DECEMBER 2022 PROFESSIONAL EXAMINATIONS
AUDIT & ASSURANCE (PAPER 2.3)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER:

The standard of the paper was good. The questions were practical and within the syllabus in terms of structure and weightings. The paper was free from errors. The rubrics of the paper were very clear without any ambiguities. The marks allocated to the various sub-questions were commensurate with the amount of time expected to be spent on the question.

PERFORMANCE OF CANDIDATES:

This diet saw an improved performance over the August 2022 session with the pass rate of approximately 94%, the best in recent times. There were high performers as well as low performers across centres.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES:

The strength of most candidates was demonstrated in question 1(a), (b) and (c), question 2(a) as well as question 4(b) and question 5(a), (b) and (c).

Areas of weakness identified with candidates were question 2(b) and 2(c), as well as question 5(d) and (e). Some candidates could not demonstrate adequate understanding of analytical procedures. Hence, their inability to answer question 4(a)(i) and (ii).

QUESTION ONE

a) Institute of Chartered Accountants, Ghana (ICAG) is established by the Institute of Chartered Accountants, Ghana, Act 2020 (Act 1058). Its mission is to train professional accountants of the highest quality, ready to provide cutting edge services to their clients at all times upholding the ethical values of the accountancy profession. In addition, all companies must have their financial statements audited by accountants regulated by ICAG as it is the sole regulator of the accountancy practice in Ghana.

Required:

i) Define the ***concept of self-regulation***. **(2 marks)**

ii) Outline **THREE (3)** roles of a regulatory body such as ICAG in regulating Accountancy profession in Ghana. **(3 marks)**

b) According to ***ISA 240: The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements,*** the term ***"Fraud"*** refers to an intentional act by one or more individuals among management, those charged with governance, employees or third parties involving the use of deception to obtain an unjust or illegal advantage.

Required:

i) State the **TWO (2)** types of fraud as identified by ***ISA 240***. **(4 marks)**

ii) For each type of fraud, list **THREE (3)** examples. **(6 marks)**

c) You are the manager in charge of the audit of God First Microfinance Co. Ltd for the year ended 31 December, 2021. Due to the highly regulated environment in which such companies have to operate, your partner has requested that right from planning stage of the audit, you strictly apply the requirement of ***ISA 220: Quality Control for an audit of financial statements***.

Required:

State **FIVE (5)** reasons for the need for a quality control system in accounting firms. **(5 marks)**

(Total: 20 marks)

QUESTION TWO

a) External Auditors play a key role in the corporate governance framework. They conduct one of the most important corporate governance checks that help to monitor management's activities. The audit of financial statement makes disclosures more reliable, thus increasing confidence in the company's transparency.

Required:
Explain **FIVE (5)** roles that External Auditors play in Corporate Governance. **(10 marks)**

b) The nature of the relationship between the audit firm and the client is specified in an engagement letter, which help reduce the possibility of misunderstanding the auditor's position. This letter should be reviewed, updated and signed on an annual basis.

Required:
Explain **FOUR (4)** mandatory terms contained in an engagement letter. **(5 marks)**

c) You have been nominated as an Auditor to replace a professional colleague who is retiring from an engagement after having served the mandatory period of six years as required by statute.

Required:
Describe **FIVE (5)** procedures you should follow to fulfil the legal and professional requirements for the acceptance of the engagement. **(5 marks)**

(Total: 20 marks)

QUESTION THREE

a) You have been asked by your Audit Manager to assess the audit evidence provided by a client, a small company owned by Mr. and Mrs. Randolph-Phillips. You observed that the files have been neatly packaged and well referenced. You are however skeptical as to the quality of evidence provided because the year's audit encountered many difficulties.

Required:
Outline **FIVE (5)** general principles in accordance with ***ISA 500: Audit Evidence***, that will assist you in assessing the reliability of the audit evidence received. **(5 marks)**

b) You have been presented with the Financial Statements of Asiki Ltd, an audit client that has been consistent in reporting good financial performance. As part of obtaining audit evidence your Audit Manager has asked you to perform analytical procedures on the company's General and Administrative Expenses using ratio analysis.

Required:
Explain to the Audit Manager **FOUR (4)** limitations of ratio analysis and how these could impact on assertions. **(5 marks)**

c) ***ISA 501: Audit Evidence – Additional considerations for specific items*** requires that, if inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence by among others being present at physical inventory counting unless impractical. The Managing Director of MLT Ltd is at a loss as to why in this age of technological advancement, auditors insist of being present during physical inventory count.

Required:

i) Explain **FOUR (4)** reasons for conducting physical inventory counts. **(6 marks)**

ii) Discuss the responsibilities of Management and Auditors with respect to physical inventory counts. **(4 marks)**

(Total: 20 marks)

QUESTION FOUR

a) You are an Audit Assistant of Apakye & Associates, a firm of Chartered Accountants. Your firm engaged an intern who would like to know more about analytical procedures.

Required:

With reference to ***ISA 520: Analytical Procedures,***

i) Explain the term '***analytical procedures***'. **(1 marks)**

ii) Explain the different types of analytical procedures available to the auditor. **(3 marks)**

iii) Describe **THREE (3)** situations in the course of audit when analytical procedures can be used. **(6 marks)**

b) Your management has decided to outsource the internal audit function in your organisation. You have been assigned to make a presentation to management.

Required:

Discuss **THREE (3)** advantages and **TWO (2)** disadvantages of outsourcing the Internal Audit function in your presentation. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

a) Auditors have various duties to perform in their role as auditors, for example, to express an opinion regarding truth and fairness of the financial statements.

Required:
State **FOUR (4)** rights that enable auditors to carry out their duties. **(4 marks)**

b) ***ISA 620: Using the Work of an Expert*** explains how an auditor may use an expert to obtain audit evidence.

Required:
State **THREE (3)** factors that the external auditor should consider when assessing the competence and objectivity of the expert. **(3 marks)**

c) You were recently appointed by Danso & Co Chartered Accountants. You were part of the team that audited a construction company with huge asset base. Your Manager reviewed your file and raise questions that audit evidence obtained was not relevant since it did not address any assertions of property, plant and equipment. ***ISA 500: Audit Evidence*** requires that audit evidence must be sufficient, relevant and reliable.

Required:
Explain **THREE (3)** assertions relevant to the audit of tangible non-current assets.

(3 marks)

d) A significant deficiency in internal control is one which merits the attention of those charge with governance.

Required:
State **THREE (3)** requirements of an Auditor when there are deficiencies in internal control of a client?

(6 marks)

e) The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit.

Required:
State **FOUR (4)** matters that an Auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency.

(4 points)

(Total: 20 marks)

SUGGESTED SOLUTION

QUESTION ONE

a)

i) ***Self-regulation*** is a system where the regulation of auditors is carried out by their own professional bodies such as ICAG instead of another Governmental agency.

(2 marks)

ii) Role of ICAG in regulating the Accountancy practice in Ghana;

- Offering professional qualifications for auditors, to provide evidence that auditors possess a minimum level of technical competence.
- Establishing procedures to ensuring that professional competence of auditors is maintained by ensuring that audit work is reformed only by fit and proper persons.
- Maintaining a list of registered auditors, which is made available to the public.

(3 points @ I mark each = 3 marks)

b)

i) Two types of fraud are identified by ISA 240

- Fraudulent financial reporting
- Misappropriation of assets. **(4 marks)**

ii) Fraudulent financial reporting includes:

- Forging or altering accounting records or supporting documentation which form the basis of the financial statements.
- Misrepresenting or intentionally omitting of transactions from the financial statements.
- Intentionally misapplying accounting principles.

(3 points @ I mark each = 3 marks)

Misappropriation of assets includes:

- Embezzling receipts (for example, diverting them to personal bank accounts)
- Stealing physical assets (such as inventory) or intellectual property (for example, by selling "trade secrets" to a competitor)
- Causing an entity to pay for goods and services not received (for example, by the creation of fictitious suppliers)
- Using an entity's assets for personal use.

(3 points @ I mark each = 3 marks)

c) The need for quality control system in accountancy firms.

Quality control is needed to should reduce the risk for the audit firm that it will:

- Issue an incorrect audit opinion, and
- Be sued for negligence.
- Legal damages and legal costs.
- The loss of the client
- Adverse publicity and damage to the reputation of the audit firm
- Disciplinary proceedings by a professional body such as ICAG.

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

(Total: 20 marks)

EXAMINER'S COMMENTS
Performance by the candidates was satisfactory.

QUESTION TWO

a) Roles External Auditors play in Corporate Governance

- External auditors play a key role in the corporate governance framework. They conduct one of the most important corporate governance checks that help to monitor management's activities.
- The audit of financial statement makes disclosures more reliable, thus increasing confidence in the company's transparency.
- The role of external auditors is to make sure that Board of Directors and the management are acting responsibly towards the shareholders' investment interests. By acting objectively, the external auditors can add value to shareholders by ensuring that the company's internal controls are strong and effective.
- By working with the audit committee and liaising with internal auditors, external auditors can help to facilitate a more effective oversight of the financial reporting process by the Board of Directors.
- The annual audit enables the directors to present audited Financial Statements to the shareholders and other bodies as required by statutes.
- However, the "audit expectations gap' needs to be acknowledged, as the audit function can only do so much on the fraud. The external auditor cannot be expected to find every fraud and error during an audit. In accordance with the Cadbury Report, it is important to know that the external auditor's role is not to prepare the financial statements, nor to provide assurance that the data in the financial statements are correct, nor to guarantee that the company will continue as a going concern.

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

b) The engagement letter will be sent before the audit. It specifies the nature of the contract between the audit firm and the client and minimises the risk of any misunderstanding of the auditor's role. It should be reviewed every year to ensure that it is up to date but does not need to be reissued every year unless there are changes to the terms of the engagement. The auditor must issue a new engagement letter if the scope or context of the assignment changes after initial appointment. ISA 210 requires the auditor to consider whether there is a need to remind the entity of the existing terms of the audit engagement for recurring audits and many firms choose to send a new letter every year, to emphasise its importance to clients.

The contents of a letter of engagement for audit services are listed in ISA 210 Agreeing the Terms of Audit Engagements. They should include the following:

- The objective and scope of the audit;
- The responsibilities of the auditor;
- The responsibilities of management;
- The identification of an applicable financial reporting framework; and
- Reference to the expected form and content of any reports to be issued.

(Any 4 points @ I.25 marks each = 5 marks)

c) If offered an audit role, the auditor should:

- Ask the client for permission to contact the outgoing auditor (reject role if client refuses)
- Contact the outgoing auditor, asking for any reasons why they should not accept appointment. If a reply is not received, the prospective auditor should try and contact the outgoing auditor by other means e.g. by telephone. If a reply is still not received, the prospective auditor may still choose to accept but must proceed with care.
- Ensure that the legal requirements in relation to the removal of the previous auditors and the appointment of the firm have been met.
- Carry out checks to ensure the firm can be independent, is competent to do this audit and has the necessary resources.
- Assess whether this work is suitably low risk.
- Assess the integrity of the company's directors.
- As a commercial organisation, the firm should also ensure that this is a desirable client (e.g. right industry, suitable profit margin etc).
- Not accept the appointment, where it is known that a limitation will be placed on the scope of the audit.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 2 a) was well answered by most candidates because the question was practical. Question 2 b) quite a straightforward question was not well answered by most candidates. Performance for question 2 c) was average.

QUESTION THREE

a) General principles to assist the auditor in assessing reliability of audit evidence:

- Audit evidence is more reliable when it is obtained from independent sources outside the entity under audit.
- Internally generated audit evidence is more reliable when the internal controls are effective.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable if it exists in documentary form.
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or documents that have been filmed or otherwise transformed into electronic form.

(5 points @ 1 mark each = 5 marks)

b) Limitations of ratio analysis

- Its usefulness depends on the quality of the underlying financial information. It is usual for the auditor to calculate financial ratios from the client's management accounts, which are more detailed than financial statements and can provide a source of more and better information.
- For comparison purposes, the information must be calculated on a consistent basis.
- The two figures used to calculate a ratio must be logically related.
- The auditor needs to understand the client's business so that he is able to understand the potential significance of ratios, or reasons for differences.

(4 points @ 1.25 marks each = 5 marks)

c)

i) Reasons for conducting physical inventory count

- Physical counts may be fairly easy to arrange particularly where most items of inventory are held in a limited number of physical locations.
- Physical counts provide evidence of actual existence of the inventory thereby enhancing reliability of statements.
- Physical counts can be used by the entity to check the accuracy of its inventory records where it maintains continuous inventory records.
- Discrepancies between the physical count of inventory and the entity's inventory records may indicate weaknesses in physical controls over inventory and losses due to theft or other causes.
- A physical count of inventory can be used to check the physical condition of inventory and whether there has been any deterioration in condition.

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

ii) It is the responsibility of management to arrange for physical counts to be conducted and to establish appropriate procedures for counting to that a complete and accurate count is undertaken. Hence it is management responsibility to ensure that the valuation of inventory in the financial statements is reliable.

It is the responsibility of the Auditor to gather evidence from which he/she can reach a conclusion on the figure for inventory in the financial statements. Observation and other audit procedures performed by the auditor at the inventory count will provide some audit evidence.

The Auditor's attendance at the physical inventory count is covered by ***ISA 501: Audit Evidence – Additional Considerations for Specific Items***. The requirement of ISA 501 in respect of inventory state that, if inventory is material to the financial statements, the Auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance of physical inventory counting unless impracticable.

(4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

A few candidates scored good marks for this question, especially Question 3 c). Question 3 b) had a very low performance because most candidates could not give limitations of ratio analysis let alone its impact on assertions. Question 3 a) was straightforward so most candidates were able to answer.

QUESTION FOUR

a)

i) **Explanation of analytical procedures**

Analytical procedures are used in obtaining an understanding of an entity and its environment and in the overall review at the end of the audit.

'Analytical procedures' actually means the evaluation of financial and other information, and the review of plausible relationships in that information. The review also includes identifying fluctuations and relationships that do not appear consistent with other relevant information or results. **(1 mark)**

ii) **Types of analytical procedures**

Analytical procedures can be used as:

- Comparison of comparable information to prior periods to identify unusual changes or fluctuations in amounts.
- Comparison of actual or anticipated results of the entity with budgets and/or forecasts, or the expectations of the auditor in order to determine the potential accuracy of those results.
- Comparison to industry information either for the industry as a whole or by comparison to entities of similar size to the client to determine whether receivable days, for example, are reasonable.
- Study of relationship between elements of the Financial Statement.
- Reasonableness tests – eg. Computation of interest on fixed interest bearing securities.

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

iii) **Use of analytical procedures**

- **Risk assessment procedures**
  Analytical procedures are used at the beginning of the audit to help the auditor obtain an understanding of the entity and assess the risk of material misstatement. Audit procedures can then be directed to these 'risky' areas.
- **Analytical procedures as substantive procedures**
  Analytical procedures can be used as substantive procedures in determining the risk of material misstatement at the assertion level during work on the income statement and statement of financial position (balance sheet).
- **Analytical procedures in the overall review at the end of the audit**
  Analytical procedures help the auditor at the end of the audit in forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's understanding of the entity.

(3 points @ 2 marks each = 6 marks)

b) The importance of Internal Audit function to an organization cannot be overemphasised, it is a management function which gives early warning signals to management to afford decision making and recalibrate management action.

Internal Audit function can be a full department of an organization, co-source or outsourced. Outsourcing the department means giving the work to outside entity to undertake the audit responsibility with their own staff.

The main reasons for outsourcing internal audit work are as follows:

1. Cost of maintaining a permanent internal audit function may be very high.
2. Smaller companies may have a need for an internal audit function but not on a permanent basis.

Benefits of outsourcing

The following advantages accrue to outsourcing internal audit function:

- There is no need to recruit and train internal audit staff. The function can be instantly procured for delivery.
- The service supplier is likely to have specialist staff available, such as computer audit experts and staff with long experience in discharging audit responsibilities.
- The cost of the internal audit function is a variable one rather than a fixed cost. A company therefore only pays for the internal audit time it uses.
- Outsourcing is likely to be more economical for a small entity that does not have enough audit work to justify a full time internal audit team.

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

Possible disadvantages of outsourcing

Problems are likely to arise when internal audit unit is outsourced. Some of the problems are as stated below:

- Staff provided by external firm may not be permanent on the job. They may change often. Making it difficult for successive staff to understand the business and follow through pending and sticky audit issues.
- Charges of the external firm delivering the service may be very high when compare with what should have been paid if the service had been rendered by the company itself.
- The external firm may not hold the company's information in confidence. There could be the tendency of leaking corporate information to outsiders.
- The company may to some extent lose control over its audit work if it is outsourced.
- If the internal audit work is carried out by the firm's external auditors, there could be conflict of interest as the auditors may be reviewing their own work during the time of their external audit work.

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

Conclusion

With that said, I am of the view that because our firm is small, it will be costly to set up the department at this stage. We therefore have to start the internal audit function by outsourcing it. As we increase our activities and grow, we can set up a full-fledged internal audit.

(Total: 20 marks)

EXAMINER'S COMMENTS

Question 4 b), many candidates did quite well here, because it is popular and practical with candidates.

There was a mix up for question 4 a) because, many candidates could not explain the different types of analytical procedures. Hence, a mix-up between sub-questions ii) and iii).

QUESTION FIVE

a) **Auditor rights;**

- Right of access to the company's books and records at any reasonable time to collect the evidence necessary to support the audit opinion.
- Right to require from the company's officers the information and explanations the auditor considers necessary to perform their duties as auditors.
- Right to receive notice of and attend meetings of the company in the same way as any member of the company.
- Right to speak at general meetings on any matter affecting the auditor or previous auditor.
- Where the company uses written resolutions, a right to receive a copy of those resolutions.

(Any 4 points @ 1 mark each = 4 marks)

b) **Competence and objectivity of experts**

- The expert's professional qualification. The expert should ideally be a member of a relevant professional body or have the necessary licence to perform the work.
- The experience and reputation of the expert in the area in which the auditor is seeking audit evidence.
- The independence of the expert from the client company. The expert should not normally be employed by the client.

(3 points @ 1 mark each = 3 marks)

c) **Tangible non-current assets – assertions**

- **Completeness** – ensure that all non-current assets are recorded in the non-current asset register by agreeing a sample of assets physically verified back to the register.
- **Existence** – ensure non-current assets exist by taking a sample of assets from the register and physically seeing the asset.
- **Valuation and allocation** – ensure assets are correctly valued by checking the reasonableness of depreciation calculations.
- **Rights and obligations** – ensure the company owns the asset by seeing appropriate document of ownership for example, a purchase invoice.
- **Presentation and disclosure assertions** – ensure all necessary financial statements disclosures have been made by reviewing the financial statements and ensure non-current assets are correctly categorised in those financial statements.

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

d) **Requirements of an Auditor when there are deficiencies in internal control of a client**

- The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.

If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

- The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.

  The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:

  In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and
- Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

The auditor shall include in the written communication of significant deficiencies in internal control:

1) A description of the deficiencies and an explanation of their potential effects; and
2) Sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor shall explain that:
   - The purpose of the audit was for the auditor to express an opinion on the financial statements;
   - The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
   - The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

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

e) Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.

(Any 4 points @ 1 mark each = 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Performance of question 5 a), b) and c) was satisfactory. However, question 5 d) and e) were poorly handled by many candidates.

CONCLUSION

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

- Tuition providers should guide candidates to appreciate the provisions in the Institute of Chartered Accountants Ghana Act, 2020 (Act 1058), as it is now an examinable material.
- More and intensified teaching and learning by Tuition Providers and candidates should be continued.
- A lot of mock tasks should be conducted prior to the examinations so that candidates will be exposed to the approach of ICAG's professional examination questions for improved performance.
- Candidates must be encouraged to make good use of their study text as well as previous examinations questions so that performance in subsequent examinations will continue to improve.
- Candidates must be encouraged by Tuition Providers to improve on their English language writing skills so that they can express their thoughts well on paper in future examinations.