DECEMBER 2022 PROFESSIONAL EXAMINATIONS
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER

The standard of the paper was similar to previously administered diets. The spread of the question was appropriate and aligned with the syllabus. The paper covered every section of the syllabus. Marks allocated to questions conformed to the requirement of the syllabus and were also commensurate with the effort required for each question. The clarity of the questions was very good.

PERFORMANCE OF THE CANDIDATES

The performance of candidates was average. In a few instances candidates wrote wrong question numbers for answers provided. High and low performers were spread across centres.

QUESTION ONE

a) "Professional Skepticism is an essential concept in auditing practice and theory. It has been identified in almost all existing auditing standards. However, the way it should be characterised is still unclear" according to Maciej Ciolek (2017).

Required:

i) Explain the term ***Professional Skepticism*** within the context of the auditing profession. **(2.5 marks)**

ii) Discuss **THREE (3)** areas of audit that are complex, subjective or highly judgmental where Professional Skepticism may be important. **(7.5 marks)**

b) You are the Audit Manager in Peptom Partners, a firm of Chartered Accountants. Your role includes performing post-issuance audit quality reviews. You have been tasked to review the audit work performed on Kaaklo Plc for the financial year ended 31 January 2021. The following information was gathered from your review of the audit file:

Audit team and fees

Kaaklo Plc is a listed company operating in the construction industry. The company complies with corporate governance regulations and has an audit committee. Kaaklo Plc has been an audit client of Peptom Partners for eight years, and Kofi Sika has been the Audit Engagement Partner during this time. Kaaklo Plc's auditor's report was signed by Kofi Sika and issued last week. The report contained an unmodified opinion.

Peptom Partners requires its staff to record each hour they spend working on each client in the firm's time management system.

From reviewing the time records relating to the audit of Kaaklo Plc, you identified that Kofi Sika and the other audit team members recorded the following hours. amount of time on the audit:

Kofi Sika – Audit Engagement Partner	2 hours
Coffie – Senior Audit Manager	6 hours
Mabel – Audit Manager	35 hours
Six Audit Assistants	130 hours
Total time spent on audit	173 hours

It is apparent from your review that, almost all the detailed review of the audit working papers was completed by Mabel, who has evidenced her review by stating 'final review' on each page of the audit file. She has recently been promoted to the position of Audit Manager.

You are also aware that Kofi Sika booked a total of 40 hours to Kaaklo Plc in respect of non-audit work performed. The only information you can find in the file is that the non-audit work related to a 'special investigation', and that Kofi Sika confirms that it does not create a threat to auditor objectivity. The total fee charged for the audit was GH¢250,000 and the fee for the 'special investigation' was GH¢890,000.

Going concern

From reviewing the audit working papers, you are aware that Kaaklo Plc's ability to continue operating into the foreseeable future was identified as a significant audit risk at the planning stage of the audit due to low profit margins or losses being made on many of the company's construction contracts and increasing economic uncertainty. The company typically has 20 contracts ongoing at any time.

Most of the audit work on going concern was performed by Mary Lamptey, an audit assistant who has just written her last professional exam and is not yet qualified. The majority of the audit work performed on the going concern focused on a review of five major contracts to determine their profitability. The management of Kaaklo Plc identified the major contracts for review and provided Mary with forecasts indicating that the contracts would have little impact on profit. Mary confirmed that the assumptions used in the forecasts agreed to assumptions used in previous years and concluded that the contracts which she had reviewed support the going concern status of the company. Having reviewed these major contracts, Mary concluded that there is no significant uncertainty over Kaaklo Plc operating into the foreseeable future.

Required:
Comment on the quality of the planning and performance of the audit of Kaaklo Plc.

(10 marks)

(Total: 20 marks)

QUESTION TWO

You are the Manager responsible for the audit of Rail Expert Plc, a listed entity whose principal activity is the operation of a regional railway network. The audit for the year ended 28 February 2021 is the first year your firm is auditing Rail Expert Plc. The draft financial statements received from your client indicated a total assets of GH¢58 million and profit before tax of GH¢7.4 million. The detailed audit fieldwork has started and the audit supervisor has brought the following matters to your attention in relation to the testing of key accounting estimates:

Cash-settled share-based payment scheme
On 1 March 2020, Rail Expert Plc granted 550,000 share appreciation rights to 55 executives and senior employees of the company with each eligible member of staff receiving 10,000 of the rights. The fair value of the rights was estimated on 28 February 2020 by an external expert using an options pricing model at GH¢4.50 each. Rail Expert Plc prides itself on good employee relations and the senior management team has estimated that all 55 staff will qualify for the rights when they vest three years after the granting of the rights on 1 March 2020. The company recognised an expense of GH¢825,000 with its associated liability in the draft accounts. **(7 marks)**

Regulatory penalties
Rail Expert Plc has been subject to a review by the national railways regulator following a complaint from a member of staff with safety concerns. The regulator identified breaches in safety regulations and issued a penalty notice on 30 September 2020. Rail Expert Plc has appealed against the initial penalty payable. Negotiations with the regulator are still ongoing and the amount payable has not yet been finalised. Rail Expert Plc currently estimates that the total penalty payable as a result of the breach will be GH¢1.3 million

which it expects to repay in equal annual instalments over the next ten years with the first payment falling due on 1 March 2021. The company's draft statement of profit or loss for the current year recognises an expense of GH¢1.3 million and the draft statement of financial position includes a liability for the same amount. **(7 marks)**

Property development

Rail Expert Plc owns an industrial property which it has historically used as a maintenance depot for its engines and carriages. The company has an accounting policy of revaluing its properties to fair value and at the interim audit it was noted that the depot was recorded at a carrying amount of GH¢2.5 million in the non-current asset register. During the first week of the audit fieldwork, the audit supervisor identified a year-end journal which has uplifted the depot to a fair value of GH¢4.9 million in this year's statement of financial position as at 28 February 2021. Management has advised that this represents the estimated sales value of the building following Rail Expert Plc's plan to develop the building as a residential property. The client has confirmed that the property is suitable for conversion into residential apartments at an estimated cost of GH¢1.2 million and has negotiated secured finance for the development with their bank. The development will be subject to the payment of fees to the local council's building regulator of GH¢173,000. **(6 marks)**

Required:

Evaluate the client's accounting treatments above and state **THREE (3)** audit procedures you will undertake when auditing each of the transactions.

(Total: 20 marks)

QUESTION THREE

You are the audit manager with Kaycee & Associates, a firm of Chartered Accountants in charge of the 2021 audit of Mantemante Ltd. The issue below occurred during the audit of Mantemante Ltd.

Trade receivables

Trade receivables recognised in the company's current assets includes a balance of GH¢200,000 relating to a specific customer, Tonto Ltd. Audit procedures indicate that as at 31 December 2021, the balance was more than six months overdue for payment. In relation to this balance, the following procedures have been performed:

- Agreement of the balance to invoices and original customer order.
- Discussion with the credit controller who states that 'we are in discussions with Tonto Ltd and we are confident that some or all of the amount due to us will be paid. We have always allowed this customer extended credit terms and they have always paid eventually.'
- Tonto Ltd was included in the trade receivables direct confirmation audit procedure, whereby a sample of customers were asked to confirm their respective outstanding balance, but no reply was received.

Mantemante Ltd auditor's report is due to be issued in the next few days. Materiality for the audit of the Mantemante Ltd's financial statements has been determined to be GH¢150,000. The following information has been provided:

Supplementary information

A letter was received from Tonto Ltd's administrators on 31 January 2022, stating that Tonto Ltd is in liquidation, and that its creditors will receive a payment of 10% of the outstanding balances. The audit team has concluded that GH¢20,000 can remain recognised as a trade receivable, and that GH¢180,000 should be written off as irrecoverable. However, management of Mantemante Ltd refuses to make any adjustment, and the full GH¢200,000 remains recognised as trade receivable in the financial statements.

Extract of Draft audit report

Basis for opinion and opinion

Audit procedures indicate that trade receivables are overstated by GH¢200,000. For this reason we consider that the company's financial statements are likely to be materially misstated and do not fairly present the financial position and performance of the Company for the year ended 31 December 2021.

Emphasis of matter

We draw your attention:

The finance director obstructed our audit by refusing to allow access to audit evidence. He has also refused to adjust the financial statements in relation to the material misstatement of trade receivables, which led to the qualified audit opinion being issued. For this reason, we wish to resign as auditor with immediate effect and he is responsible for the material misstatement.

Required:

a) In respect of the trade receivables:

i) Comment on the sufficiency and appropriateness of the audit evidence obtained. **(7 marks)**

ii) Recommend the actions to be taken by the auditor, including the further evidence which should be obtained. **(3 marks)**

b) Critically appraise the extract from the draft auditor's report taking into consideration the supplementary information of Mantemante Ltd for the year ended 31 December 2021. **(10 marks)**

Note: You are NOT required to re-draft the extracts from the auditor's report.

(Total: 20 marks)

QUESTION FOUR

a) Governments, through Parliament levy and collect taxes from the Citizens of their countries. The taxes collected must be used in providing services to the citizenry. The tax payer must be assured that taxes paid are used and accounted for transparently.

Supreme Audit Institutions (SAI) are set up under their countries constitutions to carry out audits of Public funds on behalf of the citizens. According to ***INTOSAI-P 12: The Value and Benefits of Supreme Audit Institutions – making a difference to the lives of citizens***, the extent to which a SAI is able to make a difference to the lives of citizens depends on the SAI:

i) Strengthening the accountability, transparency and integrity of government and public sector entities;
ii) Demonstrating ongoing relevance to citizens, Parliament and other stakeholders; and
iii) Being a model organisation through leading by example.

Required:
Discuss **THREE (3)** principles under each of the headings (i-iii). **(10 marks)**

b) The purpose of performing preliminary engagement activities in Financial Audit in the public sector is to help ensure that the auditor has considered any events or circumstances that may adversely affect the auditor's capability to plan and perform the audit engagement to reduce audit risk to an acceptably low level.

Required:
Explain **FIVE (5)** preliminary engagement activities a Public Sector Auditor must consider in Financial Audit. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

a) The Sustainable Development Goals (SDGs) are 17 goals tackling major world issues agreed by 193 UN member states to be achieved by 2030. These goals include zero hunger, decent work and economic growth, and reduced inequalities.

Required:
Justify **FOUR (4)** reasons a company should focus on sustainable business practices in view of investor interest in SDGs. **(10 marks)**

b) Brotherlink & Associates (BLA) has been appointed as Auditors of Kontiba Ltd and Bambi Ltd. Kontiba Ltd is a small company and Bambi Ltd is an investment company whose assets and liabilities are substantial in relation to its transactions.

Required:
Discuss the audit strategy/approach BLA should adopt in auditing both companies.
(4 marks)

c) Auditors performing an audit in accordance with statutory requirements are required to issue a report that give “a true and fair view” of the Financial Statements audited.

Required:
Outline **FOUR (4)** implications of the term “***true and fair***” in an audited financial statements. **(6 marks)**

(Total: 20 marks)

SUGGESTED SOLUTION

QUESTION ONE

a)

i) Professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud and a critical assessment of audit evidence.
This means being alert to the actual circumstances of the engagement and the work being done, and to the possibility that things may not be as they appear to be on the first sight, e.g. that evidence obtained is unreliable, or may point to fraud. If an auditor is not skeptical in this way, then they may not realize that something is unusual; they may not tailor audit procedures to the actual risk at hand; or they may jump to hasty conclusions.
Professional skepticism lies at the heart of auditing both in the sense that it is part of being a competent auditor, and that it is important part of being ethically independent. **(2.5 marks)**

ii) Areas where Professional Skepticism may be important

- **Accounting estimates**
  This can include fair value accounting estimates, the use of significant assumptions by management in developing accounting estimates, and reviewing the judgements and decisions used by management for management bias in developing accounting estimates.
- **Going concern**
  The auditor should review management's assessment of going concern and whether management's plans are feasible, this being particularly important where there is a significant doubt over the entity's ability to continue as a going concern.
- **Related party relationships and disclosures**
  It can be difficult to obtain information on related parties, as knowledge may be confined to management, meaning that the auditor may have to rely on management to identify all related parties. The auditor should also be skeptical when assessing the business rationale behind related party transactions.
- **Consideration of laws and regulations**
  The auditor should be alert throughout the audit for indications that there may have been a suspected non-compliance with laws and regulations.
- **Investigation of Fraudulent activities**
  Highly complex and risk areas

(Any 3 points @ 2.5 marks each = 7.5 marks)

b) **Kaaklo plc**
A review of the information relating to the audit of Kaaklo Plc indicates many problems with how the audit has been planned and performed which imply that the audit has not been conducted in accordance with ISA 220 *Quality Control for an Audit of Financial Statements*, ISQC 1 *Quality Control for Firms that Perform Audits and*

Reviews of Financial Statements, and other Assurance and Related Services Engagements, and the IESBA *International Code of Ethics for Professional Accountants* (the *Code*).

Audit partner rotation

Kofi Sika has been acting as audit engagement partner for eight years. As Kaaklo Plc is a listed company this goes against the requirements of the *Code* which requires that an individual shall not act as the engagement partner for more than seven years. The problem is that long association of the engagement partner with the client leads to a self-interest threat to auditor objectivity, whereby the audit firm's judgement is affected by concern over losing the long-standing client. There may also be a familiarity threat due to close relationships between the audit engagement partner and management of Kaaklo Plc, meaning that the partner ceases to exercise sufficient professional scepticism, impacting on audit quality. This is especially the case given that Kofi Sika is performing additional non-audit services for the client, which will be discussed further below. Kofi Sika should be replaced as soon as possible by another audit engagement partner.

The fact that Kofi has been allowed to continue as audit partner for longer than the period allowed by the *Code* indicates that Peptom Partners does not have appropriate policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, as required by ISQC 1. The firm should review whether its monitoring of the length of time that audit engagement partners act for clients is operating effectively and make any necessary improvements to internal controls to ensure compliance with ISQC 1.

Supervision and review

Kofi Sika has booked only two hours for audit work performed on Kaaklo Plc. This is not sufficient time for the audit partner to perform their duties adequately. The audit partner is required to take overall responsibility for the supervision and performance of the audit. He should have spent an appropriate amount of time performing a review of the audit working papers in order to be satisfied that sufficient appropriate audit evidence had been obtained; this is a requirement of ISA 220. Instead it appears that most of the final review was performed by a newly promoted audit manager who would not have the necessary experience to perform this review. It is possible that there is insufficient evidence to support the audit opinion which has been issued, or that inappropriate evidence has been obtained.

There is also a related issue regarding the delegation of work. Possibly some of the detailed review of the working papers could have been delegated to someone other than the audit partner, in which case the senior audit manager kofi would be the appropriate person to perform this work. However, Pat only recorded six hours of work on the audit. Thus, confirming that too much of the review has been delegated to the junior audit manager, especially given that going concern was identified as a significant audit risk, meaning that the audit partner has even more reason for involvement in the final review of audit work.

There is also an issue around the overall amount of time which has been recorded for the audit work performed on this client. A total of 173 hours does not seem sufficient for the audit of a listed company, suggesting that audit quality could have been impacted by inadequate time spent in planning and performing the audit work.

Special investigation
Kofi Sika's focus appears to have been on the special investigation performed for Kaaklo Plc, to which he booked 40 hours of time.
There is insufficient documentation as to the nature of this non-audit work, and it could relate to the provision of a non-audit service which is not allowed for a public interest entity. Kaaklo Plc is a listed company, and the *Code* prohibits the audit firm from providing certain non-audit services, for example certain internal audit services, valuation services and tax services. The lack of documentation means that Peptom Partners could have provided a prohibited service and therefore be in breach of the *Code*.

The fact that GH¢890,000 was charged for this special investigation indicates that it was a substantial engagement and just the matter of inadequate documentation is a cause for concern. There is also a possibility that in fact no work has been performed, and the firm has accepted this money from the client but provided no service. This would be a very serious issue, could be perceived as a bribe, and it should be investigated with urgency.

However, there are also possible threats to auditor objectivity including a self-interest threat due to the monetary value of the service provided meaning that Kofi Sika's attention seems to have been focussed on the special investigation rather than the audit, leading to the problems of inappropriate delegation of this work as discussed above. His additional involvement with Kaaklo Plc by providing this work compounds the familiarity threat also discussed previously. Depending on the nature of the work performed for the client there may also be other threats to objectivity including self-review and advocacy.

A self-interest threat is created as the value of the services provided is substantial compared to the audit fee. The fact the non-audit fees are so high would create a proportionately bigger intimidation threat because they would form a larger part of the firm's income and the audit firm may not be objective for fear of losing the client.
Peptom Partners should ensure that its policies and documentation on engagement acceptance, especially in relation to additional services for existing audit clients, are reviewed and made more robust if necessary.

Engagement Quality Control Review
As this is a listed audit client, an Engagement Quality Control Review should have been performed. It is not clear whether this took place or not, but no time has been

recorded for this review. If a pre-issuance review was carried out then it should have picked up these problems prior to the audit opinion being issued.

Audit of going concern

The audit work on going concern has been inappropriately delegated to an audit assistant who would not have the necessary skill or experience. This is of special concern given that going concern was identified as a significant audit risk, and that the work involves using judgement to evaluate information relating to contract performance. The work should have been performed by a more senior member of the team, probably one of the audit managers, who is more able to exercise professional scepticism and to challenge management where necessary on the assumptions underpinning the forecasts.

It is concerning that the audit work appears to have been based on a review of contracts which were selected by management. First, only five contracts were reviewed but the company is typically working on 20 contracts at one time. So it is likely that the coverage of the audit work was insufficient, and more contracts should have been subject to review. Given the risk attached to going concern perhaps all the contracts currently being carried out should have been reviewed, or the sample selected based on the auditor's evaluation of the risk associated with each contract and their materiality.

Second, management may have selected the better performing contracts for Mary to review. This would create a false impression of the performance of the company as a whole, leading to an inappropriate conclusion on going concern being reached.

Finally, the work performed by Mary on this small selection of contracts appears insufficient and inappropriate. Assumptions should not just be agreed as consistent with the previous year, especially in a situation of increasing economic uncertainty as applies in this case. Assumptions should be challenged and other work performed as required by ISA 570 *Going Concern*. The lack of further audit procedures means that the audit evidence is not likely to be sufficiently robust in this significant area.

Audit Committee

It is concerning that the audit committee of Kaaklo Plc does not appear to have raised concerns about the issues discussed, especially the provision of the non-audit service and the length of time which Kofi Sika has served as audit engagement partner. One of the roles of the audit committee is to oversee ethical issues relating to the external auditor and to be involved with the engagement of external providers. Peptom Partners should ensure that these matters are discussed with the audit committee so that further ethical issues do not arise in the future.

Conclusion

From the discussion above it can be seen that there are many problems with the audit of Kaaklo Plc. Kofi Sika appears to have ignored his responsibilities as audit engagement partner, and the audit firm needs to discuss this with him, consider further training or possibly taking disciplinary action against him. Peptom Partners need to implement procedures to ensure all work is carried out at the appropriate level of personnel with the appropriate experience and that training is given to staff to ensure they understand the client does not pick or specify the audit work to be carried out in any area, it is to be selected by the audit team in accordance with the audit firms methodology and sampling tools.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Sub-questions a) required candidates to explain professional skepticism and identify areas where professional skepticism could be applied. Most candidates were able to explain what professional skepticism is and fairly identify its application.

For the b) part of the question, candidates were required to comment on the quality of the planning and performance of an audit from a given scenario. Candidates needed to apply their knowledge in ISA 220: Quality Control for an Audit of Financial Statements, ISQCI Quality control for firms that perform Audits and reviews of the Financial Statement and other Assurance and related services. Engagements and the IESBA International code of the Ethics for professional Accountant (the code). With the exception of the some few candidates who displayed their lack of knowledge in the above area the section was fairly well attempted by candidates.

QUESTION TWO

Treatment of accounting transactions

Cash-settled share-based payment scheme
The expense recognised this year of GH¢825,000 in respect of the cash-settled share-based payment scheme represents 11.1% of profit before tax and is therefore material to Rail Expert Plc's statement of profit or loss for the year. The related liability of GH¢825,000 which would be recognised on the statement of financial position is on the borderline of materiality to assets at 1.4%.

IFRS 2 *Share-Based Payment* requires that for cash-settled share-based payment transactions, the entity should measure the services acquired and the liability incurred at the fair value of the liability. Moreover, it states that until the liability is settled, the entity should remeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period. In the case of Rail Expert Plc, the expense and the associated liability has been calculated based on the fair value of the rights as at the reporting date and the treatment therefore complies with the requirements of IFRS 2 (GH¢4.50 x 550,000 x 1/3 = GH¢825,000).

IFRS 2 also requires that the amount recognised as an expense for cash-settled share-based payments should be based on the best available estimate of the number of awards which are expected to vest. The entity must therefore estimate the number of awards which are expected to vest. In this case, management's estimate that all 55 staff will qualify for the rights appears to be based on a perception of good historic staff relations which may be inaccurate and the expectation that none of the eligible staff will leave over the three-year vesting period may prove to be unrealistic. The predictive nature of management's estimate in this regard represents a challenge to the auditor as it is difficult to obtain reliable evidence.

The fair value estimate of GH¢4.50 is based on an options pricing models which is an example of a complex valuation model which, according to ED-540, is built on significant estimates and assumptions and is therefore challenging to audit. The initial choice of which option-pricing model to use is also a matter of judgement and whichever model is selected, it will incorporate judgemental inputs such as the current risk-free interest rate and measures of share price volatility.

Procedures:

- Obtain a copy of the contractual documentation for the share-based payment scheme and supporting file notes detailing principal terms and confirm:
  - ✓ grant date and vesting date
  - ✓ number of executives and senior employees awarded share appreciation rights to number of share appreciation rights awarded to each individual member of staff conditions attaching to the share appreciation rights.

- Perform an assessment of the appropriateness of the model used to value the share appreciation rights and confirm that it is in line with the requirements of IFRS 2.
- Obtain details of the external expert used and assess the appropriateness of their appointment by considering their professional certification, experience, reputation and objectivity.
- Perform a review of the expert's valuation including an assessment of the assumptions used in order to determine the fair value of the share appreciation rights.
- Obtain details of historic staff turnover rates obtained from the human resources department including actual data for the first year of the vesting period and consider this in conjunction with the assumptions made by management.
- Perform a review of the forecast staffing levels through to the end of the vesting period including an assessment of the reasonableness of the assumptions used and their consistency with other budgets and forecasts.
- Discuss the basis of staff retention assumptions with management and challenge their appropriateness.
- Perform sensitivity analyses on both the valuation model and the staffing forecasts.

Appropriate accounting treatment = 4 marks
Appropriate audit procedures performed = 3 marks

Regulatory penalties

The expense recognised in this year's statement of profit or loss for the year of GH¢1.3 million is material to both profit (17.6%) and assets (2.2%). According to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the fine should be measured at its present value at the reporting date. IAS 37 states that where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation and that the discount rate used in the calculation should be a pre-tax rate which reflects current market assessments of the time value of money and the risks specific to the liability. The cash flows for the repayment of the fine over the ten years should therefore be discounted at an appropriate rate to present value as at 28 February 2021.

The audit of the provision represents a challenge for the auditor in a number of respects. First, it is difficult to estimate the amount payable as it has not yet been finalised and the amount currently recognised is an estimate based on management's judgement. These difficulties are compounded by IAS 37 requirements to measure the provision at present value. The measurement process therefore also requires management to predict the payment dates and to identify an appropriate pre-tax rate to be applied as the discount factor. Both of these will require a significant level of management judgement which will be a challenge for the auditor to obtain sufficient relevant and reliable evidence on. Moreover, there is also the possibility of other provisions being needed in relation to the costs of remedying the safety issues which the regulator has identified and in relation to other potentially unidentified safety problems. Here, addressing the completeness assertion will represent a key challenge to the auditor as it is inherently difficult to predict all of the costs to be incurred in the future especially when they have not yet been determined.

Procedures:

- Obtain a copy of the regulator's notice detailing the date of the issue and any indication of the amount of the penalty to be paid by Rail Expert Plc.
- Obtain a copy of any draft instalment agreement detailing the timing and amount of each repayment.
- Review Rail Expert Plc's correspondence with the regulator for evidence of the amount payable and details of the repayment schedule.
- Confirm to post year-end cash book and bank statements if any amounts have been paid after the year end.
- Inspect Rail Expert Plc's correspondence with its lawyers in order to ascertain current status of negotiations and the views of its legal advisers.
- Review Rail Expert Plc's cash flow statements and forecasts in order to assess the company's ability to pay the instalments.
- Enquire of management in relation to the current status of the negotiations; the need to measure the provision at present value and their non-compliance with IAS 37 (i.e. their failure to measure the provision at present value).
- Review the board minutes for evidence of management's discussion of the penalty, any planned remedial action to address safety issues and any other possible safety issues.
- Discuss with management the need for the company to perform a calculation of the present value of the provision (including identification of an appropriate discount rate).

Appropriate accounting treatment = 4 marks
Appropriate audit procedures performed = 3 marks

Property development
The proposed valuation of the property at GH¢4.9 million represents 8.4% of assets and is material to Rail Expert Plc's statement of financial position as at 28 February 2021. According to IFRS 13 *Fair Value Measurement*, the fair value measurement of a non-financial asset should take into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant who would use the asset in its highest and best use.

The audit of the property development will be challenging for the auditor first because judgement will be required in order to identify the property's highest and best use per IFRS 13. The auditor must ensure, for example, that the valuation is compared to the property's fair value in its existing use as well as in any other potential uses. Indeed, there may be other potential uses which have not been considered.

IFRS 13 also states that the highest and best use of a non-financial asset such as a property must be:

- physically possible: this will therefore require independent expert confirmation that the conversion can be successfully undertaken;
- legally permissible: this will require obtaining confirmation of formal permission from the local planning authority; and
- financially feasible: this will require a detailed assessment of whether Rail Expert Plc will have sufficient cash flows in order to fund the development through to completion to complete development.

Overall therefore, the auditor will need extensive audit evidence, much of it from third parties, in order to confirm management's judgement that conversion into residential apartments represents the highest and best use of its former maintenance depot.

According to IFRS 13, when considering alternative uses for non-financial assets, the valuation should include all costs associated with the alternative uses. Hence, if the proposed development does represent the highest and best use of the property, the valuation should be adjusted for all of its associated costs. The proposed valuation at GH¢4.9 million is not therefore in compliance with IFRS 13 and on the basis of the information available, the valuation should be GH¢3,527,000
(i.e. GH¢4.9 million – GH¢1.2 million – GH¢173,000). If the additional costs are fairly stated therefore, the property is currently overstated by GH¢ 1.373 million (GH¢4.9 million – GH¢3,527,000). The auditor will, however, need external confirmation of the GH¢173,000 in fees from the local building regulator and will also need to obtain sufficient appropriate audit evidence that the conversion costs of GH¢1.2 million are fairly stated. The conversion costs will present a particular challenge to the auditor as they will be based on the estimation of industry experts and the amounts will be inherently uncertain. There may be unforeseen additional costs payable to complete the conversion which will be difficult for the auditor to identify and quantify.

Procedures:

Appropriate accounting treatment = 3 marks
Appropriate audit procedures performed = 3 marks

(Total: 20 marks)

EXAMINER'S COMMENTS

This question required candidates to evaluate the client's accounting treatment of three transactions. The question required knowledge in IFRS 2: Share – based payment, IAS 37: Provisions, contingent liabilities and contingent assets and IFRS 13: Fair value measurement. Some candidates exhibited some knowledge in the above standards but lacked the ability to sufficiently apply them in answering the question. Other candidates however, displayed a complete lack of knowledge in the standards.

QUESTION THREE

a) **Trade receivables**

i) **Sufficiency and appropriateness of audit evidence obtained**

The trade receivable is material to the financial statements of the company and currently there is not sufficient, appropriate audit evidence to determine whether the amount should remain recognised within current assets. The company's financial statements could be materially misstated if any necessary reduction in value is not recognised.

Agreeing the balance to invoices and order forms may provide evidence of existence but it does not provide evidence on the recoverability of the balance. Including the balance owed by the customer in the direct confirmation sample was appropriate given the materiality of the amount involved, but again this would not indicate the recoverability of the balance, even if the customer had replied, so additional procedures would have always been required. Therefore, there does not appear to be appropriate audit evidence to confirm the valuation of the trade receivable.

Discussing the situation with the credit controller will provide some relevant background information, but on its own it is not sufficiently robust evidence to support the continued recognition of the balance.

(7 marks)

ii) Further evidence should be obtained including:

- Any written correspondence between Liability Ltd and Prosperity Ltd, the client indicating the measures which the Prosperity Lt has taken to attempt to recover the debt, and the response from the customer.
- Search public registers for evidence of whether the customer has been placed in administration or receivership at the Registrar General's Department, this will indicate the need for an impairment review if it is listed.
- Review of post year-end cash receipts for any amounts received from the customer.

(3 points @ 1 mark each =3 marks)

b) **Critique of auditor's report**

Headings and structure

The report should not have the opinion and basis for opinion combined in one paragraph. The report should start with the opinion paragraph, which is then followed by the basis opinion.

In addition to separating out the paragraphs, they should be given appropriate headings. According to **ISA 705** ***Modifications to the Opinion in the Independent Auditor's Report***, when the opinion is modified, the heading should be used to denote the type of modification which is being made to the opinion – in this case the title 'Qualified opinion' seems most appropriate. The basis opinion paragraph should be headed 'Basis qualified opinion'.

Qualified opinion
The qualified opinion paragraph should be worded differently. According to ISA 705, when the opinion is modified the following wording should be used 'except for the effects of the matter(s) described in the Basis Qualified Opinion section, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of)…'.
The draft opinion paragraph uses different wording – in particular, using the phrase 'the financial statements are likely to be materially misstated' does not indicate that a firm conclusion has been reached, and could give users of the report some doubt as to the credibility of the auditor's opinion.

Basis for qualified opinion
This paragraph should contain further information on the reasons for the modification including a description and quantification of the financial effects of the material misstatement. In this case, the paragraph should refer to the overstatement of trade receivables of GH¢180,000, and the overstatement of profit by the same amount. Currently, the paragraph refers to an overstatement of GH¢200,000, which contradicts the conclusion based on audit evidence.

Emphasis of matter paragraph
According to **ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report***, an emphasis of matter (EOM) paragraph is used when the auditor considers it necessary to draw users' attention to a matter which is of such importance that it is fundamental to users' understanding of the financial statements. The matter discussed in the EOM paragraph must be properly presented and disclosed in the financial statements.

The draft auditor's report includes an EOM which is being used to discuss this matters, which is not appropriate for inclusion in an EOM. The EOM refers to the difficulties encountered in the audit of trade receivables due to the finance director refusing to allow full access to necessary sources of evidence. This matter should not be reported to shareholders in the auditor's report. The appropriate method of reporting is to those charged with governance of the Company, as required by ISA 260 *Communication With Those Charged With Governance*. ISA 260 requires the auditor to communicate to those charged with governance regarding a range of matters, including significant difficulties, if any, encountered during the audit.

Related to this, stating that it is the finance director personally who is responsible for the material misstatement and hence the modification of the auditor's opinion is not professional and could raise further legal problems, for example, the finance director could accuse the audit firm of making false statements or defamation of character.

In addition, referring to the potential resignation of the audit firm anywhere in the auditor's report is not appropriate. This matter should be discussed with those

charged with governance who will then take the matter up with the Company's shareholders.
(2.5 marks each for any four valid points made)

(10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
Question three a) was in relation to a scenario on trade receivables. It required candidates to comment on the sufficiency and appropriateness of audit evidence obtained. Same candidates tried to explain the meaning of sufficiency and appropriateness of audit evidence rather than relating to the context of the scenario. Despite this, the question was fairly answered by candidates.

The b) part of the question required candidates to critically appraise an extract from a draft auditors report taking into consideration a supplementary information for the year ended 31 December 2021. Some candidates' answers were on audit work to be performed (ie audit procedure) rather than comments on the draft audit report. Candidates knowledge in ISA 705: Modifications to the opinion in the Independent Auditor`s Report, ISA 706 Emphasis of matter paragraphs and other matter paragraphs in the independent auditor`s report, ISA 260: Communication with those charged with governance is required to sufficiently answer the question.

QUESTION FOUR

a) The Principles are grouped under three main headings.

i) Strengthening the accountability, transparency and integrity of government and public sector entities

Principles:

- Safeguarding the independence of SAIs – ensuring that the operations of the SAI's are out of government control.
- Carrying out audits to ensure that government and public sector entities are held accountable for their stewardship over, and use of, public resources.
- Enabling those charged with public sector governance to discharge their responsibilities in responding to audit findings and recommendations and taking appropriate corrective action.
- Reporting on audit results and thereby enabling the public to hold government and public sector entities accountable.

ii) Demonstrating ongoing relevance to citizens, Parliament and other stakeholders

Principles

- Being responsive to changing environments and emerging risks.
- Communicating effectively with stakeholders.
- Being a credible source of independent and objective insight and guidance to support beneficial change in the public sector.

iii) Being a model organization through leading by example

Principle

- Ensuring appropriate transparency and accountability of SAI.
- Ensuring good governance of SAIs.
- Complying with the SAI's Code of Ethics.
- Striving for service excellence and quality.
- Capacity building through promoting learning and knowledge sharing.

3 Marks each for any of the three areas
1 Mark for presentation

(10 marks)

b) In the context of private sector audit, the auditor conducts an assessment as to whether the audit engagement can be accepted or whether there are any professional reasons why it cannot. There is also a practice, where applicable, of obtaining professional clearance from the previous auditor before accepting the engagement. In the public sector, however, the SAIs are bound by their legislation and other relevant laws and regulations to conduct the financial audit of entities mandated for audit. Therefore, not accepting the engagement will be a very rare situation in a public-sector audit.

The financial audit process commences with pre-engagement activities. The purpose of conducting the pre-engagement activities is, among others; to see whether the preconditions for audit exist, such as an acceptable financial reporting framework, an understanding of its responsibilities by management, etc.

A Public auditor must consider the following factors before undertaking any audit.

- Mandate for the audit to be performed – Whether the institution have the mandate to perform the audit or the assignment given? Is the audit sanctioned by the constitution, any legislation, and law or requested by the executive or legislature?
- Annual Plan – It is considered in the annual plan of the Auditor unless it is a request by the executive or legislature, or unexpected assignment of great importance.
- Identify the institution to be audited – Where the auditor is to make a choice of institution to be audited he must identify the institution or the assignment to be audited.
- Assess whether pre-conditions for audit for the institution are present – proper accounting frame work are being used.
- Assess the competency of the staff to be used – with the view of attaining the objective of the audit.
- Assess the auditor's ethical code of conduct and declaration of the conflict of interest of staff to be engaged in the audit.
- Assess ethical threats and safeguards of staff in relation to the audit.
- Agree on the terms of audit engagement with management or those charge with governance.
- Form the audit team and brief them on the assignment to be undertaken, giving them the overview of the nature, scope and the timing of the assignment
- Conduct audit entry conference
- Pre-engagement activities review and sign off by Audit engagement supervisor

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Candidates were examined on INTOSAI–P I2: The values and benefits of Supreme Audit Institutions - making a difference to the lives of citizens. Candidates were asked to discuss three (3) Principles under each of the three headings. With the exception of some few candidates who misplaced principles under the headings, the question was fairly well answered.

The b) part required candidates to explain five preliminary engagements activities a public section auditor must consider in Financial audit. Candidates performance in this question was very good.

QUESTION FIVE

a) The Sustainable Development Goals (SDGs) apply to all countries and set the priorities for governments. Demographic and social change, shifts in global economic power, urbanisation, climate change, resource scarcity, inequality and technological breakthroughs demand a corporate response. The SDGs can provide insights for companies on how they can create economic, social and environmental value for their investors and other stakeholders. The goals will allow business to understand and better respond to the risks and opportunities created by rapid change across the various sectors.

There is increasing interest by the investors in understanding how businesses are developing SDGs. Investors seek information on the relevance of the SDGs to overall strategies, and thus entities providing relevant SDG data will help investors make informed decisions which can lead to capital being channeled to responsible businesses. Companies are developing business strategies that embrace the growth potential of responsible environmental and societal policies.

Investors realise that the SDGs will not all be equally relevant to all companies, with boilerplate disclosures having little relevance at all. Good disclosure will qualitatively show how the company's SDG related activities affect the primary value drivers of the business. It would be natural to assume that SDG reporting should be based around the disclosure of information to mitigate business risk and the drive for improved predictability of investment decisions. However, if there is to be fair presentation, then there should also be disclosure of any negative and positive impacts on society and the environment

Investors' expectations will still be focused on companies realising their core business activities with financial sustainability as a prerequisite for attracting investment. However, institutional investors have a fiduciary duty to act in the best interests of their beneficiaries, and thus have to take into account environmental, social and governance (ESG) factors, which can be financially significant. Companies utilising more sustainable business practices provide new investment opportunities.

Investors screen companies as regards their ESG policies and integrate these factors into their valuation models. Additionally there is an increased practice of themed investing, whereby investors select a company for investment based upon specific ESG policy criteria such as clean technology, green real estate, education and health. Investors are increasingly factoring impact goals into their decision making whereby they evaluate how successful the company has been in a particular area for example, the reduction of educational inequality. This approach can help optimise financial returns and demonstrate their contribution to the SDGs through their portfolios. Investors are increasingly incentivised to promote sustainable economies and markets to improve their long-term financial performance.

Institutional investors realise that environmental events can create costs for their portfolio in the form of insurance premiums, taxes, and the physical cost related with disasters. Social issues can lead to unrest and instability, which carries business risks which may reduce future cash flows and financial returns.

Investors seek SDG information produced in line with widely-accepted recommendations. The Global Reporting Initiative (GRI) and the UN Global Compact amongst others, have developed guidance documents that mutually complement each other and create a reference point for companies.
For investors, it is important that SDG-related reporting is presented in the context of the strategy, governance, performance and prospects of the entity. Stakeholders should be engaged from the beginning in order to identify any potential impact with some investors expecting companies to have a stakeholder dialogue that goes beyond financial matters. Investors often require an understanding of how the entity feels about the relevance of the SGDs to the overall corporate strategy, and this will include a discussion of any risks and opportunities identified and changes that have occurred in the business model as a result.

The SDGs and targets are likely to present some of the greatest business risks and opportunities for companies who should publish material SDG contributions, both positive and negative, as part of their report. For example, an inability to address negative social and environmental impacts may also be directly detrimental to short-term financial value for a business. Investors are increasingly seeking investment opportunities that can make a credible contribution to the realisation of the SDGs.
However, if an investor wants to have a positive impact on working conditions for example, they cannot assume that any investment in this area is relevant. The investor would need to be provided with additional information such as data on the lowest income workers, any potential income increase and how confident the company is that an increase in income will occur.
Investors can choose not to invest in, or to favour, certain investments. Alternatively, they can actively engage in new or previously overlooked opportunities that offer an attractive impact and financial opportunity, even though these may involve additional risk.

There is an assumption that the disclosure of ESG factors will ultimately affect the cost of capital; lowering it for sustainable businesses and increasing it for non-sustainable ones. It may also affect cash flow forecasts, business valuations and growth rates. Investors employ screening strategies, which may involve eliminating companies that have specific features, for example, low pay rates for employees and eliminating them on a ranking basis. They may also be eliminated on the basis of companies who are contributing or not, to a range of SDGs and targets. Investors will use SDG-related disclosures to identify risks and opportunities on which they will, or will not, engage with companies. Investors will see potential business opportunities in those companies that address the risks to people and the environment and those companies that develop new beneficial products, services and investments that may mitigate the business risks related to the SDGs.

SUMMARY OF POINTS

Reasons why companies should focus on sustainable business practices include:

- the increased future government focus on sustainable business;
- such business practices often improve performance as they lower operational, reputational and regulatory risk;
- there significant business growth opportunities in products and services that address the SDG challenges;
- the fact that short term profit based models are reducing in relevance, companies and their stakeholders are changing how they measure success and this is becoming more than just about profit.

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

b) The Audit Strategy/Approach that BLA could adopt in auditing both companies is the **statement of Financial Position approach**. This is an approach to the audit based wholly on substantive testing. However, with this approach the auditor concentrates primarily on:
Testing balances, as opposed to
Testing balances and transactions

This approach is based on the following accounting equation:
Opening net assets + Profit for the year = closing net assets
The theory is that if the opening and closing statements of financial position are "correct" then the profit for the year must also be correct.

(4 marks)

c) The term "True and Fair" on an audited Financial Statements imply;

- Compliance with any relevant legislation and accounting standards.
- The use of accurate figures or best possible estimates.
- Meaningful presentation and disclosure of information.
- The avoidance of bias, distortion and manipulation of figures.
- No concealment of material information.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Question five a) required candidate to justify why a company should focus on sustainable business practices in view of investor interest in SDGs. Candidates knowledge in The Sustainable Development goals were required to sufficiently answer the question. This question was well attempted by some candidates.

Five b) required candidates to discuss audit strategy / approach for small companies and investment companies. Most candidates could not specify the audit strategy / approach appropriate for each of the organisations.

The c) part of the question required candidates to outline the implication of "True and fair" in an audited financial statement. This question was well answered by candidates.

CONCLUSION

Candidates must study the principles of Auditing with understanding so that they can apply them in answering questions. Candidates must understand the various International Standards of Auditing (ISAs) very well in order to apply them where necessary in answering questions.