# MARCH 2023 PROFESSIONAL EXAMINATIONS
# ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
# CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

## STANDARD OF THE PAPER

Appropriate verbs were used in setting the questions. They include, discuss, comment, recommend, analyze, differentiate, evaluate, and explain. The standard of the paper is acceptable. The paper covered all sections of the syllabus.

## PERFORMANCE OF THE CANDIDATES

The general performance was encouraging. Some candidates recorded the page numbers in the space provided for question numbers. In certain cases, it appeared that candidates did not take their time to understand the requirements of the question, resulting in candidates providing answers to certain questions that completely deviated from the requirement.

The performance in the March 2023 diet of 43.81% pass rate was almost the same as that of December 2022 pass rate of 43.03%.

**QUESTION ONE**

a) A conflict of interest is a situation in which a person or organisation is involved in multiple interests, financial or otherwise, and serving one interest could involve working against another. However, due to the difficulty involved in identifying a conflict of interest situation, you could engage in a conflict without realising it.

**Required:**
Discuss **FOUR (4)** strategies you would recommend to Management to help mitigate or prevent a conflict of interest situation at the workplace. **(10 marks)**

b) You are a Senior manager in Bintu & Associates, a firm of Chartered Accountants which offers a range of assurance services. You are responsible for the audit of Mmatan Ltd, a company which provides approximately 10% of your firm's practice income each year. The Finance Director of Mmatan Ltd has recently contacted you to provide information about another company, Kita Ltd, which is looking to appoint a provider of assurance services.

An extract from an email received from the Finance Director of Mmatan Ltd to you is stated below:
'One of my friends, Mr. Preprah, is the Managing Director of Kita Ltd, a small company which is seeking to expand in the next few years. I know that Mr. Preprah has approached the company's bankers for GH¢6 million to finance the expansion. To support this loan application, Mr. Preprah will need to present its audited Financial Statements, hence the need for an Auditor immediately. Mr. Preprah is also in need of a firm to provide tax planning advice and also to prepare both the company's and his personal tax computations for submission to the tax authorities. In this regard, I have asked Mr. Preprah to contact you, and I hope that Bintu & Associates will be able to provide these services to Kita Ltd for a low fee. If the fee you suggest is too high, and unacceptable to Mr. Preprah, then I will recommend that Mr. Preprah approaches Kwateng & Associates instead. Should the arrangement with Kita Ltd not go through, then Mmatan Ltd would also advice itself'.

Kwateng & Associates is a firm of Chartered Accountants which has an office in the same town as Bintu & Associates. The company is owner-managed, with the Mr. Preprah family owning 90% of the share capital. Mr. Preprah is a director and majority shareholder of three other companies. An article in a newspaper from several years ago about Mr. Preprah indicated that one of his companies was once fined for breach of employment law and that he had used money from one of the company's pension funds to set up a business abroad, appointing his son as the Managing Director of that business.

**Required:**
Discuss the ***ethical issues*** and ***other matters*** which should be considered in relation to Bintu & Associates's potential acceptance of Kita Ltd as its client. **(10 marks)**

**(Total: 20 marks)**

## QUESTION TWO

a) You are an Audit Manager in Aboto & Associates, responsible for the audit of the Obina Group (the Group). You are reviewing the audit working papers for the consolidated financial statements relating to the year ended 31 March 2021. The Group specialises in the wholesale supply of steel plate and sheet metals. The draft consolidated financial statements recognise revenue of GH¢7,670 million (2020 – GH¢7,235 million), profit before taxation of GH¢55 million (2020 – GH¢80 million) and total assets of GH¢1,560 million (2020 – GH¢1,275 million). Aboto & Associates audits all of the individual company financial statements as well as the Group consolidated financial statements. The Audit Senior has brought the following matters, regarding a number of the Group's companies, to your attention:

**Fuga Plc**
The Group purchased 40% of the share capital and voting rights in Fuga Plc on 1 May 2020. Fuga Plc is listed on the Ghana Alternative Market. The Group has also acquired options to purchase the remaining 60% of the issued shares at a 10% discount on the market value of the shares at the time of exercise. The options are exercisable in 18 months from 1 May 2021. Fuga Plc's draft financial statements for the year ended 31 March 2021 reveals revenue of GH¢ 90 million and a loss before tax of GH¢ 12 million. The Group's Finance Director has recognised Fuga Plc as an associate in this year's group accounts and has included a loss before tax of GH¢ 4.4 million in the consolidated statement of profit or loss. **(7 marks)**

**Bavi Plc**
Bavi Plc is a foreign subsidiary whose functional and presentational currency is the same as Obina Plc and the remainder of the Group. The subsidiary specialises in the production of stainless steel and holds a significant portfolio of forward commodity options to hedge against fluctuations in raw material prices. The local jurisdiction does not mandate the use of IFRS and the Audit Senior has noted that Bavi Plc follows local GAAP, whereby derivatives are disclosed in the notes to the financial statements but are not recognised as assets or liabilities in the statement of financial position. The disclosure notes includes details of the maturity and exercise terms of the options and a directors' valuation stating that they have a total fair value of GH¢6.1 million as at 31 March 2021. The disclosure notes states that all of the derivative contracts were entered into in the last three months of the reporting period and that they required no initial net investment. **(6 marks)**

**Kontomo Plc**
Kontomo Plc is a long-standing subsidiary in which the Group parent has a direct holding of 80% of the equity and voting rights. Audit work on revenue and receivables at Kontomo Plc has revealed sales of aluminium to its parent company in March 2021 amounting to GH¢77 million which have been recorded in the subsidiary's financial statements. However, the audit procedures have identified that, the receipt of aluminium was not recorded by the parent company until 2 April 2021. The group has made no adjustment for this transaction in the draft consolidated financial statements. Kontomo Plc makes a 10% profit margin on sale of aluminium. **(7 marks)**

**Required:**
Comment on the matters to be considered and the audit evidence you should expect to find during your review of the Group audit working papers in respect of each of the issues raised above.

**(Total: 20 marks)**

## QUESTION THREE

a) You are the manager responsible for the audit of Alpha Ltd, a listed company specialising in the manufacture and installation of sound-proof partitions for domestic and industrial buildings. You are currently reviewing the draft auditor's report on the company's financial statements for the year ended 31 March 2022. Extracts from the draft auditor's report are shown below:

**Independent auditor's report to the shareholders and directors of Alpha Ltd**
**Basis for opinion**
We conducted our audit of Alpha Ltd (the Company) in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the ethical requirements which are relevant to our audit of the financial statements in the jurisdiction in which the Company operates, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Opinion**
We have audited the financial statements of Alpha Ltd, which comprises of the statement of financial position as at 31 March 2022, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 March 2022, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Material uncertainty regarding going concern**
The Company is financed by a long-term loan from its bankers which is due for redemption in August 2022. At the date of this auditor's report, the Company is in the process of renegotiating the loan but has not yet reached a final agreement with its bankers. It is our view that the loan finance is essential to the continued survival of the Company and that at the time of reporting, therefore, the absence of a finalised agreement represents a material uncertainty regarding going concern. The financial statements have been prepared on a going concern basis but do not make any reference to the loan redemption or the ongoing negotiations with the bank. As the external auditor therefore, we are fulfilling our duty by bringing the matter to the attention of users of the financial statements.

**Other information**

The Company's principal activity is the manufacture and installation of sound-proof partitions for domestic and industrial buildings. The Company therefore engages in long-term contracts which are incomplete at the reporting date and which are material to its revenue figure. The installation process is complex and significant judgement is applied in assessing the percentage of completeness which is applied to calculate the revenue for the year. The significance of this judgement requires us to disclose the issue as other information which is relevant to the users of the financial statements.

**Required:**

Comment on the issues raised in the extract from the draft auditor's report for the year ended 31 March 2022.

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

**(10 marks)**

b) Your firm, Lardi & Associates, has asked you to perform an independent review of the working papers of Adorko Plc which is a listed entity and has been an audit client of your firm for the last ten years. The audit fieldwork is almost complete and as part of your review, you have been asked to advise the audit team on the drafting of their report to those charged with governance. Adorko Plc is a discount food retailer which operates 85 stores nationwide.

Below is an extract of the financial statements for the period:

| | 2022<br>GH¢ million | 2021<br>GH¢ million |
|---|---|---|
| Revenue | 247 | 242 |
| Profit before tax | 14.6 | 14.1 |
| Total Assets | 535 | 321 |

After a period of rapid expansion, 2022 has been a year in which Adorko Plc has strengthened its existing position within the market and has not acquired any additional stores or businesses. The company's draft statement of financial position for 2022 includes a property portfolio of GH¢315 million all of which are legally owned by the entity. In the current year, the company has chosen to adopt a policy of revaluing its property portfolio for the first time and this is reflected in the draft figures for 2022. The audit work on property, plant and equipment included testing a sample of the revaluations. Lardi & Associates requested at the planning stage that independent, external valuation reports should be made available to the audit team at the start of the final audit visit. A number of these documents was not available when requested and it took three weeks for them to be received by the audit team. The audit working papers also identified that on review of the non-current asset register, there were four properties with a total carrying amount of GH¢11.1 million which had not yet been revalued and were still recorded at depreciated historic cost.

The audit supervisor's review of Adorko Plc's board minutes identified that the company has renovated seventeen car parking facilities at of its stores which has resulted in a significant increase in customer numbers and revenue at each of these locations. The total cost of the renovation work was GH¢ 13.2 million and has been included in operating expenses for the current year. The audit file includes a working paper recording discussions with management which confirms that capital expenditure authorisation forms had not been completed for this expenditure.

You are aware that your firm had intended to replace the current engagement partner, Mr. Kunta, with Mr. Barima who is Lardi & Associates's other specialist in food retail. Unfortunately, Mr. Barima was taken ill earlier in the year and will not now be available until next year's audit engagement. As a result, 2022 is the eighth consecutive year in which Mr. Kunta has acted as engagement partner.

**Required:**
From the information provided above, recommend the matters which should be included in Lardi & Associates's report to those charged with governance, and explain the reason for their inclusion. **(10 marks)**

**(Total: 20 marks)**

## QUESTION FOUR

a) Internal Auditing has assumed great importance as a tool of accountability in organisations both public and private. Internal auditors being employees of the organisation they audit, do not enjoy the protection they need to operate independently. There arose the need for an independent regulatory and supervisory authority to give professional direction and protection to internal auditors to do their work without undue interference. It was for those reasons that the Internal Audit Agency was established as a supervisory authority to regulate the practice of Internal Auditing in the Public Sector.

**Required:**
Discuss the impact of Internal Audit Agency on MDAs, MMDAs and Government Agencies since its establishment in Ghana. **(10 marks)**

b) In his mid-year assessment of the national budget, the Minister of Finance made a suggestion that outsourcing of government payroll might be considered. The assurance of cost was the primary factor. A biometric exercise carried out by SSNIT in April 2017 made sure that 27,000 "ghost" names were found and taken off the government payroll.

**Required:**
i) Discuss the effects of payroll outsourcing in this stance. **(5 marks)**
ii) Analyse what the service user auditor must do in the course of his duties when the outsourcing programme is implemented. **(5 marks)**

**(Total: 20 marks)**

## QUESTION FIVE

a) The Central Bank of Ghana (BoG) is mandated to ensure the smooth running of the banking system. Over the years, Bank of Ghana has taken pride in enforcing stricter regulation and supervision. In this regard, the BoG formulated the Banks and Specialised Deposit Taking Institutions Act, Act 930 in 2016, which empowers it to be more aggressive in dealing with deviations in the sector. The BoG, aside instituting regulations, undertook a clean-up of the financial sector. This saw the number of universal banks drop from 30 at the beginning of 2018 to 23, as at the end of December 2018. These 23 universal banks were able to meet the minimum capitalisation requirement of GH¢ 400 million by the end of December 2018 (BoG, MPC reports, 2018).

Major corporate failures worldwide have dented investor confidence as well as raised several questions on the effectiveness of a firm's internal control system and the corporate governance structures and also poor risk management especially for banks. Bank of Ghana in addressing collapse of Rural Banks and the risk management gap of the rural banking space introduced the Risk Management Guidelines for Rural and Community Banks in May 2021.

**Required:**
Evaluate **FIVE (5)** of the responsibilities of the Board for risk management of rural banks.
**(10 marks)**

b) You are the audit manager in charge of the audit of Sandy Snacks, a company which runs a chain of snack bars operating in a number of beach holiday resorts. Your firm has been the auditor for a number of years and has always had to substantively test cash sales because of a lack of control over the recording of takings. The auditor's reports to date have been unmodified.

You have recently been informed that the company has taken on a newly qualified chartered accountant as chief internal auditor and an unqualified assistant internal auditor. Since their appointment half way through the year ended 31 December 2022 the two have spent most of their time carrying out substantive procedures on cash sales.

The directors are hopeful that your audit fee this year will decrease because you will be able to use the work carried out by the internal auditors.

**Required:**
Explain the issues that will be relevant to your firm in deciding whether you can use the work performed by the internal auditors. **(6 marks)**

c) An auditor's report may include an 'emphasis of matter' paragraph and/or an 'other matter' paragraph. These types of paragraph are the subject of ***ISA 706*****:** ***Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report***. The purpose of these paragraphs is to provide additional communication in the auditor's report.

**Required:**
Differentiate between the '***emphasis of matter****' paragraph and '****other matter****' paragraph* citing **ONE (1)** circumstance in each case. **(4 marks)**
**(Total: 20 marks)**

**SUGGESTED SOLUTION**

**QUESTION ONE**

a) Strategies to recommend to Management to help mitigate or prevent a conflict of interest situation at the workplace:

**Review the employee handbook:** Most organizations dedicate a section of the employee handbook to describing what a conflict of interest is for the organization, how you can avoid them, and what the consequences are if you knowingly engage in a conflict. You may also find this information in a company's code of conduct or a non-disclosure agreement.

If you want to perform an action in the workplace or make a decision and you are unsure if your employer will consider it a conflict, consider asking your Human Resources representative or manager first.

**Attend business ethics training:** If your company offers a training on business ethics, consider signing up. This training can provide even more knowledge about conflicts of interest in the workplace. You may hear about more scenarios that can help guide you in future situations, helping you understand what constitutes a conflict of interest and, more importantly, what you can do about your situation if you conflict with interest.

**Report conflicts of interest:** If you know that a coworker or manager is engaging in a conflict of interest, consider taking the appropriate steps as outlined in your employee handbook. This may include approaching the individual and discouraging the behavior or making them aware that their actions are a conflict of interest.

Otherwise, most organizations ask that you inform human resources of any questionable activities so they can investigate. By taking this action, you comply with the company's code of conduct and possibly preventing future conflicts in the workplace.

**Disclose:** One of the best ways to prevent conflicts of interest is by disclosing your relationships and potential conflicts with management or human resources. They should be able to guide you in what you can do or should be doing to prevent conflicts from occurring.

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

b) Ethical and other matters to be considered before accepting Kita Ltd as a client of the firm:

Requirements and guidance relevant to accepting and continuing client relationships is contained in ISQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements. The fundamental requirements are that a firm must consider:

- Its competence to perform the engagement and whether the firm has the capabilities, including time and resources to do so,

- Whether the relevant ethical requirements can be complied with, and
- The integrity of the client, and whether there is information which would lead it to conclude that the client lacks integrity.

**Competence and resources**
Looking at each consideration in turn, there seems no reason why Bintu & Associates would not have the competence to carry out the assignment, which is a limited assurance review of historical financial statements. Being a firm of Chartered Accountants, and performing assurance services such as the audit of Mmatan Ltd, means that the firm has the relevant knowledge and experience to perform a high quality limited assurance review.

However, the pressure to perform the audit for a low fee could impact on Bintu & Associates's ability to perform a high quality limited assurance review if insufficient resources are made available, given the potential restriction on the fee which can be charged to provide the service. ISQC 1 also mentions that where the client is aggressively concerned with maintaining the firm's fees as low as possible, this can indicate a lack of integrity of the client.

**Ethical issues**
In terms of ethics there are several matters to consider. First, it appears that Mmatan Ltd is putting pressure on Bintu & Associates to accept the engagement. Mmatan Ltd is a relatively significant client of Bintu & Associates, providing 10% of the firm's annual practice income, and there is an intimidation threat in that Mmatan Ltd has threatened to move to another audit provider if Bintu & Associates does not accept Kita Ltd as a client and perform the work for a low fee. This could also be perceived as a self-interest threat in that Bintu & Associates has a financial interest in maintaining a good relationship with Mmatan Ltd.

A further ethical issue arises from the suggestion that Bintu & Associates should provide tax planning advice to Kita Ltd and prepare its tax submissions. This would give rise to a self-review threat because Bintu & Associates would have some input to the tax figures which form part of the financial statements which would then be subject to the limited assurance review. Providing the tax planning advice could also be seen as acting on behalf of management, further impairing the objectivity of the limited assurance provided on the financial statements.

Bintu & Associates should consider whether safeguards can be used to reduce any ethical threats to an acceptable level, for example, through the use of separate teams to provide the limited assurance review and the tax services and by having an independent second partner to review the work performed. If safeguards do not reduce the threats to an acceptable level, then the tax service should not be carried out in addition to the limited assurance review.

**Client integrity**

Preparing the personal tax computations of Mr. Preprah is less of an ethical issue in terms of objectivity as his personal tax is a separate issue and not reflected in the company's financial statements, but there may be other issues with providing this advice, linked to integrity, which will be discussed next.

The integrity of Mr. Preprah will need to be carefully evaluated. There is nothing wrong with him having business interests in several companies, though information about each of these will need to be obtained. The key issues with integrity relate to the breach of employment law and his taking money from a company pension plan to set up a business which is managed by his son. The breach of employment law indicates that Mr. Preprah has a questionable reputation and possibly that he has been involved in criminal activity, depending on what laws have been breached, and the seriousness of the non-compliance. The information comes from a newspaper article, so it may not be very credible and may not even be true, and more information will need to be sought on this issue.

Taking money from the company pension plan is likely to be a breach of the relevant regulations, and it would seem that this was done for the benefit of his son. The fact that this business is located in a foreign country makes the business arrangements complicated, and while it could be completely innocent, it could also mean that there is something more sinister behind the connections between the companies, for example, it could be an arrangement to facilitate money laundering.

Bintu & Associates must obtain sufficient information to carefully evaluate the appropriateness of accepting Kita Ltd as a client, and they must document the acceptance decision in accordance with ISQC.

**(10 marks)**

**(Total: 20 marks)**

**EXAMINER'S COMMENTS**

For sub-question a), candidates in their response mixed up conflict of interest at workplace with conflict of interest of professional accountants in exercising their duties. Both views from candidates were considered appropriate. Candidates performed well in the question.

The b) part of the question was also well answered by candidates.

## QUESTION TWO

**Matters to be considered**

**Fuga Plc**

The key matter to be considered is the status of the investment in Fuga Plc in the consolidated financial statements of the Group. Although the 40% holding falls within the usual percentage presumption range for an associate following ***IAS 28 Investments in Associates and Joint Ventures***, the existence of the share options over the remaining 60% is indicative of control following ***IFRS 10: Consolidated Financial Statements***. IFRS 10 contains specific guidance on situations where control may exist when the investor does not hold a majority of the voting rights. According to IFRS 10, control and therefore status as a subsidiary may be based on potential voting rights provided such rights are substantive. In the case of Fuga Plc, the potential voting rights are exercisable in the near future (within one month of the reporting date) and the 10% discount on market price makes them commercially attractive to the Group. The options therefore represent substantive potential voting rights and Fuga Plc's statement of profit or loss should be consolidated line by line from the date of acquisition.

The 40% holding in Fuga Plc has been held for 11 months of the current reporting period. The time apportioned revenue of GH¢82.5 million (GH¢90 million x 11/12) is therefore material to the consolidated financial statements at 1.1%. On the same basis, the time apportioned loss before tax is GH¢11 million (GH¢12 million x 11/12) which is GH¢6.6 million greater than the loss recognised under the equity method of GH¢4.4 million. The difference is also material to the financial statements at 12% of the Group's profit before tax. Given the loss making status of Fuga Plc, there is an incentive not to consolidate the entity. The auditor should exercise professional scepticism and consider whether there are any implications in relation to management integrity.

**Evidence**

- A copy of the legal documents supporting the acquisition of the shares and the options including the voting rights and the terms of exercise for the options.
- A review of the audit working papers for Fuga Plc, including details of the issued share capital and the associated voting rights attached to shares.
- The group board minutes relating to the acquisition and the intentions of management in relation to Fuga Plc.
- Written representations from management on the degree of influence exercised over Fuga Plc and the future intentions of management in relation to the share options.

**(7 marks)**

**Bavi Plc**

The fair value of the derivatives of GH¢6.1 million is material to consolidated profit before tax at 11.1% but in isolation, it is immaterial to consolidated assets at 0.4%.

***IFRS 9: Financial Instruments*** requires the recognition of derivatives on the statement of financial position at fair value with the associated gains and losses

being recognised in profit or loss for the period. The fair value of GH¢6.1 million should therefore be included in current assets on the Group's consolidated statement of financial position and given that the options were entered into in the last three months of the period at no initial net investment, a fair value gain of GH¢6.1 million should also be recorded in the Group's consolidated statement of profit or loss for the year. The treatment of the derivatives under local GAAP is acceptable in Bavi Plc's individual entity financial statements. For group purposes, however, accounting policies must be consistent and the profit before tax in the draft consolidated financial statements is materially understated.
The auditor must also exercise professional scepticism with regard to whether the directors have the required expertise to value the derivatives and should consider the need for independent, external evidence of the fair value of the options at the reporting date.

**Evidence**

- Details of the fair value of the options based on prices derived from an active market or if this is not available, an independent expert valuation.
- Audit documentation of the review of derivative contracts and confirmation of the terms and maturity dates.
- Notes of a discussion with management in relation to the basis of their valuation and the accounting treatment required in the consolidated financial statements.

**(6 marks)**

**Kontomo Plc**

Consolidated financial statements are prepared from the group perspective and intra-group transactions and balances must be eliminated on consolidation. The sales value of GH¢77 million is material at 1% of consolidated revenue and 4.9% of consolidated assets. The unrealised profit of GH¢7.7 million (GH¢77 million x 10%) is also material to consolidated profit before tax for the year at 14% (GH¢7.7 million/GH¢55 million). Group revenue, receivables and profit before tax are therefore materially overstated. The transactions should be verified in the accounting records of the individual entities to confirm that Kontomo Plc has included the sale in its financial statements and that the parent company has not included the purchase in its financial statements. However, given that the goods are still in transit at the reporting date, group inventory will be understated by GH¢69.3 million (GH¢77 million x 90%) which is also material to group assets at 4.4%. Consolidated retained earnings will be overstated by GH¢6.16 million (GH¢ 7.7 million x 80%) and non-controlling interests will be overstated by GH¢1.54 million (GH¢7.7 million x 20%). The accounting for the transaction within the individual entity financial statements will also be misstated.
The failure to identify and adjust for the intra-group trading transaction indicates a deficiency in internal control within the group and therefore increased control risk for the audit of the consolidated financial statements.

**NB:** ***Credit should also given to candidates who discussed the impact of the inter-company transactions on the financial statements of the individual entities.***

**Evidence**

- Agreement of the transaction details to underlying documents such as sales invoices, goods despatch notes at Kontomo Plc and goods received notes, purchase invoices at its parent company.
- The cost of the inventory in transit should have been confirmed to production records at Kontomo Plc to confirm the 10% profit margin.
- A copy of the goods received note dated 2 April 2021 raised by the parent company confirming details of the inventory in transit and the transaction being recorded in inventory and the purchase ledger after the year end.
- A copy of the sales invoice traced to Kontomo Plc's sales ledger agreeing details of the sales value.
- The adjustments required to eliminate the transaction should be noted on a schedule of uncorrected misstatements for discussion with the client.

**(7 marks)**

**(Total: 20 marks)**

**EXAMINER'S COMMENTS**

The mini case study question was not well answered especially evidence gathering procedures. Candidates' performance in answering this question was not encouraging. Candidates should be advised to improve their knowledge in evidence gathering. They provided shallow answers which made them lose a lot of marks. Question on audit evidence, audit test and audit procedures always poses problems for the candidate.

**QUESTION THREE**

a) Alpha Ltd – Critical appraisal of extract from draft auditor's report.

**Presentation and structure of auditor's report extract**

The structure and format of the auditor's report is prescribed by ***ISA 700: Forming an Opinion and Reporting on Financial Statements***. The auditor's report should be addressed solely to the shareholders of the reporting entity and the title should not include any reference to the directors of Alpha LTD. In addition, the first two paragraphs are presented in the incorrect order, the Opinion paragraph should precede the Basis for Opinion paragraph.

**Reference to ethical code**

ISA 700 requires that in the Basis for Opinion paragraph, the auditor should identify the relevant ethical code, naming the **IESBA** ***International Code of Ethics for Professional Accountants***. The draft auditor's report does not specifically refer to the ethical code which has been applied during the audit and is therefore not in compliance with the requirements of ISA 700.

**Material uncertainty regarding going concern**
***ISA 570: Going Concern*** provides guidance on how an auditor should report uncertainties regarding going concern in the auditor's report. According to ISA 570, if adequate disclosure about the material uncertainty is not made in the financial statements, the auditor should express a qualified opinion or adverse opinion as appropriate.

The use of a 'material uncertainty regarding going concern' paragraph in the draft auditor's report extract is therefore incorrect. This paragraph should only be used when adequate disclosure has been made by the directors in the financial statements and would include a cross reference to this disclosure. Given that this disclosure has not been made, this is therefore not appropriate in this case.

In this case, therefore, the absence of any disclosure in the financial statements in relation to the uncertainties regarding going concern is grounds for a modification of the auditor's opinion. The modification is due to a material misstatement in relation to the absence of this key disclosure. If, in the auditor's professional judgement, the impact of this non-disclosure on the financial statements is material but not pervasive, a qualified 'except for' opinion should be issued. In this case, the opinion paragraph should be headed 'qualified opinion' and this should be followed immediately by a 'basis for qualified opinion' paragraph. If, on the other hand, the auditor believes that the impact on the financial statements of the non-disclosure is both material and pervasive, an adverse opinion should be given. The opinion paragraph should then be headed 'adverse opinion' and should be followed immediately by a 'basis for adverse opinion' paragraph.
In addition, details of the uncertainty regarding going concern should be given in the basis for qualified or adverse opinion paragraph.

**Long-term contracts**
The use of the 'other information' section in this context is inappropriate. This section should be used to describe the auditor's responsibilities for 'other information' (e.g. the rest of the annual report, including the management report) and the outcome of fulfilling those responsibilities.

The disclosure regarding long-term contracts is more in line with the requirements of **ISA 701:** ***Communicating Key Audit Matters in the Independent Auditor's Report***, where key audit matters are those which in the auditor's professional judgement were of most significance to the audit. In determining which matters to report, the auditor should take into account areas of significant auditor attention in performing the audit, including:
- Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with **ISA 315 (Revised):** ***Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment***.
- Significant auditor judgements relating to areas in the financial statements which involved significant management judgement, including accounting estimates

which have been identified as having high estimation uncertainty.

- The effect on the audit of significant events or transactions which occurred during the period.

The extract from the draft auditor's report states that significant judgement is applied in assessing the percentage of completeness of material long-term contracts and that this percentage is then applied in calculating the revenue for the year. This is a matter of high risk requiring significant auditor attention and given that Alpha Ltd is a listed entity, it would be appropriate for this to be disclosed in the KAM section of the auditor's report. The KAM section of the auditor's report should begin with an introductory paragraph explaining what a KAM is. The KAM section should then explain why this matter is considered to be a KAM due to the significant judgement involved in assessing the percentage completeness of the long-term contracts and the high risk of material misstatement associated with this judgement process. The KAM section should also include an explanation of how the KAM was addressed by the audit process. In this case, this might include, for example, an evaluation of the controls designed and implemented by Alpha Ltd to monitor the progress of and the amounts owing on service and construction contracts; a review of the financial performance of key contracts against budgets and historical trends; and challenging management's estimates and judgements in respect of the progress to date on the contracts.

**(10 marks)**

b) **Adorko Plc – Report to those charged with governance**

A report to those charged with governance (TCWG) is produced to communicate matters relating to the external audit to those who are ultimately responsible for the financial statements. ***ISA 260: Communication With Those Charged With Governance*** requires the auditor to communicate many matters including independence and other ethical issues and the significant findings from the audit. In the case of Adorko Plc, the matters to be communicated would include the following:

**Revaluation of property portfolio**

According to ISA 260, the significant findings from the audit include the auditor's views about significant qualitative aspects of the entity's accounting practices including accounting policies and any circumstances which affect the form and content of the auditor's report. In the case of Adorko Plc, therefore, the significant findings from the audit would relate to the changes in the accounting policy in relation to the revaluation of property and related material misstatements and the following matters should be communicated:

***IAS 16: Property, Plant and Equipment*** states the revaluation policy should be consistent across a class of assets. However, four properties, which are material to the statement of financial position at 2.1% of total assets, are still carried at depreciated historic cost. This therefore represents a breach of IAS 16 and a material misstatement, which will impact on the form and content of the auditor's report.

According to ISA 260, the significant findings from the audit also include significant difficulties encountered during audit such as information delays. The independent external valuation reports requested by Expert Reviewers & Partners at the planning stage were not available when requested by the auditor and it took three weeks before they were received by the audit team. The auditor should report this delay to those charged with governance, detailing its impact on the efficiency of the audit process together with any resulting increase in the audit fee.

**Renovation of car parking facilities**
The renovation expenditure on the car parking facilities at Adorko Plc's properties should be recognised as an asset according to IAS 16 if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. In Adorko Plc's case, the cost has been quantified as GH¢ 13·2 million and it has already derived economic benefits in the form of a significant increase in customer numbers and revenue at each of these locations. The expenditure should therefore be capitalised and its inclusion in operating expenses is not in compliance with IAS 16. The amount of GH¢ 13·2 million is also material to the statement of financial position at 2·5% of total assets. The incorrect application of IAS 16 and the material misstatement should be included in a report to TCWG as a significant finding from the audit which will impact on the form and content of the auditor's report.

***ISA 265: Communicating Deficiencies in Internal Control to Those Charged With Governance and Management*** requires the auditor to communicate appropriately to those charged with governance deficiencies in internal control which the auditor has identified during the audit and which, in the auditor's professional judgement, are of sufficient importance to merit their respective attentions. The audit working papers include minutes of discussions with management which confirm that authorisation had not been gained for this expenditure. The lack of authorisation indicates a lack of management oversight and a serious weakness in control which could allow fraud to occur. Furthermore, the lack of integrity shown by management in going ahead with the renovation works without the necessary permission is an example of management override and could be indicative of the tone set throughout the organisation. This therefore represents a high risk matter and they may wish to implement controls and procedures to prevent further breaches. The report to those charged with governance should include full details on this significant deficiency in internal control and should include recommendations to management in order to reduce the associated business risk.

**Long association of audit partner**
As discussed above, ISA 260 requires the auditor to communicate matters in relation to auditor independence. Mr. Kunta has acted as audit engagement partner for Adorko Plc for eight consecutive years. According to the **IESBA *Code of Ethics for Professional Accountants* (the *Code*)**, his long association with the audit client creates both familiarity and self-interest threats to auditor independence. The familiarity threat arises due to the long and potentially close

relationship which he has with the staff of Adorko Plc leading to his being too sympathetic to their interests or too accepting of their work. This in turn gives rise to a self-interest threat in that her long association and close relationship with the client create a personal interest which may inappropriately influence her professional judgement or behaviour. In order to address these risks, the *Code* requires that an audit partner in a listed entity should be rotated at least every seven years and therefore his eight-year tenure as the audit partner of Adorko Plc appears to be in clear breach of this provision. However, the *Code* does allow for an engagement partner to serve for an additional year if the required rotation is not possible due to unforeseen circumstances such as the illness of the intended engagement partner, in this case Mr. Barima. In these circumstances, safeguards should be applied such as the independent review of the engagement which is being performed and this should be communicated to those charged with governance. Going forward beyond the current year, if it remains impossible to rotate the audit partner due to a lack of alternative expertise within the firm, it may be possible for Mr. Kunta to continue as the audit partner if special dispensation is received from the relevant regulator and the necessary safeguards are applied such as the engagement is subject to regular review by an independent, external expert.
**(10 marks)**

**(Total: 20 marks)**

**EXAMINER'S COMMENTS**
The a) part of the question was standard but the candidates could not understand the question due to limited knowledge and understanding of the contents of standard independent auditor's report. In general, the performance was not encouraging. This area is always a challenge for many candidates.

The b) part of the question was a practical question which was about reporting to those charged with governance. Candidate's performance in answering this question was encouraging.

**QUESTION FOUR**

a) Internal Audit Agency was established by the Internal Audit Agency Act, 2003 (Act 658) with the aim of strengthening the Internal Audit Departments of MDAs, MMDAs and Government Agencies.

**Functions**

It does it work by monitoring and by undertaking inspections and evaluating internal audit activities of MDAs, MMDAs and Government Agencies, for the purpose of ensuring that:

- Financial, management and operating information reported internally or externally by of MDAs, MMDAs and Government Agencies is accurate, reliable and timely.
- The financial activities of MDAs, MMDAs and Government Agencies are in compliance with laws and government policies.
- National ressources are adequately safeguarded
- Public resources are used economically, effeciently and effectively
- The goals of MDAs and MMDAs are achieved
- The agency should also facilitate the prevention and detection of fraud in MDAs and MMDAs.

**Performance**

To a large extent IAA has been performing it functions:

- It has been establishing Inter Audit Units in organization which hither to, were not having internal audit units, ensuing controls are checked and public sector spending are monitored.
- It has been signing audit charter specifying the mandate and responsibility of internal audit units and management of Government Agencies to ensure that internal audit is given the necessary recognition to perform to the benefit of that government Institution.
- It reviews internal audit work plans and reports, and makes sure that work programmes are followed and adverse factors encountered are corrected for the good management of state resources.
- It establishes audit committees to supervise internal audit functions in MDAs and MMDAs. The audit committees intend summit annual reports on their work done, implementation recommendations of deficiencies in reports which are endorse by the sector minister and submitted to Parliament, the Presidency and the Auditor-General within six months after the end of the year.

**Outcome**

The above legal provision has given enough direction to the Internal Auditors helping them to have insight into their work. Awareness of Internal Audit function is also being created for workers to know that Internal Auditors are available to facilitate their work but not to put them into unnecessary trouble.

Even though fraud and misappropriation of government funds have not been wiped out as yet, it has been on the decrease to a large extent since establishment of IAA. Also with the establishment of IAA, Internal Audit Units in Publich Sectors have grown in knowledge and experience.

It is clearly that if the internal audit departments are given continuous training and are resourced, the work of IAA will be much felt than what we see now.

**(10 marks)**

b)

i) **Positive Effects**

In view of the tremendous savings being achieved as a result of removal of ghost names, it is believed that out-sourcing government payroll will inure to the benefit of the government. Additionally, the government can achieve the following:

- Reduction in cost of preparing the payroll as there will not be the need to engage more people and sophisticated software programme to work on the payroll.
- Payroll will be prepared by specialist which will not have been the case with the staff of government department.
- Service company may provide the government a comfort zone by giving indemnity in event of problems arising.
- It will help the government to focus on its core services of offering social services to the public.
- It may reduce payroll fraud.

**(Any 3 points for 3 marks)**

**Negative Effects**

- Staff may be laid off as not all the employees may be maintained. This may result in redundancy which may cost the government.
- Ghost names may still persist as dismissals and terminations may not be advised promptly
- If Government fails, it may have to pay redundancy cost for dismissals and workers may go to court.

**(Any 2 points for 2 marks)**

ii) **The user auditor must do the following:**

- Understand the transaction by examining all the contracts and identify potential risks
- Evaluate all the controls at the user entity that relate to the service organization and determine whether that gives the auditor sufficient understanding to provide a basis for assessing risks of material misstatement from the side of the government If the auditor concludes that this is insufficient, he must carry out one of the following activities:
- Obtain Type 1 or Type 2 report from service organization (if Available)
- Contact the service organization to get specific information (with permission)
- Visit the service organization and perform procedures to obtain information (with permission)

- Use another auditor to perform procedures at the service organization (with permission)

**(1 mark each for any 5 points)**

**(Total: 20 marks)**

**EXAMINER'S COMMENTS**

Candidates' general performance in this question was above average even though majority of them performed poorly in the part which relates to what the user auditor must do in the course of his duties when outsourcing programme is implemented.

**QUESTION FIVE**

a) Responsibilities of the board for risk management of rural banks.

- The board of the RCB oversees the operations of the RCB and is an important check on management's performance including risk management. The Board's responsibility for risk management emanates from provisions in various laws and regulations. Section 56 (d) of the Banks and Specialised Deposit-taking Institutions Act, 2019 (Act 930) 2 example enjoins Bank of Ghana to ensure prudent operation including matters relating to risk management. The RCB Board has to ensure compliance with the provision of this section.

- The Board shall be responsible for ensuring the establishment and operation of an effective risk management system in line with the provisions of this Act. The Board shall also have responsibility for the level of risk assumed by the RCB Board. To carry out the responsibilities effectively, RCB Boards need to be fully aware of risk management methodologies. This shall be further strengthened through participation in training in Rural Bank risk management within twelve months of appointment.

- The Board shall ensure Key management Personnel and other staff responsible for managing RCB risk go through training in risk management and have appropriate expertise for the risk management functions.

- The Board shall ensure the RCB adopts and implement s sound methodologies for the identification, measurement and monitoring of risks.

- In ensuring that RCB adopts sound methodologies for risk management, the Board shall have responsibility for approving all policies for the RCB including all risk management policies, procedures and strategies; ensure availability of required resources, compliance with approved risk management policies, procedures and strategies; continually assess the relevance of the policies, procedures and strategies in line with existing and emerging risk and hold management accountable.

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

b) Issues relevant to deciding whether the firm can use the work performed by the internal auditors:

**Objectivity**

- The chief internal auditor is a newly qualified chartered accountant, so he will be bound by ethical guidance which requires him to carry out his work with independence and objectivity. He should also be expected to have briefed his assistant on the importance of an objective approach.
- The internal audit function will have greater independence if the chief internal auditor reports directly to the board.
- The scope of the internal audit function should be unrestricted. If put upon enquiry, the internal auditors should be able to conduct non-routine investigations.
- It is more likely that reliance can be placed on the internal audit work if findings are reported directly to the board and management make a positive response to those findings.

**Technical competence and due professional care**

- Although the function has accounting experience its experience of internal auditing and the snacks industry may be limited. The audit firm will need to assess the effectiveness of the internal audit function via discussion and a review of working papers.
- The internal audit work should be properly planned, reviewed, supervised and recorded. In particular, the substantive procedures on the cash sales system should adequately cover the different locations. Working papers should set out audit objectives, tests performed, results and conclusions. The work of the assistant should show evidence of monitoring and review.

**Effective communication**

It is more likely that reliance can be placed on the internal audit work if the function is allowed to communicate freely with the external auditors. There should be regular meetings between the two and one should notify the other of any significant matters discovered which might affect the other's work.

**(3 points @ 2 marks each = 6 marks)**

c) An ***emphasis of matter*** paragraph draws the attention of users to an item (or 'matter') that is included in the financial statements and which the auditor considers fundamental to an understanding of the financial statements.

Note that if such a matter is considered a 'Key Audit Matter' (per ISA 701), then it shall be addressed in the 'key audit matters' section of the auditor's report rather than in an 'emphasis of matter' paragraph.

An ***other matter paragraph*** deals with a matter which is not included in the financial statements but which is relevant to an understanding of the audit, the auditor's responsibilities or the auditor's report.

**(4 marks)**

**(Total: 20 marks)**

**EXAMINER'S COMMENTS**

The question on responsibilities of the board for risk management of rural banks, though restrictive, was well answered by majority of the candidates.

The b) part of the question was well answered by majority of the candidates. Most candidates however, could not differentiate between "emphasis of matter" and "other matter" paragraph.