NOVEMBER 2020 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 is acceptable as the level of difficulty of the questions was reasonable. The paper covered all sections of the syllabus.

PERFORMANCE OF THE CANDIDATES

The general performance of candidates was not encouraging. 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 pass rate for this paper was 39% while that of the May 2020 was 43%. Answers provided represented the efforts of the individual candidates. Nothing showed from answers provided that there was copy work or attempt to cheat.

Some candidates did not take their time to write, making reading difficult for markers

QUESTION ONE

a) You are an audit manager with AA & Co. Chartered Accountants and Business Consultants. You have been assigned to the audit of Western Decors Ltd (WD), a long-established firm of event planning service in the city where your practice is located. The audit of the financial statements for the year ended 31 March 2019 is due to commence shortly. ***The audit firm is aware that the client has received a loan from the bank in April 2018 and that the bank will rely on the audited financial statements as part of the terms and conditions in the loan agreement***.

The partner in charge of AA & Co. has just visited the client and made the following notes during his trip:

- The firm has a number of individual and corporate clients outside Accra and has invested heavily in recording and broadcasting equipment to allow some events to be broadcasted over the internet. This facility is now available at all events conducted in WD's premises and is proving to be very popular. To date, no specific extra charge has been levied for this service but the Chief Executive Officer (CEO) of WD has asked us to prepare a report for him advising on whether it would be practical to charge separately for it; and, if so, the level at which the charge should be set.
- Unfortunately, WD's main supplier of chairs went into liquidation during the year. The Partner said that they were fortunate to be able to find an alternative supplier with whom they entered into a three-year contract for the supply of chairs. At the time of signing the contract, WD considered the contract to be on very favourable terms. However, the supplier is based in Nigeria and the contract was denominated in Naira. Movements in the exchange rate now make the contract look far less attractive and the CEO has requested that we examine the contract to see if there is any way he can legally set it aside.

Required:

i) Critically evaluate any possible ***ethical issues*** arising from the client's requests**.** **(4 marks)**

ii) Discuss whether the auditors may be liable to the bank in case the audit was negligently done. **(6 marks)**

b) You have been recently promoted as the Ethics Partner in Famous Chartered Accountants, a licensed audit firm. At your first visit to the Managing Partner, he informs you of an appointment by Phobia Foods Ltd (PFL), and gives you a file to go through. You open the file and find a copy of an e-mail from the Managing Director of PFL, extracts which read as follows:

From: Managing Director, Phobia Foods Ltd.
To: Managing Partner, Famous Chartered Accountants
Subject: Evaluation of Business Expansion Plan and Associated Items

Congratulations on your offer of appointment as auditor cum advisor of our company. As discussed in our earlier meeting, Phobia Foods Ltd (PFL) would like to open three more outlets, two in Sunyani and one in Sogakope. The necessary financing will be obtained through a new bank loan and the rescheduling of the payments of the existing loan, which is technically in default.

Your appointment and fees
Your audit fee will be GH¢16,000 for the year ended 30 June 2018.Your fee for evaluation of our expansion plan and advisory services in relation to obtaining a bank loan will be GH¢9,000. For advisory services and business efficiency and strategic decisions, your fee will be GH¢3,400 per month for the next two years.

Shareholders and key management issues
Five founding directors, each with equal shares, incorporated PFL which commenced trading in 2009. I still maintain my original 20% holding.

Audit and accounts 2016-2018
Ofosu-Mensah & Associates., a firm of licensed auditors audited the accounts for the years ended 30 June 2016 to 30 June 2018 inclusive. The audit of PFL for the year ended 30 June 2018 was signed off on 16 November 2018 with an unqualified opinion, notwithstanding that qualified opinions had been published on the previous two years' accounts. *The shareholders of PFL approved your firm's appointment at the annual general meeting held on 15 April 2019 for the year ended 30 June 2019.*

The funds raised by the new bank loan will be used for expansion of the business. Your firm is also expected to advice the company on the application for the new bank loan and the rescheduling of repayments of the existing loan in default.

Yours sincerely, Managing Director.

Required:
Evaluate **FIVE (5)** risk considerations and issues for Famous Chartered Accountants that should be identified prior to accepting this engagement. **(10 marks)**

(Total: 20 marks)

QUESTION TWO

You were recently employed by AD Chartered Accountants as a Manager. You are currently preparing the planning memorandum for your client, Manuf Co., a manufacturer of machinery used in the bauxite extraction industry. The Company is a member of the Manufacturing Association of Ghana and has won several awards for manufacturing environmentally friendly products. You are also planning the audit of the financial statements for the year ended 31 March 2019. The draft financial statements show revenue of GH¢100 million (2018 – GH¢50 million), profit before tax of GH¢1 million (2018 – GH¢0.5 million) and total assets of GH¢200 million (2018 – GH¢150 million). Your firm was appointed as auditor to Manuf Co. for the first time in October 2018.

Below is an extract of the business operation and development of Manuf Co:
One of the key customers, Law Co Ltd, communicated in January 2019, via its lawyers with Manuf Co., claiming damages for injuries suffered by a drilling machine operator whose arm was severely injured when a machine malfunctioned. Odo Pa Nye, the Chief

Executive Officer of Manuf Co., has told you that the claim is being ignored as it is generally known that Law Co Ltd has a poor health and safety record, and thus the accident was their fault. Two orders which were placed by Law Co Ltd in February 2019 have been cancelled.

All machines are supplied carrying a one year warranty. A warranty provision is recognised on the balance sheet as GH¢2.5 million (2018 – GH¢ 2.4 million). Odo Pa Nye estimates the cost of repairing defective machinery reported by customers, and this estimate forms the basis of the provision.

Work in progress is valued at GH¢ 15 million as at 31 March 2019. A physical inventory count was held on 23 March 2019. The Chief Engineer estimated the stage of completion of each machine at that date. One of the major components included in the bauxite extracting machinery is now being sourced from overseas. The new supplier, Osoro Co., is located in Germany and invoices Manuf Co in euros. There is a trade payable of GH¢ 1.5 million owing to Osoro Co. recorded within current liabilities.

Manuf Co. designs, constructs and installs machinery for three key customers. Payment is due in three instalments: 70% is due when the order is confirmed (stage one), 15% on delivery of the machinery (stage two), and 15% on successful installation in the customer's bauxite mine (stage three). Generally it takes four months from the order being confirmed until the final installation.

At 31 March 2019, there was an amount outstanding of GH¢1.5 million from Mmere Pa Nye Company Ltd which was in dispute. Mmere Pa Nye Company Ltd is refusing to pay until the machinery, which was installed in August 2017, is running at 100% efficiency.

Odo Pa Nye owns 60% of the shares in Manuf Co. She also owns 55% of Pacific Co., which leases a head office to Manuf Co. Odo Pa Nye is considering selling some of her shares in Manuf Co. in late January 2019, and would like the audit to be finished by that time.

Required:

a) Using the information provided, identify and explain the significant audit risks, and any other matters to be considered when planning the final audit for Manuf Co. for the year ended 31 March 2019. **(15 marks)**

b) Explain the significant audit procedures to be performed during the final audit in respect of the estimated warranty provision in the statement of financial position of Manuf Co. as at 31 March 2019. **(3 marks)**

c) Discuss **TWO (2)** problems that you may face in implementing quality control procedures in a small firm of Chartered Accountants, and recommend how these problems may be overcome. **(2 marks)**

(Total: 20 marks)

QUESTION THREE

GBA Co. Ltd. (GBCAL) operates a chain of food wholesalers across the country and its year end is 31 December 2018. The company is financed solely from equity including internally generated fund of the Company since incorporation.
The final audit is nearly complete and it is proposed that the financial statements and audit report will be signed on 31 January 2019. Revenue for the year is GH¢ 100 million and profit before taxation is GH¢ 15 million. Total assets amounted to GH¢ 500 million.

The following events have occurred subsequent to the year end.

Warehouse
GBCAL has three warehouses and following a torrential rain on 25 January 2019, the warehouse located in Adenta got flooded. All the inventory was damaged and has been written-off. The insurance company has already been contacted. No amendments or disclosures have been made in the financial statements.

Lawsuit
A key supplier of GBCAL is suing them for breach of contract. The lawsuit was filed prior to the year end, and the sum claimed by them is GH¢ 2 million. This has been disclosed as a contingent liability in the notes to the financial statements. However, a correspondence has just arrived from the supplier indicating that they are willing to settle the case for a payment by GBCAL of GH¢0.9 million. It is likely that the company will agree to this.

Receivable
A customer of GBCAL has been experiencing cash flow problems and owed the company GH¢ 0.08 million. The company has just become aware that its customer is experiencing significant going concern difficulties. GBCAL believe that as the company has been trading for many years, they will receive some, if not full, payment from the customer, hence they have not adjusted the receivable balance.

Required:

a) For each of the three events above:
i) Discuss whether the financial statements require amendment. **(3 marks)**
ii) Describe audit procedures that should be performed in order to form a conclusion on the amendment. **(4 marks)**
iii) Explain the impact on the audit report should the issues remain unresolved. **(3 marks)**

b) Describe your responsibility for subsequent events;
i) Assuming the events occurred before your report is signed **(5 marks)**
ii) Assuming the events occurred after signing your report but before the report was issued. **(5 marks)**

(Total: 20 marks)

QUESTION FOUR

a) The Auditor- General of Ghana has unfettered power and not subject to the control of any other authority in the discharge of his duties. He therefore refuses to accept any directives from cabinet ministers.

Required:
Evaluate the extent to which it can be said that the Auditor-General is not subject to direction of any other authority. **(10 marks)**

b) You led a team of auditors from the Auditor-Generals' Department to audit the Financial Statements of Ministry of Defence. You have just completed the audit and about to report your findings.

Required:

i) Explain the factors you will take into account to determine that the financial statements have been properly prepared in accordance with compliance framework. **(6 marks)**

ii) Explain the difference between fair presentation framework and compliance framework. **(4 marks)**

(Total: 20 marks)

QUESTION FIVE

a) In the audit of financial statements, auditors consider the regulatory requirements. These cover professional standards promulgated by the International Federation of Accountants (IFAC) in the form of International Standards on Auditing (ISAs), International Standards on Quality Control (ISQC) as well as the International Ethics Standards Board for Accountants (IESBA). The other consideration involve legal requirements.

Required:
Identify **THREE (3)** regulatory authorities in Ghana whose requirements may be taken into account in the conduct of an audit and discuss their roles. **(10 marks)**

b) You are a Partner in Green & Co., a firm of Chartered Accountants, with specific responsibility for the quality of audits. Green & Co. was appointed auditor of Cleanup Co, a provider of waste management services, in July 2019. You have just visited the audit team at the head office of Cleanup Co. The audit team comprises an audit manager, an audit senior and two audit trainees.

Cleanup Co's draft accounts for the year ended 30 June 2019 show revenue of GH¢ 11.6 million (2018 – GH¢ 8.1 million) and total assets of GH¢ 3.6 million (2018 – GH¢ 2.55 million).
During your visit, a review of the audit working papers revealed the following:

i) On the audit planning checklist, the audit senior has crossed through the analytical procedures section and written 'not applicable – new client'. The audit planning checklist has not been signed off as having been reviewed.

ii) The audit manager last visited Cleanup Co. office when the final audit commenced two weeks ago on 1 August. The audit senior has since completed the audit of tangible non-current assets (including property and service equipment) which amount to GH¢ 600,000 as at 30 June 2019 (2005 – GH¢ 600,000). The audit manager spends most of his time working from Green & Co's office and is currently allocated to three other assignments as well as Cleanup Co's audit.

iii) At 30 June 2019 trade receivables amounted to GH¢ 2.1 million (2018 – GH¢ 900,000). One of the trainees has just finished sending out requests for direct confirmation of customers' balances as at the end of the reporting period.

iv) The other trainee has been assigned the audit of the consumable supplies which includes inventory amounting to GH¢ 88,000 (2018 – GH¢ 53,000). The trainee has carried out tests of controls over the perpetual inventory records and confirmed the 'roll-back' of a sample of current quantities to book quantities as at the year end.

v) The audit manager has noted the following matter for your attention. The financial statements as at 30 June 2018 disclosed, as unquantifiable, a contingent liability for pending litigation. However, the audit manager has seen a letter confirming that the matter was settled out of court for GH¢ 450,000 on 14 September 2018. The auditor's report on the financial statements for the year ended 30 June 2018 was unmodified and signed on 19 September 2018. The audit manager believes that management of Cleanup Co. is not aware of the error and has not brought it to their attention.

Required:

Identify and comment on the implications of these findings for Green & Co's quality control policies and procedures. **(10 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)

i)

- The provision of any other services to an audit client has the potential to create threats such as those identified by the International Ethics Standards Board for Accountants (IESBA). On the other hand the provision of such services is nearly universal in practices from the very smallest to the largest.

- In terms of threats identified by IESBA the ones that nearly always have some relevance are self-interest and familiarity. So we should always consider our level of dependence on fees from the client and be aware that if more than 15% of the gross recurring fee income of our practice comes from any one client (or group of closely related clients) then there is a presumption that our independence is impaired. Also, heavy involvement with a client can impair our objectivity and so lead to a familiarity threat.

- There is nothing in the scenario to suggest that either of these situations are especially applicable in this case. The most relevant threat in relation to the advice on the price to charge for certain extra services is a threat recognised by IESBA as an Advocacy threat. Advocacy threat exists when "the audit firm undertakes work that involves making judgements and taking decisions that are properly the responsibility of management". The important point here is that the audit firm may provide advice but that any decisions are left entirely to management.

- That would also apply to advice about the possibility of setting aside the contract with the Nigeria based chairs supplier. On top of the other issues mentioned this would also raise the question of competence. This would appear to be more in the nature of a legal issue so we may not be competent to advise on it. Obviously, if we do advise any decision must be unambiguously left to the client.

(Any 2 points @ 2 marks = 4 marks)

ii) Negligence is some act or omission which occurs because the person concerned has failed to exercise the degree of professional care and skill, appropriate to the case, which is expected of accountants or auditors. It would be a defence to an action for negligence to show:

a) that there has been no negligence; or
b) that no duty of care was owed to the plaintiff in the circumstances; or
c) in the case of actions in tort that no financial loss has been suffered by the plaintiff.

For the bank to succeed in any case against the auditors, it must prove the following:

- The auditors owed it a duty of care since there is no contrast between the bank and Auditors, the bank must establish close proximity or sufficient relationship with the Auditors. In this case, the auditors were aware that the bank will rely on the audited financial statements in respect of the loan therefore a duty of care has been established through proximity.

- The bank must prove that the auditor has breached that duty of care by conducting the audit negligently. However, if the auditor can demonstrate to the court that it has followed the applicable auditing standards as evident by its working papers, it may not be found negligent.

- The bank must prove that it suffered financial loss as a result of its reliance on the negligent work of the auditor.

(3 points @ 2 marks each =6 marks)

b) **The risks to be considered in relation to accepting this particular client is as follows:**

- The client appears more focused on our role as business advisors than auditors. The managing director refers to us as "auditor cum advisor". The risk here is that the client does not appreciate the nature of assurance services and sees them as a mere extension of our advisory roles. This could lead to confusion and even conflict later.

- The client's financial position appears precarious. Although I do not yet have access to very detailed financial information about the client, there is a suggestion of a loan being, in the client's own words, "technically in default". Clients whose financial position is unsound present a much greater risk for several reasons. One reason is that their management teams tend to be under pressure rendering them more susceptible to unethical conduct or even outright fraud. Another reason is that accounting practices are more often pursued through the courts when clients have failed financially.

- A third point concerning this appointment is that the fees appear to have been fixed by the client in advance. A fee of GH¢16,000 has been agreed as the audit fee. It seems imprudent to have fixed such a fee in advance of really understanding the client or fully appreciating what is involved with the audit. This is an ethical risk because personnel performing the audit may feed under psychological pressure to reduce the time spent on the audit commensurate with the fee.

- Also, a fee has been agreed in relation to our advice and support in relation to the client's application for some sort of "roll-over" of the bank financing. This would appear to create an advocacy threat to our independence. There is also an offer on a rolling fee of GH¢3,400 per month for general business, strategic and financial advice. It is commendable that this income will be received monthly by the practice but we need to be assured that we have the resources to invest in this on a continuous basis. It also gives rise to a familiarity threat so we will need to ensure the existence of robust information and communication barriers (so-called "Chinese Walls") between the audit team and others working for the client.

- It would appear that there were difficulties with audits in two of the three previous years. It appears that the audit reports for the years ended 30 June 2016 and 2017 were both subject to qualification. Although the 2017 report was not so qualified, the fact that there were difficulties in two of the three previous years is still a cause of concern. At this point, there appears to be insufficient detail of what lead to the qualifications but there must be a risk that these issues are still relevant notwithstanding the unmodified report in year to 30 June 2018.

(5 points well explained @ 2 marks each = 10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
The a) part of the question was fairly attempted by candidates. However, most candidates failed to state what the standard says regarding the auditor's liability and did not relate their answers to the question. The b) part of the question was poorly answered by candidates and answers provided did not relate to the question.

QUESTION TWO

a) Principal Audit Risks of Manuf Co

Legal claim
The claim should be investigated seriously by Manuf Co. The chief executive officer's (CEO) opinion that the claim will not result in any financial consequence for Manuf Co is naïve and flippant. Damages could be awarded against Manuf Co if it is found that the machinery is faulty. The recurring high level of warranty provision implies that machinery faults are fairly common and therefore the accident could be the result of a defective machine being supplied to Law Co Ltd. The risk is that no provision is created for the potential damages under IAS 37 Provisions, Contingent Liabilities and Contingent Assets, if the likelihood of paying damages is considered probable. Alternatively, if the likelihood of damages being paid to Law Co Ltd is considered a possibility then a disclosure note should be made in the financial statements describing the nature and possible financial effect of the contingent liability. As discussed below, the CEO, Odo Pa Nye, has an incentive not to make a provision or disclose a contingent liability due to the planned share sale post year end.

A further risk is that any legal fees associated with the claim have not been accrued within the financial statements. As the claim has arisen during the year, the expense must be included in this year's income statement, even if the claim is still on- going at the year end.

The fact that the legal claim is effectively being ignored may cast doubts on the overall integrity of senior management, and on the integrity of the financial statements. Management representations should be approached with a degree of professional scepticism during the audit.

Law Co Ltd has cancelled two orders. If the amounts are still outstanding at the year end then it is highly likely that Law Co Ltd will not pay the invoiced amounts, and thus receivables are overstated. If the stage one payments have already been made, then Law Co Ltd may claim a refund, in which case a provision should be made to repay the amount, or a contingent liability disclosed in a note to the financial statements.

Law Co Ltd is one of only five major customers, and losing this customer could have future going concern implications for Manuf Co if a new source of revenue cannot be found to replace the lost income stream from Law Co Ltd. If the legal claim becomes public knowledge, and if Manuf Co is found to have supplied faulty machinery, then it will be difficult to attract new customers.

A case of this nature could bring bad publicity to Manuf Co, a potential going concern issue if it results in any of the five key customers terminating orders with Manuf Co. The auditors should plan to extend the going concern work programme to incorporate the issues noted above.

Warranty provision

The warranty provision is material at 2·6% of total assets (2018 – 2·7%). The provision has increased by only GHS 100,000, an increase of 4·2%, compared to a revenue increase of 21·4%. This could indicate an underprovision as the percentage change in revenue would be expected to be in line with the percentage change in the warranty provision, unless significant improvements had been made to the quality of machines installed for customers during the year. This appears unlikely given the legal claim by Law Co Ltd, and the machines installed at Mmere Pa Nye Company Ltd operating inefficiently. The basis of the estimate could be understated to avoid charging the increase in the provision as an expense through the income statement. This is of special concern given that it is the CEO and majority shareholder who estimates the warranty provision.

Inventories

Work in progress is material to the financial statements, representing 8·9% of total assets. The inventory count was held two weeks prior to the year end. There is an inherent risk that the valuation has not been correctly rolled forward to a year end position.

The key risk is the estimation of the stage of completion of work in progress. This is subjective, and knowledge appears to be confined to the chief engineer. Inventory could be overvalued if the machines are assessed to be more complete than they actually are at the year end. Absorption of labour costs and overheads into each machine is a complex calculation and must be done consistently with previous years.

It will also be important that consumable inventories not yet utilised on a machine, e.g. screws, nuts and bolts, are correctly valued and included as inventories of raw materials within current assets.

Overseas supplier

As the supplier is new, controls may not yet have been established over the recording of foreign currency transactions. Inherent risk is high as the trade payable should be retranslated using the year end exchange rate per IAS 21 The Effects of Changes in Foreign Exchange Rates. If the retranslation is not performed at the year end, the trade payable could be significantly over or under valued, depending on the movement of the dollar to euro exchange rate between the purchase date and the year end. The components should remain at historic cost within inventory valuation and should not be retranslated at the year end.

Revenue Recognition – timing

Manuf Co raises sales invoices in three stages. There is potential for breach of IFRS 15 Revenue from Contract with Customers.

The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework.

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognise revenue when (or as) the entity satisfies a performance obligation.

These steps ensure revenue should only be recognised once the seller has the right to receive it, in other words the seller has performed its contractual obligations. This right does not necessarily correspond to amounts falling due for payment in accordance with an invoice schedule agreed with a customer as part of a contract. Manuf Co appears to receive payment from its customers in advance of performing any obligation, as the stage one invoice is raised when an order is confirmed i.e. before any work has actually taken place. This creates the potential for revenue to be recognised too early, in advance of any performance of contractual obligation. When a payment is received in advance of performance, a liability should be recognised equal to the amount received, representing the obligation under the contract. Therefore a significant risk is that revenue is overstated and liabilities understated.

Disputed receivable

The amount owed to Mmere Pa Nye Company Ltd is highly material as it represents 50·9% of profit before tax, 2·3% of revenue, and 3% of total assets. The risk is that the receivable is overstated if no impairment of the disputed receivable is recognised.

Majority shareholder

Odo Pa Nye exerts control over Manuf Co via a majority shareholding, and by holding the position of CEO. This greatly increases the inherent risk that the financial statements could be deliberately misstated, i.e. overvaluation of assets, undervaluation of liabilities, and thus overstatement of profits. The risk is severe at this year end as Odo Pa Nye is hoping to sell some Manuf Co shares post year end. As the price that she receives for these shares will be to a large extent influenced by the financial position of the company at 31 March 2019, she has a definite interest in manipulating the financial statements for her own personal benefit. For example:

- Not recognising a provision or contingent liability for the legal claim from Law Co Ltd
- Not providing for the potentially irrecoverable receivable from Jacks Mines Co
- Not increasing the warranty provision
- Recognising revenue earlier than permitted by IFRS 15 Revenue from Contract with Customers

Related party transactions

Odo Pa Nye controls Manuf Co and also controls Pacific Co. Transactions between the two companies should be disclosed per IAS 24 Related Party Disclosures. There is risk that not all transactions have been disclosed, or that a transaction has been disclosed at an inappropriate value. Details of the lease contract between the two companies should be disclosed within a note to the financial statements, in particular, any amounts owed from Manuf Co to Pacific Co at 31st December, 2019 should be disclosed.

Other issues

- Odo Pa Nye wants the audit to be completed as soon as possible, which brings forward the deadline for completion of the audit. The audit team may not have time to complete all necessary procedures, or there may not be time for adequate reviews to be carried out on the work performed. Detection risk, and thus audit risk is increased, and the overall quality of the audit could be jeopardised.
- This is especially important given that this is the first year audit and therefore the audit team will be working with a steep learning curve. Audit procedures may take longer than originally planned, yet there is little time to extend procedures where necessary.
- Odo Pa Nye may also exert considerable influence on the members of the audit team to ensure that the financial statements show the best possible position of Manuf Co in view of her share sale. It is crucial that the audit team members adhere strictly to ethical guidelines and that independence is beyond question.
- Due to the seriousness of the matters noted above, a final matter to be considered at the planning stage is that a second partner review (Engagement Quality Control Review) should be considered for the audit this year end. A suitable independent reviewer should be indentified, and time planned and budgeted for at the end of the assignment.

Conclusion
From the range of issues discussed in these briefing notes, it can be seen that the audit of Manuf Co will be a relatively high risk engagement.

(15 marks)

b) ISA 540 Audit of Accounting Estimates requires that auditors should obtain sufficient audit evidence as to whether an accounting estimate, such as a warranty provision, is reasonable given the entity's circumstances, and that disclosure is appropriate. One, or a combination of the following approaches should be used:

- Review and test the process used by management to develop the estimate
- Review contracts or orders for the terms of the warranty to gain an understanding of the obligation of Manuf Co
- Review correspondence with customers during the year to gain an understanding of claims already in progress at the year end
- Perform analytical procedures to compare the level of warranty provision year on year, and compare actual to budgeted provisions. If possible disaggregate the data, for example, compare provision for specific types of machinery or customer by customer
- Re-calculate the warranty provision
- Agree the percentage applied in the calculation to the stated accounting policy of Manuf Co
- Review board minutes for discussion of on-going warranty claims, and for approval of the amount provided
- Use management accounts to ascertain normal level of warranty rectification costs during the year
- Discuss with Odo Pa Nye the assumptions she used to determine the percentage used in her calculations
- Consider whether assumptions used are consistent with the auditors' understanding of the business
- Compare prior year provision with actual expenditure on warranty claims in the accounting period
- Compare the current year provision with prior year and discuss any fluctuation with Odo Pa Nye.
- Review subsequent events which confirm the estimate made
- Review any work carried out post year end on specific faults that have been provided for. Agree that all costs are included in the year end provision.
- Agree cash expended on rectification work in the post statement of financial position period to the cash book
- Agree cash expended on rectification work post year end to suppliers invoices, or to internal cost ledgers if work carried out by employees of Manuf Co
- Read customer correspondence received post year end for any claims received since the year end.

(Any three well explained points) (3 marks)

c) ISQC 1 Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements

provides guidance on the overall quality control systems that should be implemented by an audit firm. ISA 220 Quality Control for Audits of Historical Financial Information specifies the quality control procedures that should be applied by the engagement team in individual audit assignments.
Therefore the quality control procedures I will use on this engagement are as follows:

Client acceptance procedures
There should be full documentation, and conclusion on, ethical and client acceptance issues in each audit assignment. The engagement partner should consider whether members of the audit team have complied with ethical requirements, for example, whether all members of the team are independent of the client.

Additionally, the engagement partner should conclude whether all acceptance procedures have been followed, for example, that the audit firm has considered the integrity of the principal owners and key management of the client.

Other procedures on client acceptance should include:

- Obtaining professional clearance from previous auditors
- Consideration of any conflict of interest
- Money laundering (client identification) procedures.

Engagement team
Procedures should be followed to ensure that the engagement team collectively has the skills, competence and time to perform the audit engagement. The engagement partner should assess that the audit team, for example:

- Has the appropriate level of technical knowledge
- Has experience of audit engagements of a similar nature and complexity
- Has the ability to apply professional judgement
- Understands professional standards, and regulatory and legal requirements.

Direction
The engagement team should be directed by the engagement partner. Procedures such as an engagement planning meeting should be undertaken to ensure that the team understands:

- Their responsibilities
- The objectives of the work they are to perform
- The nature of the client's business
- Risk related issues
- How to deal with any problems that may arise; and
- The detailed approach to the performance of the audit.

The planning meeting should be led by the partner and should include all people involved with the audit. There should be a discussion of the key issues identified at the planning stage.

Supervision
Supervision should be continuous during the engagement. Any problems that arise during the audit should be rectified as soon as possible. Attention should be focused on ensuring that members of the audit team are carrying out their work in accordance with the planned approach to the engagement. Significant matters should be brought to the attention of senior members of the audit team. Documentation should be made of key decisions made during the audit engagement.

Review
The review process is one of the key quality control procedures. All work performed must be reviewed by a more senior member of the audit team. Reviewers should consider for example whether:

- Work has been performed in accordance with professional standards
- The objectives of the procedures performed have been achieved
- Work supports conclusions drawn and is appropriately documented.
- The review process itself must be evidenced

Consultation
Finally the engagement partner should arrange consultation on difficult or contentious matters. This is a procedure whereby the matter is discussed with a professional outside the engagement team, and sometimes outside the audit firm. Consultations must be documented to show:

- The issue on which the consultation was sought; and
- The results of the consultation.

(Any two well explained points) (2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
Generally, the question was well attempted by most candidates. However, few candidates provided answers about general audit risk without relating it to the question.
For the b) part, some candidates showed inadequate knowledge in ISA 540 (Audit of accounting estimates and Related Disclosures) and as a result could not answer this part of the question.
For the c) part, some candidates wrote on quality control procedures for an individual audit engagement rather than problems of implementing quality control in small firm.

QUESTION THREE

a) **Warehouse**

The warehouse at Adenta has been subject to flood in late January, the entire inventory has been written off and the company has insurance in place. This event occurred after the year end and the flood would not have been in existence as at 31 December, and hence this event indicates a non-adjusting event.

The financial statements should not be adjusted; however, if the impact of any uninsured losses are material, then a disclosure of the nature of the event and any estimates of the financial impact may be required. If the amount is not material then it may not be necessary to include any disclosures.

The following audit procedures should be applied to form a conclusion as to the extent of any disclosures:

- Discuss the matter with the directors, checking whether the company has sufficient inventory to continue trading in the short term.
- Obtain a written representation confirming that the company's going concern status is not impacted.
- Obtain a schedule showing the inventory destroyed and compare this to the average inventory in the other two warehouses to see if the amount claimed to be damaged is reasonable.
- Review any correspondence from the insurers, confirming the amount of the insurance claim to assess the extent of any uninsured amounts.

The amount of damaged inventory is likely to be material; however, the company has insurance and so it is only the uninsured level of inventory which should possibly be disclosed.

If disclosures are not required, because the uninsured loss is immaterial, then there will be no reporting implications for the audit report.

If disclosure of this subsequent event is required and management refuse to make these disclosures, then the audit report will need to be modified with a qualified 'except for' opinion.

If the impact of the uninsured level of inventory is such that the company's going concern status is impacted, consideration should be given to modifying the audit report opinion. This would involve including an emphasis of matter paragraph drawing attention to the possible risk in relation to going concern.

Lawsuit

A key supplier is suing GBCAL for GH¢2 million; the company has made contingent liability disclosures. However, subsequent to the year end the supplier agreed to settle at GH¢0.9 million and it is likely the company will agree. Although the settlement was agreed after the year end, it provides further evidence that the company had a present obligation as at 30 September.

The financial statements should be adjusted with the contingent liability disclosures being removed and instead a provision of GH¢0.9 million being recorded.

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

- The auditor should contact the company's lawyers to ask their view as to whether the settlement is probable and whether GH¢0.9 million is the likely amount.
- Review the correspondence with the supplier to confirm that the amount they are willing to accept is in fact GH¢0.9 million.
- Discuss with management as to whether it is probable that they will pay this sum and obtain a written representation confirming this.

The sum being claimed is GH¢2 million but the probable payment is GH¢0.9 million, this is material as it represents 6% of profit (0.9/15) and hence management should provide for this amount.

If management refuse to make provision then the audit report will need to be modified. As management has not complied with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the error is material but not pervasive then a qualified opinion would be necessary.

A basis for qualified opinion paragraph would be required and would need to include a paragraph explaining the material misstatement in relation to the lack of a provision and the effect on the financial statements. The opinion paragraph would be qualified 'except for'.

Receivable
A customer, owing GH¢0.08 million at the year end, is experiencing significant going concern difficulties. This information was received after the year end but provides further evidence of the recoverability of the receivable balance at the year end. Under IAS 10 Events after the Reporting Period, if the customer is experiencing cash flow difficulties just a few months after the year end, then it is highly unlikely that the GH¢0.08 million was recoverable as at year end.
The receivables balance is overstated and consideration should be given to adjusting this balance, if material, through the use of an allowance for receivables or by being written off.
The following audit procedures should be applied to form a conclusion as to the level of the adjustment:

- The correspondence with the customer should be reviewed to assess whether there is any likelihood of payment.

- Discuss with management as to why they feel an adjustment is not required.
- Review the post year-end period to see if any payments have been received from the customer.

The receivable of GH¢0.08 million is not material as it represents 0.53% of profit (0.08/15) and 0.08% of revenue (0.08/100) and therefore, although overstated, it does not require adjustment. However, the GH¢0.08m should be noted in the summary of unadjusted errors.

As the error is immaterial then no amendment is required to the audit opinion.

(10 marks)

b) **ISA 560 Subsequent Events responsibilities**

i) **Period between the year-end date and the date the auditor's report is signed**

I have an active duty to design and perform audit procedures to identify and obtain sufficient and appropriate evidence of all events up to date of the auditor's report that may require adjustment or disclosure in the financial statements. These procedures should be performed as close as possible to the date of the auditor's report and in addition representation regarding subsequent events should be sought on the date the report was signed. I would ensure that management have accounted or disclosed subsequent events properly if not the implication on the audit report.

Audit procedures to meet the above requirement include

- Review management procedures for ensuring that subsequent events are identified
- Read board minutes of shareholders and management for evidence of subsequent events
- Enquire from management of any subsequent events
- Obtain correspondence from solicitors of the outcome of any pending legal case

(5 marks)

ii) **Period between the date the auditor's report is signed and the date the financial statements are issued**

However, if a fact becomes known to me that, had it been known to the auditor at the date of the auditor's report, may have caused me to amend my report, the auditor shall: discuss the matter with management, determine whether the financial statements need amendment and, if so, inquire how management intends to address the matter in the financial statements.

The auditor does not have any responsibility to perform audit procedures or make any enquiry regarding the financial statements or subsequent events after the date of the auditor's report. In this period, it is the responsibility of management to inform the auditor of facts which may affect the financial statements.

When the auditor becomes aware of a fact which may materially affect the financial statements, the matter should be discussed with management. If the financial statements are appropriately amended then a new audit report should be issued, and procedures relating to subsequent events should be extended to the date of the new audit report. If management does not amend the financial statements to reflect the subsequent event, in circumstances where the auditor believes they should be amended, a qualified or adverse opinion of disagreement should be issued. **(5 marks)**

(Total: 20 marks)

EXAMINER'S COMMENTS

Some candidates could not differentiate between events that are to be adjusted and those that are not to be adjusted. As a result, events that are not adjusting events were said to be adjusted and vice versa.

Some candidates showed a lack of knowledge in subsequent events responsibilities and as such could not answer this part of the question well.

QUESTION FOUR

a) The office of the Auditor General is enshrined in the 1992 constitution of Ghana. He is appointed by the President on the advice of the Council of State. **(2 mark)**

The Auditor General is the head of the Ghana Audit Service which is the supreme audit institution of Ghana. He is a part of the Audit Service Board, which is responsible for:

- Determining the terms and condition of service of employees in the Ghana Audit Service. **(1 mark)**
- Making regulations for the effective and efficient administration of the Ghana Audit Service. **(1 mark)**

In the performance of his duties the constitution gives the Auditor General the right of access to all books, records, returns and other documents relating to or relevant to those accounts. **(1 mark)**

The constitution provides in article 187(7) that in the performance of his functions under the constitution or any other law the Auditor General shall not be subject to the direction or control of any other person or authority. **(1 mark)**

However in clause 8 of article 187 it is provided that paragraph (a) of clause (7) of article 187 shall not preclude the president acting in accordance with the advice of the Council of State, from requesting the Auditor General, in the public interest to audit at any particular time, the accounts of any such organisation in respect of the public accounts of Ghana. **(2 marks)**

From the foregoing it is clear that it is the president acting on the advice of the Council of State that can direct the Auditor General to audit any public account in the public interest. Therefore a cabinet minister cannot issue any directive to the Auditor General. However if the cabinet minister is acting on the instructions of the president, it would appear as if the instructions is coming from the president and should be carried out. This may be subject to interpretation by the Supreme Court. **(2 marks)**

b)

i) The factors to consider whether the financial statements have been prepared in accordance with compliance framework include:

- The accounting policies used by the entity. Ensuring that management selects and uses accounting policies which are acceptable, reasonable, correctly applied and adequately disclosed.
- Compliance with International Public Sector Accounting Standards (IPSAS).
- Ensuring that the financial statements should comply fully with laws and regulations. **(6 marks)**

ii) Under fair presentation framework the financial statements must give a true and fair view in accordance with the relevant financial reporting standards. This may involve compliance with International Public Sector Accounting Standards (IPSAS) or local accounting standards.
Under compliance framework the main requirement is that the financial statements should comply with relevant laws and regulations. The application of the laws and regulations may not necessarily result in fair view being given. Once the laws and regulations have been complied with, the financial statements become acceptable. **(4 marks)**

(Total: 20 marks)

EXAMINERS'S COMMENTS

This question was generally well answered by candidates. However, some candidates provided answers regarding the functions of the Auditor- General instead of his/her independence.

QUESTION FIVE

a) In the audit of financial statements the requirement of the following regulatory authorities may be taken into account during the audit namely, Bank of Ghana, Securities and Exchange Commission, the Ghana Insurance Commission.

Bank of Ghana: It is the regulatory authority over financial institution. In the banking Act as amended gave authority to the Bank of Ghana to grant financial institution operating license. The auditor of financial institution must consider whether the entity is licenced to carry on the business it is doing and whether it is complying with the terms and conditions of the operating charter. The Bank of

Ghana has various requirements for banks to fulfil, examples are liquidity ratio, Capital adequacy ratio and submission of returns on persons transferring foreign currency out of the country beyond $10,000.00.

Securities and Exchange Commission: It has listing requirements that companies listed on the Ghana Stock Exchange (GSE) must comply with. It also requires filing of annual audited accounts and information required to be disclosed in the financial statements.

Insurance Commission: It regulates the operations of the Insurance companies in Ghana. Insurance companies must be general, life or reinsurance. This clear lines of operations must be followed by the companies in line with the business they are licensed to do. The commission also specifies the capital that qualifies a company to undertake general, life or reinsurance business.

National Pensions Regulatory Authority: It register the pensions fund under (NPRA Act) and provides regulations and periodic filing of actuarial valuation of the funds to ensure that the funds are viable.

(10 marks)

b)

i) **Analytical procedures**

Applying analytical procedures at the planning stage, to assist in understanding the business and in identifying areas of potential risk, is enshrined in an auditing standard (ISA 315) and therefore mandatory. Analytical procedures should have been performed (e.g. comparing the draft accounts to 30 June 2019 with prior year financial statements).

The audit senior may have insufficient knowledge of the waste management service industry to assess potential risks. In particular, Cleanup may be exposed to risks resulting in unrecorded liabilities (both actual and contingent) if claims are made against the company in respect of breaches of health and safety legislation or its licence to operate.

The audit has been inadequately planned and audit work has commenced before the audit plan has been reviewed by the audit manager. The audit may not be carried out effectively and efficiently.

ii) **Audit manager's assignments**

The senior has performed work on tangible non-current assets which is a less material (17% of total assets) audit area than trade receivables (58% of total assets) which has been assigned to an audit trainee. Non-current assets also appear to be a lower risk audit area than trade receivables because the carrying amount of non-current assets is comparable with the prior year (GH¢ 600,000 at both year ends), whereas trade receivables have more than doubled (from GH¢ 900,000 to GH¢ 2.1m). This corroborates the implications of (a).

The audit is being inadequately supervised as work has been delegated inappropriately. It appears that Green & Co does not have sufficient audit staff with relevant competencies to meet its supervisory needs.

iii) **Direct confirmation**
It is usual for direct confirmation of customers' balances to be obtained where trade receivables are material and it is reasonable to expect customers to respond. However, it is already six weeks after the end of the reporting period and, although trade receivables are clearly material (58% of total assets), an alternative approach may be more efficient (and cost effective). For example, monitoring of after-date cash will provide evidence about the collectability of receivables (as well as corroborate their existence).

iv) **Inventory**
Inventory is relatively immaterial from an auditing perspective, being less than 2.4% of total assets (2018 – 2.1%). Although it therefore seems appropriate that a trainee should be auditing it, the audit approach appears highly inefficient. Such in-depth testing (of controls and details) on an immaterial area provides further evidence that the audit has been inadequately planned.
Again, it may be due to a lack of monitoring of a mechanical approach being adopted by a trainee.
This also demonstrates a lack of knowledge and understanding about Cleanup's business – the company has no inventory, only consumables used in the supply of services.

v) **Prior period error**
It appears that the subsequent events review was inadequate in that an adjusting event (the out-of-court settlement) was not taken account of. This resulted in material misstatement in the financial statements to 30 June 2018 as the provision for GH¢ 450,000 which should have been made represented 18% of total assets at that date.
The audit manager has not taken any account of the implications of this evidence for the conduct of the audit as the overall audit strategy and audit plan should have been reconsidered. For example:

- the oversight in the subsequent events review may not have been isolated and there could be other misstatements in opening balances (e.g. if an impairment was not recognised);
- there may be doubts about the reliability of managements' written representations if it confirmed the litigation to be pending and/or asserted that there were no events after the reporting period to be taken account of.

The misstatement has implications for the quality of the prior period's audit that may now require that additional work be carried out on opening balances and comparatives.
As the matter is material it warrants a prior period adjustment (IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). If this is not made Cleanup's

financial statements for the year ended 30 June 2019 will be materially misstated with respect to the current year and comparatives – because the expense of the out-of-court settlement should be attributed to the prior period and not to the current year's net profit or loss.
The need for additional work may have a consequential effect on the current years' time/fee/staff budgets.
The misstatement should have been brought to the attention of Cleanup's management when it was discovered, so that a prior year adjustment could be made. If the audit manager did not feel competent to raise the matter with the client he should have discussed it immediately with the partner and not merely left it as a file note.

QC policies procedures at audit firm level/conclusions
That the audit is not being conducted in accordance with ISAs (e.g. ISA 300 *Planning an Audit of Financial Statements*, ISA 315 *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment* and ISA 520 *Analytical Procedures*) means that Green's quality control policies and procedures are not established and/or are not being communicated to personnel.
That audit work is being assigned to personnel with insufficient technical training and proficiency indicates weaknesses in procedures for hiring and/or training of personnel.
That there is insufficient direction, supervision and review of work at all levels to provide reasonable assurance that audit work is of an acceptable standard suggests a lack of resources.
Procedures for the acceptance of clients appear to be inadequate as the audit is being conducted so inefficiently (i.e. audit work is inappropriate and/or not cost-effective). In deciding whether or not to accept the audit of Cleanup, Green should have considered whether it had the ability to serve the client properly. The partner responsible for accepting the engagement does not appear to have evaluated the firm's (lack of) knowledge of the industry.
The staffing of the audit of Cleanup should be reviewed and a more experienced person assigned to its completion and overall review.

(10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS
The question was in two parts that is a) and b). a) was on regulatory authorities relevance to audit of financial statements. This question seemed simple but to our surprise, it was poorly answered by candidates.
b) was on quality control policies and procedures and its practical applications. Likewise, this question too was poorly answered.

CONCLUSION
Candidates should take their time to study well before taking the examination. They should study with understanding. There is the need to provide guidance to students on how to answer questions.