

**NOVEMBER 2021 PROFESSIONAL EXAMINATION
AUDIT & ASSURANCE (PAPER 2.3)
CHIEF EXAMINER'S REPORT, QUESTIONS & MARKING SCHEME**

STANDARD OF THE PAPER

The standard of the paper was good. The questions were practical and within the syllabus regarding structure and weightings. The paper was free from errors. The rubrics of the paper were very clear without any ambiguities.

PERFORMANCE OF CANDIDATES

The performance of the candidates was generally mixed. The questions were within the structure of the syllabus. While others had good marks, others performed poorly. High performers were spread across some centres, and so were low performers. Some candidates exhibited a high sense of preparedness, and others were not well prepared.

Candidates performance in this diet (70.65%) was marginally below the May 2021 diet (75.11%). The high performance in the paper may be attributed to the fact that tuition providers now better appreciate the syllabus requirements and can tailor their teaching quite well to the understanding of candidates.

Question 4 was a high scoring question because it was practical and popular, especially the b) part. Question 2 even though a straightforward question, the performance was below expectation because most candidates mixed up their understanding of the substantive audit procedures for the valuation of PPEs with the valuation of inventory.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

The strength of most candidates was demonstrated in questions 1(a) and (c), 3(ai) and (c), 4(b), as well as 5(a) and (bi) because these questions were more practical and popular within the structure of the syllabus.

Areas of weaknesses identified with candidates were with questions 2(a) and 4(aii) because candidates could not adequately express their thoughts on paper due to weakness in the English language.

QUESTION ONE

- a) Traditionally, internal audit work is undertaken mainly by in-house teams. However, in recent times many organizations outsource either completely or partially their internal audit function. Kofi Krakye, the Financial Controller of BHB Ltd, has advised management to consider outsourcing their internal audit function to FPP Ltd.

Required:

Explain **TWO (2)** advantages and **THREE (3)** disadvantages of outsourcing the internal audit function to FPP Ltd. **(5 marks)**

- b) Mogya Bi Accounting Firm is the Auditors of Abronyeh Enterprise (Abronyeh), a retailer selling computers, phones and other high technology equipment. Abronyeh was set up just a year ago by its sole owner Adam Joseph. Adam Joseph has employed a number of bookkeepers to help him with accounting records and the preparation of financial statements, and the most recent one has just left. In order to start the business, Adam Joseph re-mortgaged his house and, in addition, took out a business loan. As part of the loan agreement, Adam Joseph is obliged to provide a copy of the annual financial statement.

Required:

Explain **SIX (6)** business risks that Mogya Bi Accounting Firm faces when conducting the audit of Abronyeh and explain why they could be identified as risks. **(12 marks)**

- c) Audit evidence may come in many forms. For instance, enquiries may be verbal, while confirmations may be in written form. Regardless of the form of audit evidence they obtain, auditors need to document their procedures. The process of documenting audit evidence is known as audit documentation.

Required:

Explain **THREE (3)** purposes of audit documentation in line with *ISA 230: Audit Documentation*.

(3 marks)

(Total: 20 marks)

QUESTION TWO

Hamosa Manu Hospital (HMH) is one of the government hospitals in Ghana where healthcare is free due to the National Health Insurance Scheme, as taxpayers' fund healthcare by contributing indirect tax of 2.5% on consumptions.

All purchase requisition forms for medical supplies are forwarded to a centralized procurement department. Upon receipt, the procurement team will research the lowest price from suppliers and raise a purchase order. This is then passed to the Procurement Manager, who authorizes all orders. The small procurement team receives in excess of 300 forms a day.

Due to the government's announcement of free Covid 19 testing in public hospitals, the hospital has invested heavily in new equipment, which, although very expensive, has meant that more testing could be performed and patient recovery rates would be faster. Currently, there is a shortage of appropriately trained medical staff. As a result, a capital expenditure committee has been established, made up of senior managers, and they plan and authorize any significant capital expenditure items.

Required:

- a) Explain audit risks that auditors of HMH should consider during evidence gathering. **(5 marks)**
- b) Describe **FOUR (4)** substantive procedures the external auditor of HMH should adopt to verify each of the following assertions in relation to an entity's property, plant and equipment;
- i) Valuation; **(6 marks)**
- ii) Completeness; and **(5 marks)**
- iii) Rights and obligations. **(4 marks)**

(Note: Assume that the hospital prepares Financial Statements in accordance with International Financial Reporting Standards)

(Total: 20 marks)

QUESTION THREE

- a) The International Ethics Standards Board for Accountants (IESBA) code guides all Professional Accountants on how to respond when their clients are not complying with the laws and regulations of a country or a state.

Required:

- i) State **FIVE (5)** areas where auditees can be non-compliant. **(5 marks)**
- ii) When an auditor becomes aware of non-compliant situations, what **FIVE (5)** actions can the auditor take? **(5 marks)**
- b) Ackah Senzu, had been the Finance Director of Keke Ltd for the immediate past eight years influencing all the major financial policies of the company. Last year he moved to Plus Associates, an audit firm, as a Partner. The Directors of Keke Ltd then appointed Plus Associates as their auditors because of the strong relationship with Ackah Senzu. The Senior Partner assumed the engagement responsibility of the audit of Keke Ltd but asked Ackah Senzu to review the audit work.

Required:

Discuss the threats and safeguards of this decision. **(6 marks)**

- c) Kom & Associates, an audit firm, has regularly been auditing Ake Ltd. Beginning of the current financial year, the wife of Koffie, the engagement partner of Kom & Associates,

was appointed the personal assistant to the chief executive of Ake Ltd. In the course of the fieldwork, the audit team was given lunch and money for transport by Ake Ltd.

Required:

Discuss the threats and safeguards for the audit.

(4 marks)

(Total: 20 marks)

QUESTION FOUR

- a) You are an audit intern in Transparency & Associates, a firm of Chartered Accountants. This year, one of your new clients is Obuse Ltd, a company having net assets of GH¢20,000,000. The audit work has been completed, but there is one outstanding matter you are currently investigating; the directors have decided not to provide depreciation on buildings in the financial statements, although International Financial Reporting Standards suggest that depreciation should be provided. The estimated depreciation is GH¢500,000.

Required:

- i) State **FOUR (4)** additional audit procedures and actions you should take in respect of the above matter. **(6 marks)**
- ii) What should be the impact on the audit report if the issue remains unresolved at the reporting stage of the audit? **(4 marks)**
- b) Mr William Kofi Ansah is the Founder, Chief Executive Officer and Major Shareholder of Formation Bank Ltd. He single-handedly appointed his father-in-law as board chair and three related parties as Non-Executive directors in addition to the existing five (5) Executive Directors. Rewards such as first-class tickets and large consulting contracts were granted to Directors, and compensation for the Directors were excessive and not commensurate with the Bank's performance.

There is no formal credit management policy for the Bank, and regular Board review meetings were not carried out. Large non-performing loans were granted to the related parties, which resulted in the Bank being heavily exposed. The Bank sent false monthly credit reports to the regulator, and the regulator failed to assess the report and provide prompt feedback.

The External Auditors and Regulator were treated to a high-end reception during audits and given large brown envelopes at the end of the audit. The internal audit unit is ill resourced and reports directly to the Chief Executive Officer.

Required:

Explain **FIVE (5)** corporate governance weaknesses faced by Formation Bank Ltd in relation to corporate governance principles and for each weakness identified, recommend a solution to overcome it. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) *ISA 210: Agreeing to the terms of an engagement* states that Engagement Letters are issued to serve as contracts between clients and auditors.

Required:

Justify **FOUR (4)** terms that could be included in an Engagement Letter in accordance with *ISA 210*. **(10 marks)**

- b) The partner in your firm has requested you to train the newly recruited junior audit staff on *ISA 260: Communication with those charged with governance*.

Required:

Draft a training material for the new junior recruits on the provisions set out in ISA 260 in relation to;

- i) The purpose of issuing a Management Letter to a client after an audit. **(5 marks)**
ii) The contents of a Management Letter. **(5 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

- a) Outsourcing Internal Audit is a means whereby the Internal Audit work is usually given to an Audit firm that does the external audit for the company or to another firm of accountants.

Advantages of Outsourcing of Internal Audit

- Staff recruitment – there is no need for the company to recruit and train its staff.
- Auditor Skills – the auditor is likely to have specialist staff available, such as IT experts.
- Cost and flexibility – the cost of the Internal Audit function is a viable cost rather than a fixed cost.
- Outsourcing is likely to be more economical.

(Any 2 points @ 1 mark each = 2 marks)

Disadvantages of Outsourcing of Internal Audit

- **Changing personnel** - The Internal Auditors provided by an external firm may change continually, and there may be a lack of continuity as a consequence.
- **Cost** - An Accountancy firm will charge high fees for Internal Audit Services.
- **Confidentiality** - The Internal Auditors provided by an external firm will be expected to maintain complete confidentiality about the client's affairs.
- **Control** - An entity may not have the same control over its Internal Audit work if it is outsourced.
- **Conflict of Interest** - If the entity's firm of external auditors carries out internal Audit work, there is likely going to be a conflict of interest (affecting independence and objectivity)

(Any 3 points @ 1 mark each = 3 marks)

b)

Business Risk	Reasons why these factors were identified as risk
High tech equipment like phones, computers etc.	There is a risk of obsolete inventory which need to be written down, and ultimately if the entity cannot keep up trends, the business may not be able to continue in existence
Startup business under a year	Any startup business is inherently risky, as many businesses fail in their first year.
Sole shareholder and director	There is a possibility of motivation to misstate figures.
A Turnover of bookkeepers	It indicates that there is pressure on bookers perhaps to misstate figures. There is a risk of material misstatements.

The most recent bookkeeper has just left.	Again this indicates a high risk of misstatement in the financial statements as there is currently no bookkeeper to prepare the financial statement.
Mortgage and bank loan	This gives personal motivation to misstate the figures to ensure that business will not be taken over when he defaults.

(12 marks)

c) **Purpose of audit documentation in line with ISA 230**

- It provides sufficient and appropriate records of the basis for the Auditors report.
- It also provides evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory framework.
- It enhances the quality of the audit.
- It facilitates an effective review and evaluation of the audit evidence.
- Assist the audit team in planning and performing the audit.
- Assist Supervisors in directing and supervising audit work.
- Keep records of matters of continuing significance to future Audits.

(Any 3 points @ 1 mark each = 3 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Performance by the candidates was satisfactory, especially question 1(c). However, few candidates could not identify the business risks that the firm faces when conducting the audit from the facts of the case as required in question 1(b).

QUESTION TWO

a) Audit risk is the risk that the auditor will issue an inappropriate opinion. Inherent risk consists of inherent risk, control risk and detection, which is also the risk model. **(2 marks)**

- **Inherent risk** is the susceptibility of an assertion about an account balance, a class of transaction or disclosure to misstatement that could be material before considering any related controls.
- **Control risk** is the risk that a misstatement will not be prevented, detected or corrected on a timely basis by an entity's internal control.
- **Detection risk** is the risk that the audit procedures performed by an auditor will not detect a misstatement that exists.

(3 points @1 mark each = 3 marks)

b)

i) **Valuation of property, plant and equipment (PPE):**

- Review depreciation policies for reasonableness by comparison to the prior year, industry practices, the entity's replacement policy and the profits/losses arising from the disposal of assets.
- For a sample of assets, recalculate the depreciation charge for the year and agree to the entity asset register.
- Reperform the total calculation of depreciation, considering the timing of additions and disposals, comparing this expectation to the actual charge, and investigating any significant differences.
- If any assets have been revalued during the year, then assess the reasonableness of the valuer. In particular, consider their experience, independence, work scope, and assumptions used.
- Agree the revalued amounts to a valuation report, for a sample, recalculate the revaluation surplus and agree to the revaluation reserve.
- For a sample of the new surgical equipment, additions vouch for the cost to a recent purchase invoice.

(Any 4 points @ 1.5 marks each = 6 marks)

ii) **Completeness of PPE**

- Compare the current year schedule of PPE to that of the previous year and investigate any differences.
- Reconcile the schedule of PPE with the general ledger.
- Select a sample of assets physically present at the entity's premises and inspect the asset register to ensure that these are included.
- Reperform the non-current asset register reconciliation to the general ledger and investigate any differences.
- Review the repairs and maintenance expense account in the statement of comprehensive income for items of a capital nature.

(Any 4 points @ 1.25 marks each = 5 marks)

iii) Rights and obligations of PPE

- Verify ownership of property via inspection of title deeds and land registration documents.
- For a sample of additions, agree to purchase invoices to verify invoice relates to the entity.
- Review new lease agreements to ensure that assets are correctly treated as finance or operating leases.
- Inspect vehicle registration documents to confirm ownership of motor vehicles.

(4 points @ 1 mark each = 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Most candidates found Question 2(a) a bit tricky and could not link the facts of the case to the Audit Risk Model. In addition, a few of the candidates could not understand what substantive procedures entails, especially with the valuation of property plant and equipment, and therefore mixed up with substantive procedures adopted to verify current assets, such as inventory.

QUESTION THREE

a)

i) Non-Complaint actions can be intentional or non-intentional. Some of the issues indicating non-compliance by audit clients can be as follows:

- Fraud, corruption and bribery
- Money Laundering, terrorist financing and concealing proceeds of crime
- Insider trading
- Non-compliance with the banking laws and regulations
- Non-compliance with data protection laws
- Flouting Environmental protection laws
- Disregarding Public health and safety regulations

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

ii) Actions that an auditor can take in a situation of non-compliance by an audit client are:

- Obtain an understanding of the matter
- Advise management to take appropriate and timely remedial action such as ratify, remediate or mitigate the consequence of non-compliance
- Deter the commission of the non-compliance where it has not occurred
- Disclose the matter to the appropriate authority
- Determine whether further action is needed by considering the appropriateness of management response

(5 points @ 1 mark each = 5 marks)

b) Ackah Senzu has just left the employment of Keke Ltd a year ago. It means the account being audited is his product, and the policies governing the preparation of the account were developed and implemented by him. Also, the fact that his firm was appointed Auditor of Keke Ltd indicates how strong he wields power and influence over the remaining directors of Keke Ltd.

Even though he was not engaged in the audit work, he will be reviewing his work if he reviews the audit work. That will pose a self-review threat and should not be countenanced. He will not have the independence to criticize what is against him.

Also, his review of the audit will pose a familiarity threat. He will not appropriately review any adverse findings against the directors.

The safeguard for the above is not to allow him to review the audit file. Instead, a neutral auditor who is another partner of the firm should be contracted to review the audit file.

(6 marks)

c) In the case of Kom And Associates, two issues are to be looked at:

Whether the appointment of Koffie's wife as a Personal Assistant of the Chief Executive of Ake Ltd poses any threat to the audit work of Kom and Associates, Koffie's wife position is not a senior executive position. She does not decide for the company and does not influence decisions. Instead, she organises the office of the chief executive. Her appointment, therefore, poses no threat to the audit.

With the field workers being given lunch and transport allowances, that poses self-interest threat, familiarity and intimidation. However, the inducement is minimal. Since those involved do not supervise or review the audit work, the threats will not affect the audit. Nevertheless, the firm should develop a policy and educate the staff to discourage them from accepting gratuities or benefits.

(4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Many candidates could not demonstrate their knowledge of NOCLAR, hence their inability to state five areas where auditors can be non-compliant with the laws and regulations of a country or state.

For Question 3(c), most candidates stated familiarity as a threat without considering the status of the wife of Koffie, the engagement partner, who was just a personal assistant to the CEO and cannot exert much influence. As a result, the performance of this question was quite unsatisfactory.

QUESTION FOUR

a)

- i) Audit procedures regarding non-depreciation of buildings
- Review audit file to ensure that sufficient appropriate audit evidence has been collected regarding this matter.
 - Ensure that GAAP does apply to the specific buildings owned by Objectivity Ltd and that a departure from GAAP is not needed in order for the financial statements to show a true and fair view.
 - Meet with the directors to confirm their reasons for not depreciating buildings.
 - Warn the directors that, in your opinion, buildings should be depreciated and that failure to provide depreciation will result in a modified audit report.
 - Determine the effect of the disagreement on the audit report in terms of the modified opinion being material or of pervasive materiality to the financial statements.
 - Draft the appropriate sections of the modified audit report.
 - Obtain a letter of representation from the directors confirming that depreciation will not be charged on buildings.

(Any 4 points @ 1.25 mark each = 6 marks)

- ii) If the issue remains unresolved at the reporting stage, the auditor must evaluate the impact of the misstatement on the financial statements. The estimated depreciation of GHS 500,000 represents 2.5% of the company's net assets and material to the financial statements using the total assets benchmark.

The opinion on the financial statements must be qualified with an "except for". In addition, the audit firm must include the basis for the qualification paragraph to explain the reasons for the qualification.

(4 marks)

b)

Weakness	Recommendations
Formation Bank is controlled by a dominant Chief Executive Officer and majority shareholder who could exert too much power and influence over corporate decision making.	The company should institute strong and larger independent non-executive directors, including a Chairman, to keep a check on the activities of the CEO.
The chairman of the Board is appointed by the CEO and he appears to lack independence from the CEO since he is the CEO's pastor.	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. In addition, Formation bank should appoint a separate chairman who

	meets the independence criteria set out in the codes.
Formation bank has only three non-executive directors compared with five executive directors. This means that non-executive directors comprise less than half the Board. This is not an appropriate balance to ensure that board decisions are questioned and ultimately taken in the interests of the shareholders and to prevent executives from pursuing their interests.	Formation bank Ltd should appoint five new non-executive directors so that there is an equal number of executive and non-executive directors. The non-executive directors should be let go as they lack the independence of the CEO.
There are no formal targets or reviews of board policies/performance carried out. This means that Formation Bank does not have any means to appraise directors' performance and identify training needs or poorly performing directors.	The Board should set performance targets for each director and undertake a formal and rigorous review of its performance and individual directors on an annual basis. In addition, the non-executive directors should undertake the performance evaluation of the chairman. The fact that the review takes place should also be stated in the annual report.
Excessive compensation packages and lucrative contracts given to directors which is not based on performance. It appears that the CEO is rewarding directors for their loyalty to him instead of the work done.	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(or the shareholders if required by the articles of association of the company). The remuneration policy should be fair and transparent.
Lucrative contracts are given to directors to reward loyalty to the CEO. Non-executive directors should have no involvement in the day to day activities of the company other than to provide strategic direction and monitor the activities of the executive.	Contracts should not be given to non-executive directors as this compromises their independence.
Formation Bank does not have an internal audit department. This means	Formation Bank should review the need for an internal audit department at least

<p>that there are weaknesses in how the Bank is directed and controlled as the internal audit department forms an important part of the entity's internal control system.</p>	<p>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 the Bank has an audit committee. If there is no audit committee, one should be established immediately and comprise at least three non-executive directors. The head of the internal audit should report to the audit committee.</p>
<p>Weak monitoring and supervision by both internal audit, external audit and Central Bank and poor feedback systems.</p>	<p>The regulatory environment for the Bank system as a whole must be strengthened. The performance of the Auditors should be reviewed on a yearly basis, and those not meeting quality standards should be replaced. Those taking bribe should be reported to the authorities, and prompt action should be taken against them. The Central Banks supervision unit should undertake an immediate review of all reports from the Banks, and those not complying should be sanctioned.</p>

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 4(aii), many candidates were only able to state that the auditor should issue a modified opinion, a few were confused with what the impact on the audit report should be if the issue remains unsolved at the reporting stage of the audit.

The performance for Question 4(b) was satisfactory because many candidates demonstrated their understanding of corporate governance principles, hence their ability to pick the case's weakness and make appropriate recommendations for improvement. As a result, this question was a high scoring question for many candidates.

QUESTION FIVE

a) Engagement Letters shall include the following:

Objective and scope of the audit.

It states what the audit is for, what period it is about, the extent of work etc. The rationale is to make the client aware of the output he has to expect so as not to create an expectation gap and also help him plan the likely disruption of his work by the audit.

The responsibilities of the auditor

This is what the auditor is supposed to do to achieve the agreed-upon objective. The auditor will make it clear what audit work is per the statute and the framework of the profession. The rationale is to disabuse the client's mind that audit is an all-inclusive assignment, including detecting fraud and taking decisions for management.

The responsibilities of the client

This is to make the client aware of his responsibilities, e.g. Preparation of Accounts, establishment of controls, detection of fraud etc. The rationale is to enable the client to put his house in order and account appropriately for his stewardship instead of assuming that the auditor has the responsibility to account for his resources and put in safeguards to protect his assets and help him manage his business.

Basis for fees

This term spells out the basis on which audit fees are to be charged and how they are to be paid. The rationale is to help the client know that the determination of the fees is not arbitrary but has a basis of time to spend, the number and level of staff to be engaged on the work, which are essential elements of the fees. This helps the client to arrange for the audit work to be done in good time.

Identification of the underlying financial reporting framework

Reference to the expected form and content of the audit report to be issued

(Note – What is above is not exhaustive. What is required is that the student should state the term, give brief explanation and indicate the rationale.

(Any 4 points @ 2.5 marks each = 10 marks)

b)

i) The purpose of issuing a management letter are:

- To enable the auditor to comment on the accounting records, accounting system, and related controls examined during the audit.
- Weaknesses in the Internal Control System (ICS) that have come to his attention and might lead to material errors should be highlighted and brought to management's attention.

- To afford management the opportunity to rectify ICS weaknesses which would otherwise lead to audit report qualification.
- To enable the auditor to make recommendations on ways of improving the ICS.
- To provide management with advice, e.g. suggest how resources could be utilized more efficiently.
- To communicate matters that have come to the auditor's attention that might impact future audits. E.g. introduction of a new accounting standard.
- To serve as a future reference in case of the negligence action against the auditor.
- To remind the auditor of areas that may need special attention during the subsequent audit.

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

ii) Content of management letter

- Transmittal or cover letter
- Executive summary
- Addressee
- Deficiencies
- Implication of deficiencies
- Risk rating of deficiencies
- Possible management response
- Recommendation
- Conclusion

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 5 b) ii) was poorly answered by candidates, as many could not state the exact content of a management letter. Candidates mistook it for the content of a generic report.

CONCLUSION

Some candidates showed excellent performance, as some candidates scored 80% and above in this paper. The under listed points can be used to strengthen the examination;

- More intensified teaching and learning by Tuition Providers and candidates should be continued.
- A lot of mock tasks should be conducted before the examinations so that candidates will be exposed to the approach of ICAG's professional examination questions for improved performance.
- Candidates must be encouraged to make good use of their study text and previous examinations questions so that performance in subsequent examinations will continue to improve.
- Candidates must be encouraged by Tuition Providers to improve their English language writing skills to express their thoughts well on paper in future examinations.