NOVEMBER 2021 PROFESSIONAL EXAMINATIONS
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER

The standard of the paper was very high. The questions were well within the syllabus in terms of structure and balanced in weightings. The paper was relatively free from errors, and each question was very clear, without any ambiguity. The requirements of each question were also easy to understand. Candidates were tasked to analyse and evaluate practical situations Auditors in practice meet in their day-to-day duties.

A question on the Public Sector Audit Standards (F: Audit of Public Sector) and the Exposure Draft on Audit of Less Complex Entities (I. Current Developments) were poorly answered. However, each question was within the syllabus in the section stated against them.

PERFORMANCE OF CANDIDATES

Candidates' performance was relatively high. 46.51% passed compared to performances in the previous sitting, where only 24.12% passed the May 2021 examinations and 39.28% passed the November 2020 examination.

The common mistakes were what appeared to be too much time spent on the first few questions, leaving little time for the last couple of questions. Candidates from large centres performed better probably due to the availability of tuition centres than those from small centres outside the large cities.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

Generally, candidates performed better in typical syllabus areas like Audit Procedures and Audit Evidence, Auditor's Report, Ethics, Risks and Quality Management.

Candidates need to prepare themselves better for questions on topical issues (especially the issue of new or revised standards and legislation) in the profession and not rely solely on issues discussed in the Study Manual under Current Developments. There also appeared to be inadequate preparation for the Public Sector Auditing Standards questions.

DETAILED QUESTION ANALYSIS

Looking at all five questions, the candidates understood the questions clearly. Except for poor performance in topics stated above, the general performance in all the questions was acceptable.

RECOMMENDATION

Looking ahead, candidates should make covering the entire syllabus a must and remember that the examination papers strictly follow the mark allocation to the various topics published in the syllabus.

QUESTION ONE

a) Although auditors can incur civil liability under various statutes, it is more likely that they will incur liability for negligence under common law, as most cases against auditors have been in this area. Therefore, auditors must be fully aware of the extent of their responsibilities to minimise the danger of professional negligence claims.

Required:
Discuss **FIVE (5)** steps that auditors should take to minimise the danger of claims against them for professional negligence. **(5 marks)**

b) Your firm has recently completed the audit of Jackson Company. After extensive discussion with the company's management, the audit opinion has been qualified in respect of the auditors' inability to agree with management on the appropriateness of a provision for obsolete inventory.

The Managing Director has informed you that the company intends to change its auditors and engage the services of a small local firm of accountants. He informed you verbally that the reason for their decision is the disagreement over the provision for inventory obsolescence.

Jackson Company is convinced that the new auditors are more likely to accept the accounting policies of management. You have received a letter from the new auditors enquiring if there are any professional reasons why they should not accept appointment as auditors of Jackson Company.

Required:
i) In view of the attitude of management towards your firm, discuss the factors which the new auditors need to consider before accepting the appointment. **(3 marks)**
ii) Explain the ethical implications for the new auditors if they accept the appointment as auditors. **(2 marks)**

c) Aglebe Ltd manufactures surgical instruments which are sold to hospitals and clinics. Due to the increased use of laser surgery in the last four years, demand for a traditional metal surgical instrument, which provided 75% of revenue in the year ended 30 June 2007, has declined rapidly.
You have been recently appointed auditor of Aglebe Ltd, and during preliminary discussions with some senior management, the following matters came to light:

Aglebe Ltd is expanding into laser surgery equipment, but research and development are at an early stage. However, the directors feel confident that the laser instruments being currently designed will eventually receive the necessary license for commercial production, and that the laser product will replace surgical instruments as a leading source of revenue. There is currently one scientist working on the laser instrument, subcontracted by Aglebe Ltd, on a freelance basis. In addition, the building in which the research is being carried out has recently been significantly extended by the construction of a large laboratory.

A considerable revenue is derived from agents who Aglebe Ltd does not employ. The agents earn a commission based on the value of sales they have secured for Aglebe Ltd

during the year. There are many suppliers in the market, and agents are used by all manufacturers to market and distribute their products.
The company's manufacturing facility is located in another country, where operating costs are significantly lower. The facility is under the control of a local Manager who visits the head office of Aglebe Ltd annually for a meeting with senior management. Products are imported by air. The overseas plant and equipment is owned by the company and was constructed 12 years ago specifically to manufacture metal surgical instruments.

The company has a bank overdraft facility and utilises it throughout the credit period. In addition, a significant bank loan that will carry a variable interest rate is currently being negotiated. The terms of the loan will be finalised once the bank has viewed the audited financial statements.

The Managing Director of Aglebe Ltd owns a supply chain company that supplies surgical instruments. He is known to be a disciplinarian and members of staff of the company including management would do everything possible to avoid any form of conflict with him.

Required:
Explain **FOUR (4)** principal audit risks facing Aglebe Ltd. **(10 marks)**

(Total: 20 marks)

QUESTION TWO

a) You are the Audit Manager responsible for the audit of Meggs Chops Ltd, a company that runs a chain of fast food restaurants. You are aware that a major risk of this sector is that poor food quality might result in damages claimed by customers.

You had satisfied yourself at the interim audit that the company's control risk as regards purchases of food and its preparation in the kitchen was low. However, during your final audit, it comes to your attention that one month before the year-end, a customer has sued the company for personal injury caused by food poisoning, claiming an amount of GH¢ 100,000 in compensation. This amount is material to the stated profit of the company, but management believes that it has good defences against the claim.

Required:

i) Recommend **TWO (2)** controls that the company should have in place to reduce the risk associated with food purchases and their preparation in the kitchen. **(2 marks)**
ii) State **TWO (2)** audit procedures you should carry out during controls testing to satisfy yourself that control risk in this area is low. **(2 marks)**
iii) Explain **TWO (2)** assertions relevant to accounts payable at the year-end date. **(4 marks)**
iv) In respect of the potential claim, state **THREE (3)** items of evidence you should obtain and explain how they might enable you to form a conclusion on the likelihood of the claim being successful. **(6 marks)**

b) Following your audit, you have concluded that there is a possibility, but not a probability, that the claim will be successful. However, management has decided not to make a provision or disclosure in the financial statements regarding this matter.

Required:
Describe how the matter should be reported in the financial statements and explain the effect on your audit report. **(6 marks)**

(Total: 20 marks)

QUESTION THREE

You are the Audit Manager of Integrity & Associates. You are currently reviewing the audit files for several of your clients for which the audit fieldwork is completed. The Audit Seniors have raised the following issues:

Gaint Ltd (Gaint)
Gaint was incorporated over two decades ago. Due to the leadership philosophy of the founders, the company has expanded significantly. As a result, it has won many local and international awards for the quality of services to customers.

However, after the Government announced the outbreak of the Corona Virus in March 2020, it negatively impacted the company's operations. Gaint has experienced difficult business conditions due to the impact of the Corona Virus and has lost significant market share. The prior year's financial statements showed a profit before tax of GH¢1.2 million; however, the current year loss before tax is GH¢ 4.4 million. The forecast net cash outflow for the next 12 months is GH¢3.2 million.

The cash flow forecast has been reviewed during the audit fieldwork, and it shows a significant net cash outflow. Management is confident that further funding can be obtained and has prepared the financial statements on a going concern basis with no additional disclosures. However, the audit senior is highly sceptical about this.

Falcon Ltd (Falcon)
Falcon's year end is 30 September, however, subsequent to the year end the company's purchases ledger has been corrupted by a computer virus. Falcon's Finance Director was able to produce the financial statements prior to this occurring. However, the audit team has been unable to access the sales ledger to undertake detailed revenue or year-end receivables testing. All other accounting records are unaffected, and there are no backups available for the sales ledger. Falcon's revenue is GH¢15.6 million. Its receivables are GH¢3.4 million and profit before tax is GH¢2 million.

The company's directors have provided the external audit firm with an oral representation confirming that the bank overdraft balances included within current liabilities are complete. An associate of your team approached you if the oral representation could be relied on or a written representation is needed.

Required:

a) For each of the two issues:

i) Discuss the issue, including an assessment of whether it is material;

ii) Recommend procedures the audit team should undertake at the completion stage to resolve the issue; and

iii) Discuss the impact on the audit report if the issue remains unresolved. **(14 marks)**

b) Explain the purpose of and procedures for obtaining written representations. **(3 marks)**

c) Explain the relevance and reliability of this oral representation as a source of evidence to confirm the completeness of the bank overdraft balance. **(3 marks)**

(Total: 20 marks)

QUESTION FOUR

a) ***ISSAI 1705*** provides supplementary guidance on ***ISA 705 (Revised): Modifications to the opinion in the Independent Auditor's Report*** for public sector auditors**.** ISA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with ISA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

ISA 705 establishes three types of modified opinions: a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon:

i) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, maybe materially misstated; and

ii) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Required:

Discuss **THREE (3)** other factors public sector auditors consider before modifying their audit opinion in accordance with ***ISSAI 1705***. **(10 marks)**

b) Risk assessment is a major component of audit planning. It is, therefore, necessary for inherent risk, control risk, and audit risk to be identified at the planning stage before the commencement of the audit work.

Required:

Explain **FIVE (5)** risks of material misstatements for entities in the public sector and how to audit the risk identified. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

a) The International Auditing and Assurance Standards Board (IAASB) has developed a separate standard for an audit of financial statements of a Less Complex Entity (LCE). These standards are based on the same underlying concepts as ISAs.

Required:
Discuss **FOUR (4)** of the underlying concepts clearly explaining this separate standard's advantages to the Auditing Profession. **(10 marks)**

b) Fitman Ltd (Fitman) operates a chain of health and fitness clubs. Audit of Fitman is yet to commence for the year ending 31 October 2020. You are the Audit Manager in charge of the audit and you have received an electronic mail from the Partner to commence the planning of the audit. The partner drew your attention to the following matters:

Reorganisation
The company recently announced its plans to reorganise its health and fitness clubs. This will involve closing some clubs for refurbishment, retraining some existing staff and disposing off surplus assets. These plans were agreed upon at a board meeting in October and announced to their shareholders on 29 October 2020. Fitman is proposing to make a reorganisation provision in the financial statements. **(5 marks)**

Receivables
Fitman's trade receivables have historically been low as most members pay monthly in advance. However, during the year under review, a number of companies have taken up group membership package at Fitman and hence the receivables balance is now material. The audit senior has undertaken a receivables circularisation for the balances at the year end. However, there were some non-responses and a number of responses with differences. **(5 marks)**

The company intends to sign the audit report on 20 November 2020.

Required:
Describe substantive procedures you would perform to obtain sufficient and appropriate audit evidence in relation to the above matters.

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a) Steps to minimise the danger of claims against negligent work includes;

- Agreements concerning the duties of the auditor should be:
  - Clear and precise
  - In writing
  - Confirmed by a letter of engagement, including matters specifically included
- Audit work should be:
  - Relevant to the system of internal control, which must be ascertained, evaluated and tested. Control cannot be entirely ignored: for the auditor to have any confidence in an accounting system, there must be evidence and the existence of minimum controls to ensure the completeness and accuracy of records.
  - Adequately planned before the audit commences.
  - Reviewed by a senior member of the firm to ensure quality control of the audit and to enable a decision to be made on the form of audit report
- Any queries arising during the audit should be:
  - Recorded on the current working papers
  - Cleared and filed
- A management letter should be:
  - Submitted to the client or the boss of directors in writing immediately following an audit
  - Seen to be acted upon by the client
- All members of an auditing firm should be familiar with:
  - The standards expected without the firm
  - The standard of the profession as a whole by means of adequate training, which should cover the complementation of the firm's audit manual and the recommendation of the professional accountancy bodies
- Insurance should take out to cover the firm against possible claims.
- Others that can be added:
  (i) Auditor and Partner Rotation
  (ii) Adherence to Auditing Standards
  (iii) Adherence to Quality Management Standards
  (iv) Adding a Disclaimer Clause

(5 points @ 1 mark each = 5 marks)

b)

(i) Factors to consider before accepting an appointment:

- The nominee auditors should be aware of the attempted manipulation on the part of the directors. If the new auditors feel that they will not be able to act within the IESBA Code of Ethics for Professional Accountants, they should not o accept the appointment.

- The auditors should ensure that the code guidelines on fee income are observed. Jackson plc should not represent more than 15 % of the practice fee income.
- Other ethical matters also need to be considered. For example, it should be ensured that there are no personal relationships between auditor and client that are restricted by the code.

(3 points @ 1 mark each = 3 marks)

(ii) Ethical implications for nominee auditor.

- The new auditor must be and be seen to be independent. In this particular case, care should be taken that the directors do not attempt to influence the audit opinion.
- The new auditor must communicate with the outgoing auditors before accepting the appointment. Permission will need to be sought from Jackson plc before marking such communication, and if permission is refused, new auditors cannot accept the appointment.
- The outgoing auditors may also need permission from Jackson plc before they can share any matters that they feel should be brought to the attention of the new auditors before responding to any request for information. If permission is refused, the new auditors must carefully consider whether to accept the appointment.
- The new auditors should also ensure that they can cope with the client's size of Jackson plc, and it is the sort of clients that will 'fit' with their current portfolio.
- The auditor should ensure that they are in compliance with or is aware of the following ethical principles/threats against independence:
  (i) Integrity
  (ii) Objectivity
  (iii) Intimidation

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

(c) The principal audit risks include the following:

- **Product life cycle**. Demand is declining for the main revenue-generating product. The market is moving such that the demand for laser surgical instruments is increasing, while demand for the traditional metal instrument is declining. The continued loss of the main revenue stream will have significant detrimental profit and cash flow implications. Demand has been declining for four years, yet it seems that research has only recently commenced into a new source of revenue. The management appears not to focus on the long-term strategy needed for survival in this competitive market.

- **Research is at an early stage**. It may take many years for the development stage to be reached. Research the development necessitates a significant cash outflow, and this is happening at the same time as the loss of cash inflows from the main revenue stream. As the company is already short of liquid funds, as evidenced by the ongoing use of an overdraft facility, it could be that the will be insufficient funds to continue to develop the new product.

- **The research is being conducted by only one scientist**, who the company does not employ. The scientist is critical for the successful development of a placement revenue stream. If the scientist were to leave, would lose Aglebe Ltd, the knowledge base of the new technology, hindering progress into the new market. This is a very specialist role, so it may be a lengthy and challenging process to find a new scientist to work on the project. It is a significant risk to rely so heavily on a person not employed by the company for such a crucial role in the business's future success.

- **There may also be confidentiality issue**s. If the scientist is freelancing for any competitor of Aglebe Ltd, the new laser equipment designs could be copied and used unless Aglebe Ltd secures protection of the design e.g. by taking out a patent.

- **The industry is highly regulated**, and licenses are necessary to take medical instruments to market. If the license is not granted, the research and development funds will have been wasted, and the continuation of the business as a going concern could be jeopardised.

- **Use of agents for marketing and distribution.** Aglebe Ltd appears to rely heavily on agents to secure sales to hospitals and clinics. If the agents are unsuccessful or decide to reduce the effort they put into promoting Aglebe Ltd products in preference for products from an alternative supplier, then the company will face a substantial reduction in revenue and cash inflows.
  A second risk associated with the use of agents is that there is a scope for fraud – the agents could deliberately overstate the value of sales to maximise the commission they receive. When the point is linked to the poor internal system and control, as indicated by Andy, such frauds would likely be detected.

- **Overseas location of the manufacturing facility**. The fact that the products are manufactured abroad could lead to problems in controlling and monitoring production. Decisions made locally may not be compatible with the overall operating strategy of the company. Also, if communication channels are not operating efficiently then decisions made at the head office may take time to be relayed to the foreign manager. This could lead to production inefficiencies. For example, e.g. if an agent secures a contract to supply a particular product, it may take time for this to be communicated to the manufacturing facility, and delays in fulfilling the order will be inevitable, leading to loss of agent and customer goodwill.

- **Monitoring the quality of output overseas.** Having the production facility operation abroad could also lead to problems with monitoring the quality of output. This is a highly regulated industry, where suppliers of faulty equipment could face fines and bad publicity in the event of supplying a poor quality item. Agents would withdraw their support for the products immediately in preference to those of competitors.

- **Fluctuating overhead costs as fuel prices and freight costs**. Importing goods using airplanes exposes the company to fluctuating overhead costs as fuel prices and freight costs are notoriously difficult to predict. Higher levels of tax could also be imposed on imported goods.

- **Exposure to exchange rate risk.** As the company manufactures abroad, it would inevitably make foreign currency payments and be exposed to exchange rate risk.

- **Capital expenditure and financial management**. Plant and equipment appear to be fairly old, constructed twelve years ago. If the research and development into the new laser equipment is successful, then capital expenditure will be needed to create the capacity to manufacture the new products. The risk is that finance may not be available to invest in new plant.

- **The company appears to have a problem managing liquidity**. Continually operating using an overdraft is expensive in terms of the financial cost. In addition, a bank loan carrying a variable interest rate exposes the company to the economic risk of fluctuations in the interest rate, making planning and budgeting cash flows difficult.

- Risk of overstatement of revenue
- Risk of overstatement of non-current assets
- Risk of understatement of liability
- Failure to comply with the requirements of specified accounting standards

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

(Total: 20 marks)

QUESTION TWO

a)

i) Controls	**ii) Procedures**
Overall authority for food purchasing should be in the hands of a designated person to ensure that the food purchased is of the desired quality. This is often in the hands of the head chef.	Review the company's organisation chart and identify the person responsible for food purchasing. Purchases is of the desired quality.
There should be a list of approved supplies to ensure that the food comes from sources known for its quality.	Examine the list of approved supplies of food and check that there are no purchases of food from other parties.
On receipt of food, whether meat, fish, or vegetables and fruit, it should be carefully inspected by informed people, including those responsible for food preparation. This would be to ensure that it was of the desired quality (as well as quantity). Goods received note (GRN) should be signed to provide evidence of receipt and inspection.	Examine a sample of GRNs to ensure that all bear an approved signature indicating that food has been inspected for quality on receipt.
Food purchased should be kept in a clean place and refrigerated, if necessary. This would be to ensure that it has kept its quality.	Examine the food storage areas, including refrigerators, on a surprise basis to ensure they are clean and tidy. Ensure that the refrigerators are maintained at the correct temperature. Another test in this area might be to examine reports of local authority and other inspectors to ensure they were happy that the food was being properly stored.
Strict adherence to use-by dates to ensure that no poor quality food is prepared.	Check that there is no food on the premises which is past its use-by date. Then, discuss with management what happens to food that is past its use-by date how it is disposed off.

(2 controls @ 1 mark each = 2 marks)
(2 procedures @ 1 mark each = 2 marks)

iii) Regarding accounts payable, many different assertions have to be addressed. Some relevant assertions are set out below:

- Rights and obligations – Accounts payable represent amounts due by the company, that is, there is an obligation, taking into account:
  - the actual performance of services for the company; or
  - transfer of title in goods transferred to the company; and
  - cash payments or other genuine debit entries.
- Valuation and allocation – Accounts payable have been correctly valued, taking into account original transaction amounts and such matters as trade discounts and local sales tax.
- Existence – The original transaction amounts are valid, and the liability exists.
- Completeness – All accounts payable are recorded in the accounting records.

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

iv) Evidence collected by the auditor to enable a conclusion to be formed on the likelihood of the claim being successful (that is, whether a provision would be necessary according to ***IAS 37: Provisions, Contingent Liabilities and Contingent Assets***) includes:

Evidence	Explanation
Obtain the written claim by the customer.	This would tell you the reason why the claim was being made and provide other relevant details, such as whether the customer dined in the restaurant or purchased carry-out food, and the date when the alleged food poisoning took place.
Review the controls in force over purchases and food preparation	This would be to ensure that the company controls appeared to be effective
Obtain written reports concerning any inspections carried out by company staff or third parties in the food store and food preparation areas.	This would provide evidence about any problems that had arisen affecting food quality. Discuss with management the actions that were taken to correct any problems that had arisen.
Discuss the matter with the company's lawyers to obtain their on the likelihood of the claim being successful	This would provide evidence from a professional third obtain party as to the likelihood of the claim succeeding and the reasons why the lawyers had reached their conclusion.

Obtain management representations regarding the likelihood of the claim succeeding	This is internal evidence and should be approached with professional skepticism, but it would provide the auditor with the views of an informed group

(Any 3 points @ 2 mark each = 6 marks)

b) As you have concluded that the likelihood of the claim being successful is only possible, it would be appropriate for the company to explain the contingent liability by way of note as required by IAS 37, describing the nature of the contingent liability, an estimate of its financial effect, an indication of the uncertainties relating to the amount and timing and the possibility of any reimbursement.

If the company includes a note of this nature, there would be no need to modify your audit opinion; however, if the litigation is viewed as exceptional, then an emphasis of matter paragraph might be appropriate. However, if the contingency is not disclosed, the auditor would modify the audit opinion on the grounds of an 'except for': on the grounds that the Financial Statements are materially misstated (do not contain all the information required). Again, this is material, but there is no evidence suggesting it is pervasive.

The auditor should persuade management to include the disclosure to avoid issuing the modified opinion.

(6 marks)

(Total: 20 marks)

QUESTION THREE

a)

Gaint Ltd

i) Gaint Ltd faces going concern problems as it has experienced difficult trading conditions and has a negative cash outflow. However, the financial statements have been prepared on a going concern basis, even though it is possible that the company is not a going concern. The prior year's financial statements showed a profit of GH¢ 1.2 million profit, and the current financial statements show a loss before tax of GH¢ 4.4 million. The net cash outflow of GH¢ 3.2 million represents 73% of this loss (3.2/4.4 million) and hence is a material issue.

ii) Management is confident that further funding can be obtained; however, the team is skeptical, and so the following procedures should be adopted:

- First, discuss with management whether any finance has now been secured.
- Review the correspondence with the finance provider to confirm the level of funding that is to be provided, and this should be compared to the net cash outflow of GH¢ 3.2 million.
- Review the most recent board minutes to understand whether management's view on Gaint Ltd's going concern has altered.
- Review the cash flow forecasts for the year and assess the reasonableness of the assumptions adopted.

iii) If management refuse to amend the going concern basis of the financial statements or at the very least make adequate going concern disclosures, then the audit report will need to be modified. As the going concern basis is probably incorrect and the error is material and pervasive, an adverse opinion would be necessary.
A basis for the adverse opinion paragraph will be required to explain the inappropriate use of the going concern assumption. Accordingly, the opinion paragraph will be an adverse opinion and state that the financial statements do not give a true and fair view.

(7 marks)

Falcon Ltd

i) A computer virus has corrupted falcon Ltd's purchases ledger; hence no detailed testing has been performed on revenue and receivables. The audit team will need to see if they can confirm revenue and receivables in an alternative manner. If they cannot do this, then two significant balances in the financial statements will not have been confirmed. Revenue and receivables are both higher than the total profit before tax (PBT) of GH¢ 2 million; receivables are 170% of PBT, and revenue is nearly eight times the PBT; hence this is a very material issue.

ii) Procedures to be adopted include:

- Discuss with management whether they have any alternative records that detail the year's revenue and receivables.
- Attempt to perform analytical procedures, such as proof in total or monthly comparison to last year, to gain comfort in total for revenue and receivables.

iii) The auditors will need to modify the audit report as they cannot obtain sufficient appropriate evidence in relation to two material and pervasive areas: receivables and revenue. Therefore a disclaimer of opinion will be required.
A basis for the disclaimer of opinion paragraph will be required to explain the limitation in the lack of evidence over revenue and receivables. The opinion paragraph will be a disclaimer of opinion and state that we cannot form an opinion on the financial statements.

(7 marks)

Marks are allocated as follows:
(i) The issue and its Materiality (2 marks)
(ii) Audit Procedures (Any 3 points @ 1 marks each = 3 marks)
(iii) Impact on Audit Report if not resolved (2 marks)

b) **Written representations**

Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

The auditor needs to obtain written representations from management and, where appropriate, those charged with governance that they believe they have fulfilled their responsibility for preparing the financial statements and for the completeness of the information provided to the auditor.

Written representations are needed to support other audit evidence relevant to the financial statements or specific assertions in the financial statements if determined necessary by the auditor or required by other International Standards on Auditing. This may be necessary for judgmental areas where the auditor has to rely on management explanations.

Written representations can be used to confirm that management have communicated to the auditor all deficiencies in internal controls of which management are aware.

Written representations are generally in the form of a letter, written by the company's management and addressed to the auditor. The letter is usually requested from management but can also be requested from the chief operating officer or chief financial officer. Throughout the fieldwork, the audit team will note any areas where representations may be required.

The auditors will produce a draft representation letter during the final review stage. The directors will review this and then produce it on their letterhead.
It will be signed by the directors and dated as at the date the audit report is signed, but not after.

(3 marks)

c) Oral representation

A representation from management confirming that overdrafts are complete would be relevant evidence. Overdrafts are liabilities, and therefore the main focus for the auditor is completeness.

Regarding reliability, the evidence is oral rather than written, which reduces its reliability. The directors could in the future deny having given this representation, and the auditors would have no documentary evidence to prove what the directors had said.

This evidence is obtained from management rather than auditor-generated and is, therefore, less reliable. Management may wish to provide biased evidence to reduce the amount of liabilities in the financial statements. The auditors are unbiased, so evidence generated directly by them will be better.

External evidence obtained from the company's banks could be used to confirm the bank overdraft balances, and this would be more independent than relying on management's internal confirmations.

(3 marks)

(Total: 20 marks)

QUESTION FOUR

a) Additional factors for public sector auditors' considerations are:

(i) The audit mandate, or obligations for public sector entities, arising from compliance to laws and regulations and pronouncements issued by Authorities including the MMDAs, Ministers, the Act setting up the MMDA itself, legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature which may result in additional objectives.

(ii) about any instances of management refusing to remove restrictions on access to audit evidence due to official secrecy regulations.

(iii) non-compliance with provisions of PMA Act, Expenditure not in compliance with budgetary allocation, and other financial maleficence.

(iv) there may be general public expectations in regard to public sector on reporting on the effectiveness of internal control.

(v) there may be general public expectations in regard to the public sector on reporting on value for money (economic, efficiency and effectiveness of expenditure).

(Any 3 points @ 3.33 marks each = 10 marks)

b) The following are examples of additional conditions and events that may indicate risks of material misstatement for entities in the public sector:

- Budget overspending due to weak budgetary controls
- Privatisations
- New programs
- Major changes to existing programs
- New financing sources
- New legislation and regulations or directives
- Political decisions such as relocation of operations
- Programs without sufficient allocated resources and funding
- Increased public expectations
- Procurement of goods and services in certain industries such as defense
- Outsourcing of government activities
- Operations subject to special investigations
- Changes in political leadership
- Indications of waste or abuse
- Higher than normal expectations to meet the budget; and
- Public and private partnerships

Source of Identification:
Communication, directive, legislature, report, approval, analytical review of financial statement as applicable to the factors above. On waste and abuse it could be the frequency of use or the expenditure incurred on the item, dumping of a large chunk of the item, left to lie idle unused. For changes in political leadership is a question of event.

Audit work:

Budget overspending due to weak budgetary controls. Compare budget to actuals, check the approval system, check expenditure documentation, check the actual item and estimate the likely cost. Then, assess the relevance of the item.

Privatisations. Check whether implementation is in line with concept and approval, Check expenditure involved compared to the intended. Check related party transactions.

New programs. Check approvals and objectives, check expenditure involved in line with intended and commensurate income. Establish its impact on the business. Check related party transactions.

Major changes to existing programs. Seek authorisation and approvals, check related expenditure and incomes. Assess the impact on the organisation. Check related party transactions.

New financing sources. Check authorisation and approval, emphasing on the rationale and the source of the fund, ensuring there are no strings attached and that source of the fund is legal. Check at the receipts and usage.

New legislation and regulations or directives. Check the legitimacy, ensure that the intended purpose is understood, check the application, check the impact.

Political decisions such as relocation of operations. Check the application and approval. Ensure the directive is properly complied with.

Programs without sufficient allocated resources and funding. Check the sum required, check the amount used, check the effect of the shortfall.

Increased public expectations. Check the expenditure incurred, check authorisation and approval, check the reason for the overspending. Check related party transactions.

Procurement of goods and services in certain industries such as defense. Check correspondence to determine approval and authorisation, check the spending process to establish whether due process was followed, cheque related party transactions.

Outsourcing of government activities. Check communication for authorisation and approval, check the basis for the outsourcing, check expenditure incurred, check benefit accruing to the organisation., due process, check related party transactions.

Operations subject to special investigations. Check for report ensure the recommendations of the report have been implemented.

Changes in political leadership. Check administration follows status quo, check all changes and directives are communicated and approved, ensure internal controls are working.

Indications of waste or abuse. Confirm the waste, seek explanation and approval for the waste, quantify the waste

Higher than normal expectations to meet the budget. Check the control environment, ensure that the internal controls are working, check incomes are not over blotted, and expenditures are not influenced.

Public and private partnerships. Check approval, check the selection of the partner conforms to the partnership structure, check timelines, check related party transactions.

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

(Total: 20 marks)

QUESTION FIVE

a) Underlying concepts

- Maintaining confidence in financial reporting of Less Complex Entities (LCEs)
- Helping auditors of LCEs undertake consistent, effective, and high-quality audits
  This requires the use of:
  Risk-based approach (Principle-based)
  Reasonable Assurance opinion
- Being responsive to stakeholder needs
  Involving Maintaining Ethical Requirements and Independence of the Auditor

- Promoting a more consistent application of the auditing standards
  Clear, consistent documentation
  Use of Audit Objectives for auditor's procedures
  Professional Judgement and Professional Skepticism
  Quality Management requirements

(Any 4 points @ 2½ marks each = 10 marks)

b) **Reorganisation**

- Review the board minutes where the decision to reorganise the business was taken, ascertain if this decision was made pre year-end.
- Review the announcement to shareholders in late October to confirm that this was announced before the year-end.
- Obtain a breakdown of the reorganisation provision and confirm that only direct expenditure from restructuring is included.
- Review the expenditure to confirm that there are no retraining costs included.
- Cast the breakdown of the reorganisation provision to ensure correctly calculated.
- For the costs included within the provision, agree to supporting documentation to confirm the validity of items included.
- Obtain a written representation confirming management discussions in relation to the announcement of the reorganisation.
- Review the adequacy of the disclosures of the reorganisation in the financial statements to ensure they are in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

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

Receivables

- For non-responses, the team should arrange to send a follow-up circularisation with the client's permission.
- Suppose the customer does not respond to the follow-up, then with the client's permission. In that case, the senior should telephone the customer and ask whether they can respond in writing to the circularisation request.
- If there are still non-responses, the senior should undertake alternative procedures to confirm receivables.
- For responses with differences, the senior should identify any disputed amounts and determine whether these relate to timing differences or possible errors in Fitman Ltd's records.

- Any differences due to timing, such as cash in transit, should be agreed to post year-end cash receipts in the cash book.
- The receivables ledger should be reviewed to identify any possible mispostings as this could be a reason for a response with a difference.
- If any balances have been flagged as disputed by the customer, then these should be discussed with management to identify whether a write-down is necessary.

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

(Total: 20 marks)