to raise issues if they lose their jobs.
- In smaller entities, internal audit may part of the finance function. Therefore, they will have to report upon the effectiveness of financial systems they form part of and may be reluctant to say that the department has deficiencies.
- If the internal audit staff has worked in the company for a long time, they may be a familiarity threat as they will be auditing the work of long-standing friends and colleagues.
- Most internal audits are denied the needed resources to operate
- Most internal audit units are not staffed with qualified personnel

Independence could be achieved through:

- Separate reporting channels of the internal audit and financial function
- Independent review of the internal audit function
- Outsource the internal audit function to the third party
- Liaise with management for resources to operate
- Ensure qualified staff are employed to man the function

(5 points @ 2 marks each =10 marks)

(Total: 20 marks)

CHIEF EXAMINER'S COMMENT

(ai&aii) Candidates were asked to (i) discuss whether the financial statement requires amendment and (ii) Describe three (3) audit procedures that should be performed to form a conclusion on the amendment. This was one question not well understood by candidates. Mixed performance

(bi&bii) Candidates were asked to describe management's responsibility for subsequent events occurring between: (i) the year-end date and the date the Auditor's report is signed (ii) the date the Auditor's report is signed, and the date the financial statements are issued. This was one question well attempted by candidates. Overall performance was good.

c) Candidates were asked to explain five (5) limitations of the Internal Audit Unit and discuss steps that the Internal Audit Unit can initiate to remain independent even though they are employees of a company. This was one question like Q4ai above well attempted by candidates. Overall performance was good.

QUESTION FIVE

a)

i) **Preconditions**

Financial Statements are premised on reporting standards to ensure acceptable preparation. On this basis, an auditor should ensure that the accounts to be audited are measured on financial reporting frameworks such as IFRS or IPSAS.

The Auditor has to obtain the agreement of management that it acknowledges and understands its responsibility:

- For the preparation of the financial statement.
- 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 personnel.

(3 points @ 2 marks each = 6 marks)

ii) **Conditions under which the Auditor will refuse the engagement**

The Auditor is required to refuse the engagement under the following circumstances:

- When there is limitation on scope imposed by management such that the Auditor would not be able to express his opinion on the financial statement.
- The financial reporting framework used is unacceptable
- When management does not agree to the preconditions stated above
- Exception to this is where statute or regulation allows the Auditor to do so.

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

b)

i) In accordance with *IAS 37: Provisions, Contingent Liabilities and Contingent Assets*, if the economic outflow to discharge the obligation is probable, then a provision must be recognised in the financial statements.

Logistics Limited has under-declared a provision for employee redundancy by GH¢ 230,000, which represents 8.5% of profit before tax (230k/2.6 million) and hence is material but not pervasive to the financial statements.

According to *ISA 705 (revised): Modification of the Auditor's Opinion*, the Auditor, should bring the refusal of the Financial Director to those charged with Governance and should issue a qualified opinion if the provision is not amended. The Auditor should include in the Basis for Opinion section a description and quantification of the financial effects of the under-declared provision, unless impracticable. If it is not practicable to quantify the financial effects, the Auditor should indicate so in this section.

(Any 2 points @ 2 marks each and 1 mark for opinion =5 marks)

- ii) An employee is suing logistics Ltd for wrongful dismissal. This matter has been disclosed as a contingent liability. In accordance with *IAS 37: Provisions, Contingent Liabilities and Contingent Assets*, if the economic outflow is possible, then a contingent liability must be recognised as the provision is material but not pervasive to the financial statements.

The basis for the qualified opinion should be placed immediately before the opinion paragraph in accordance with the requirements of *ISA 705 (revised): Modification of the Auditor's opinion* in an independent auditor's report.

The lawsuit is for GH¢1.2 million, which represents 46% of profit before tax (1.2 million/2.6 million) and hence is a material matter. This is an important matter which needs to be brought to the attention of the users of the financial statements. The outcome of the case must be considered and its impact on the financial statements.

(Any 2 points @ 2 marks each and 1 mark for opinion =5 marks)

(Total: 20 marks)

CHIEF EXAMINER'S COMMENT

(ai&ii) Candidates were asked (i) what three (3) preconditions must be established before an audit engagement is accepted and (ii) under what two (2) circumstances will an auditor refuse an engagement. All the candidates attempted this question. Most of the marks were scored from this question. On the whole, the performance was very good.

(bi&ii) The question was on redundancy provision and contingent liability. Candidates were asked to describe the impact on the Auditor's report if any, should these remain unresolved in terms of *ISA 705 (revised); Modification of the Auditor's Opinion*. This was not well answered by candidates. Average performance.

CONCLUSION

In conclusion, the following points would assist in strengthening the examination:

- More and intensified teaching and learning by teachers and students should continue.
- A lot of mock tests should be conducted online prior to the main examinations so that all rough edges could be smoothed.
- Students should practice more past questions on their own before 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 students adequately for the

examination. In addition, other private tuition institutions must be empowered by the Institute, including online portals to assist the students.

- The Distance Learning concept must be encouraged by the Institute to help students 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.