

**JULY 2023 PROFESSIONAL EXAMINATION
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME**

EXAMINERS GENERAL COMMENTS

Candidates' performance have been on the decline. This is partly due to the exemption granted to candidates in the Audit and Assurance paper. Some candidates did not take time to prepare well before writing the examination. Some candidates appeared not to have understanding of the Audit and Assurance topics resulting in poor performance in the Advanced Audit and Assurance paper.

STANDARD OF THE PAPER

The standard of the paper was similar to that of previously administered papers. The questions covered every section of the syllabus and the marks allocated to the questions were in line with the syllabus weightings. Again, the marks allocated to each question were commensurate with the amount of work required to appropriately answer the questions.

PERFORMANCE OF CANDIDATES

Candidates general performance was average. This average performance was seen across all examination centers. In few instances, candidates strayed to the columns reserved for examiners and moderators in the answer booklet. There were other instances where candidates recorded wrong question numbers for answers provided. Some candidates showed signs of inadequate preparations based on the answers they produced.

NOTABLE STRENGTHS AND WEAKNESS OF CANDIDATES

The application of standards to answer questions where necessary has been a problem to some candidates. The application of their knowledge in other topics to answer questions following scenarios had also been a problem to some candidates. Most candidates did not read over their work to correct sentences, this made reading and understanding of what exactly the candidates wanted to communicate difficult. Candidates showed strength in questions that are straight forward and therefore required straight forward answers.

QUESTION ONE

- a) Your firm has been approached to tender for an audit assignment by STK Ghana Ltd. The company is a multinational with its headquarters in Europe. STK Ghana Ltd is a manufacturing company which has operated in Ghana since 2010 and has made steady profits over the years. However, over the past few years, the company's profits have been dwindling and the group director in charge of Anglophone West Africa subsidiaries have charged the company to reduce its costs.

In a meeting with the country manager, you ascertained the following information:

- Several creditors are pursuing the company for payment of their outstanding debt including the previous auditor who is being owed for the past three years of audit work. The company has negotiated a payment plan for all its creditors.
- Staff wages have been frozen, staff morale is very low and several have left.
- The company's liquidity challenges commenced when the license of Glow Savings and Loans was revoked as part of the banking sector crises with STK Ghana Ltd funds exceeding GH¢1 million locked up in short and long-term investments.

In the Terms of Reference (TOR) for the audit engagement you are required to provide timelines for the overall audit and a financial proposal that is competitive. Upon receiving the TOR, a debate ensued among the partners on the relevance of submitting a proposal in response to the TOR.

Required:

Discuss **FIVE (5)** factors to be considered prior to developing a proposal for submission.

(10 marks)

- b) You are the Audit Manager at Ndaa & Associates whose client portfolio includes ABC Credit Plc which is a listed financial institution offering loans and credit facilities to both commercial and retail customers. You have received an email from the Audit Supervisor who is currently supervising interim testing on systems and controls in relation to the audit of ABC Credit Plc for the year ending 31 October 2022. The email gives the following details for your consideration:
- i) One of the audit team members, Obiba JK, has provisionally agreed to apply for a loan from ABC Credit Plc to finance the purchase of a domestic residence. The loan will be secured on a property and the client's business manager has promised Obiba JK that he will ensure that she gets 'the very best deal which the bank can offer.'
(5 marks)
- ii) The payroll manager at ABC Credit Plc has asked the audit supervisor if it would be possible for Ndaa & Associates to provide a member of staff on secondment to work in the payroll department. The payroll manager has struggled to recruit a new supervisor for the organisation's main payroll system and wants to assign a qualified member of the audit firm's staff for an initial period of six months.
(5 marks)

Required:

Assess the ethical and professional implications on the issues raised in respect of the audit of ABC Credit Plc and recommend actions to be taken in each case by the audit firm.

(Total: 20 marks)

QUESTION TWO

Eebuks Ltd is a retailer of academic text books which sells through its own network of book shops and online through its website. The revenue from the website includes both cash sales and sales on credit to educational institutions. The company has provided historical analysis from its trade receivables ledger indicating that for sales made on credit, 25% payment is received in the month of sale, 70% after 30 days and the remainder are irrecoverable debts.

You are a Manager in Makafui & Associates, a firm of Chartered Accountants which offers a range of services from audit to non-audit for its clients. On 1 July 2023, your firm was asked by Eebuks Ltd, a company which is not an audit client of your firm to consider a potential engagement to review and provide an assurance report on Prospective Financial Information. Makafui & Associates has already conducted specific client identification procedures in line with money laundering regulations with satisfactory results.

Additionally, Eebuks Ltd has approached your firm in order to obtain an independent assurance opinion on its cash flow forecast which is being prepared for its bankers in support of an application for an increase in its existing overdraft facility.

Required:

- a) In line with *ISAE 3400: The Examination of Prospective Financial Information*, discuss **FIVE (5)** matters to be considered by Makafui & Associates before accepting the engagement to review and report on Eebuks Ltd's Prospective Financial Information.

(10 marks)
- b) Assuming Makafui & Associates accepts the engagement, recommend **EIGHT (8)** procedures to be performed in respect of Eebuks Ltd's cash flow forecast.

(10 marks)

(Total: 20 marks)

QUESTION THREE

The audit of Nkwa Ltd's financial statements for the year ended 30 November 2022 is nearing completion and the auditor's report is due to be signed next week. Nkwa Ltd manufactures parts and components for the aviation industry. You are conducting an engagement quality control review on the audit of Nkwa Ltd which is a listed entity and a significant new client of your firm. The draft financial statements recognise revenue of GH¢8.7 million, assets of GH¢15.2 million and profit before tax of GH¢1.8 million.

You have identified the following issues as a result of your review:

- a) The planned audit approach to trade payables was to place reliance on purchasing controls and keep substantive tests to a minimum. During control testing on trade payables, from a random statistical sample, the audit team identified three purchase orders which had not been authorised by the procurement manager. On review of the supporting documentation, the audit team concluded that the items were legitimate business purchases and therefore concluded that no additional procedures were required. **(4 marks)**
- b) Following a review of petty cash transactions, the audit assistant identified that the petty cashier paid for taxi fares for personal, non-business journeys with a total value of GH¢175. Following discussions with the Audit Assistant, you have ascertained that he did not report the matter as the amount is immaterial. The audit assistant also commented that the petty cashier is his brother and that he did not want to get him into trouble. **(6 marks)**
- c) Cut-off testing on revenue has identified two goods despatch notes, dated 2 December 2022, for items sent to Chinn Co, with a combined sales value of GH¢17,880 which had been included in revenue for the year ended 30 November 2022. The client's financial controller, David Mount, has explained that Chinn Co does not order on a regular basis from Nkwa Ltd. In the absence of a regular payment history with Chinn Co therefore, and in order to minimise the receivables collection period from this particular customer, the sales invoice was raised and sent to the customer on the same day that the sales order was received. The average time period between the receipt of an order and despatching the goods to the customer is approximately one to two weeks. The audit working papers have concluded that no further investigation is necessary. **(6 marks)**
- d) The Finance Director, Leslie Gray, has not completed the tax computation for the year ended 30 November 2022. He has recently asked the audit assistant to compute the company's tax payable for the year on the basis that as a newly qualified chartered accountant, the audit assistant was more up to date with recent changes in tax legislation. **(4 marks)**

Required:

Evaluate the quality control issues and the implications for the completion of the audit including any further actions which should be taken by your audit firm. Your answer should include the matters to be communicated to management and those charged with governance in relation to the audit of Nkwa Ltd.

(Total: 20 marks)

QUESTION FOUR

- a) Audit engagement rests on mutual understanding and respect between the auditor and the auditee. The Auditor while not viewing the auditee as dishonest must also have at the back of his mind that to err is human and must therefore not accept evidence from the auditee without further cross-checking the facts. The attitude should be that the auditor must have an enquiring mind. This is known as professional skepticism; while trusting he must verify.

Required:

- i) What **FOUR (4)** issues should be considered in Professional Skepticism assessment during performance audit? **(5 marks)**
- ii) State **FIVE (5)** circumstances that can hinder Professional Skepticism at the engagement level. **(5 marks)**
- b) The Public Financial Management Act, 2016 (Act 921) requires that all public sector entities should have audit committees. The Act also prescribed the functions of such committees; the functions include mandatory responsibilities and advisory responsibilities. Fortunately, you have been appointed to serve on the audit committee of a Government Agency for a term of two years, renewable for a second term, also two years.

Required:

Discuss **FIVE (5)** responsibilities for the first year of your tenure. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) The auditing profession is very dynamic and constantly confronted with new challenges emanating from the political and economic spheres. To meet these challenges the global authority responsible for the regulation of accountancy profession, The International Federation of Accountants (IFAC) has been ensuring that the standards for conduct of audit and assurance engagements are revised and brought up to date all the time.

Required:

- i) Discuss **FOUR (4)** factors that influence the development of new Auditing Standards. **(5 marks)**
- ii) Identify the procedures for developing new Auditing Standards. **(5 marks)**
- b) Corporate Social Responsibility (CSR) is the hallmark of every well managed entity. In some cases, cost of CSR may not involve actual expenditure.

Required:

Explain **THREE (3)** appropriate procedures for audit engagements for CSR reports. **(5 marks)**

- c) During an audit engagement, it was observed that the Fixed Assets of BTL Plc were not embossed with a code of identification.

Required:

Draft a management letter relating to the issue above. **(5 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

- a) Tendering should commence only when a firm has been approached by a prospective client. The firm should not submit a proposal unless it can give satisfactory answers to the following questions:
- **Expertise to undertake the engagement:** The firm needs to make an assessment of the nature of the engagement and consider if the current manpower have adequate expertise to undertake the assignment. STK Ghana is a manufacturing organisation and a multinational. They have several legal requirements in Ghana and also in Europe. The firm needs to ensure that they are able to effectively understand the legal and regulatory framework of the company and its operational framework.
 - **Staff Available to undertake the engagement:** As a multinational, STK may be a large corporation and as such require more than usual manpower to undertake the engagement within reasonable time period. The firm needs to assess its current manpower and its audit engagements to consider whether or not they will have time to undertake the engagement.
 - **Ethical Issues:** Ethical issues are critical for any audit engagement. The firm needs to assess why it has been asked to tender. Issues to consider include, integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and independence. Considering that the group director has charged the company to reduce its costs, the firm needs to assess whether this will affect its independence and its objectivity.
 - **Liquidity challenges:** STK Ghana Limited, currently has liquidity challenges. The previous auditors have not been paid and it is possible that the firm will join the list of creditors pursuing the company for their funds. The firm needs to assess the seriousness of the liquidity challenges, the prospects of the company and decide on its ability to pay the audit fee on time.
 - **Possible liquidation:** With several creditors pursuing the company for their funds, it is possible that there will be a compulsory liquidation of the company. The firm needs to assess the going concern of STK Ghana and consider whether or not they will be able to provide an independent opinion on the financial statement.
 - **Audit Risks:** Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated, i.e., the financial statements are not presented fairly in conformity with the applicable financial reporting framework. The firm needs to considering the inherent risk of the company and how this will affect the engagement.

- **The Auditor should also consider the following:**

- Geographical coverage of the firm

- Audit fees to charge

- Possibility of communicating with the incumbent auditor

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

b) **Ethical and professional issues and actions to be taken by the audit firm.**

i) **Loan to member of the audit team**

According to the IESBA *Code of Ethics for Professional Accountants* (the *Code*), a loan to a member of the audit team may create a threat to the auditor's independence. If the loan is not made under normal lending procedures, and terms and conditions, a self-interest threat would be created as a result of Obiba JK's financial interest in the audit client. The self-interest threat arises because of the potential personal benefit derived which may motivate the audit team member to behave in a manner aimed at protecting that benefit. Such a threat would be so significant that no safeguards could reduce the threat to an acceptable level. It follows therefore that the audit team member should not accept such a loan or guarantee. The *Code*, however, also states that a loan from an audit client which is a bank or similar institution to a member of the audit team which is made under normal lending procedures, is acceptable. Examples of such loans include home mortgages, car loans and credit card balances.

It is possible therefore that the secured loan may be ethically acceptable and the key issue is whether 'the very best terms which the bank can offer' fall within ABC Credit Plc's normal lending procedures, and terms and conditions. The bank's standard lending terms and conditions should be obtained and reviewed alongside the documentation for Obiba JK's loan. Ultimately, the audit engagement partner is responsible for ensuring that ethical principles are not breached, so the partner should be involved with the discussions. The matter should be discussed with JK and the client's business manager in order to establish whether the loan is to be made under the bank's normal lending procedures. Obiba JK should be advised of the outcome of the review and ABC Credit Plc's business manager should be advised of this decision, explaining the rationale and ethical rules behind it.

(5 marks)

ii) **Temporary staff assignment**

The *Code* states that the lending of staff to an audit client may create a self-review threat to auditor independence. The self-review threat arises when an auditor reviews work which they themselves have previously performed – for example, if the external auditor is involved in the process of preparing the payroll figures for inclusion in the financial statements and then audits them. As a result, there is a risk that the auditor would not be sufficiently objective in performing the audit and may fail to identify any shortcomings in their own work. In addition, there is a risk of the staff member

assuming management responsibilities if they are involved in making judgments and decisions which are within the remit of management.

Such assistance can only therefore be given for a short period of time and the audit firm's staff must not assume management responsibilities and must not be involved in any activities specifically prohibited. According to the *Code*, an audit firm cannot provide accounting and bookkeeping services (including payroll) to an audit client which is a public interest entity unless the services relate to matters which are collectively immaterial to the financial statements.

In this case ABC Credit Plc is a listed bank and is therefore a public interest entity. The assignment of a qualified member of staff as a supervisor on the client's main payroll system is likely to be material to the financial statements of a service industry client such as a bank and, in addition, may also involve management responsibilities. The audit manager should therefore discuss details of the proposed role of the seconded member of staff with the payroll manager and other key client contacts in order to establish the significance of the role and its materiality to the financial statements. Assuming that the role is material, the audit manager should decline the proposed staff assignment.

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Q1 a. required candidates to discuss five (5) factors to be considered prior to developing a proposal for submission, from a given scenario. Candidates' performance had been encouraging.

Q1 b(i) and b(ii) required candidates to assess the ethical and professional implications on the issues raised in two given scenarios. Knowledge in IESBA Code of ethics for professional Accountants (the code) is required to answer this question. Candidates' performance in this question has been encouraging.

QUESTION TWO

a) **Matters to consider before accepting the review engagement**

Before accepting the review engagement to review and provide an assurance report on Eebuks Ltd's cash flow forecast, ISAE 3400 *The Examination of Prospective Financial Information* identifies a number of matters which need to be considered:

The intended use of the information

Makafui & Associates must consider, for example, whether the cash flow forecast and assurance report will be used solely for the purpose of the increase in Eebuks Ltd's overdraft facility. If Eebuks Ltd is planning to use the assurance report for purposes other than an extension to its current overdraft, for example, to arrange new loan finance from the company's bank, this must be made clear to Makafui & Associates .

Whether the information will be for general or limited distribution

Makafui & Associates needs to consider who will receive the report and potentially rely upon it as this will impact on the firm's assessment of the risk associated with the engagement. If the cash flow forecast is intended for general distribution, this will increase the level of risk for Makafui & Associates as a larger audience will rely on it. In this case, if the information will be used solely in support of the application to the bank and will not be made available to other parties, this should be confirmed before accepting the engagement and will reduce the risk of the assignment.

The period covered by the cash flow forecast and the key assumptions used

Makafui & Associates must also consider the period covered by the cash flow forecast and the key assumptions which have been used in its preparation. Short-term forecasts are likely to be easier to verify and provide assurance on than longer term projections. ISAE 3400 states that a prospective financial information (PFI) engagement should not be accepted when the assumptions used in its preparation are clearly unrealistic or when the practitioner believes that the PFI will be inappropriate for its intended use. In the case of Eebuks Ltd, although the forecast is only for 12 months, the growth rates assumed in relation to its operating cash receipts may, for example, be judged to be unrealistic given recent trends in its business and the requested overdraft facility of GH¢ 17 million for the next six months may prove to be insufficient.

The scope of the work

Makafui & Associates will need to consider the specific terms of the engagement, the level of assurance being sought by Eebuks Ltd and the form of the report required by the bank. Makafui & Associates will need to identify clearly the elements which it is being asked to report on – for example, is it being asked to report on the cash flow forecast only or is the firm also being asked to report on accompanying narrative or other PFI. Due to the uncertainty of forecasts and the inevitable subjectivity involved in their preparation, Makafui & Associates will need to confirm that it is only being

asked to provide negative assurance as to whether management's assumptions provide a reasonable basis for the cash flow forecast and to give an opinion as to whether it is properly prepared on the basis of these assumptions.

Resources and skills

The firm needs to consider whether it has sufficient staff available with the appropriate skills and experience needed to perform the PFI engagement for Eebuks Ltd. Makafui & Associates should also consider whether it can meet the deadline for completing the work and whether it will have access to all relevant information and client staff. Given the company's predicted need for cash in the next six months, presumably the extended overdraft facility will need to be provided very soon and this may lead to Makafui & Associates being under pressure to meet a tight reporting deadline.

Client integrity

ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Information, and Other Assurance and Related Services Engagements* requires Makafui & Associates to consider the integrity of Eebuks Ltd's management in relation to the acceptance decision. In particular, the firm should consider management's reasons for appointing a different firm from its auditors and the potential for management bias in the preparation of a cash flow forecast in support of its required overdraft facility.

In addition to the matters identified by ISAE 3400 and ISQC 1, Makafui & Associates should also consider the following ethical matters before accepting the review engagement:

Ethical matters

Given that Makafui & Associates are not the auditors, the firm's independence from Eebuks Ltd will not have been previously considered. In this regard, it is important to ensure that there are no threats to the firm's objectivity which might prevent it from accepting the appointment. If the firm is not independent and its objectivity is compromised, the reliability of the assurance report will be undermined.

Makafui & Associates should also consider why the auditors have not been asked to provide the assurance report on Eebuks Ltd's cash flow forecast. In order to provide an assurance report on PFI, a good understanding of the client and its business is required and the incumbent audit firm will usually have the requisite knowledge and understanding. Makafui & Associates should therefore consider whether the use of a different firm creates a risk that the client may be hoping that the firm may not be in a position to effectively challenge the key assumptions underlying the preparation of the forecast. When a professional accountant is asked to perform work for a non-audit client, they should be given permission by the client to contact its auditors in order to obtain relevant information. If this permission is not given, the appointment should be declined.

Overall, Makafui & Associates must assess the risks associated with the review engagement and should not accept an engagement when the assumptions are clearly unrealistic or when the firm believes that the prospective financial information will be inappropriate for its intended use.

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

b) Examination procedures on cash flow forecast

- Cast the cash flow forecast to confirm its mathematical accuracy.
- Confirm the consistency of the accounting policies used in the preparation of the forecast financial statements with those used in the last audited financial statements.
- Agree the opening cash position to the cash book and the bank statement.
- Discuss the key assumptions underlying the preparation of the forecast with management, including:
 - the stated collection and payment periods in relation to receivables and payables.
 - confirm that the assumptions appear reasonable and are consistent with the firm's knowledge and understanding of the client.
- Analytically review the forecast trends in cash flows comparing them with historical cash flow statements and other forecast data which is available for the sector and local economy and investigate any significant differences.
- Recalculate the patterns of cash flows based on management's historical analysis of credit sales to confirm that the forecast has been properly prepared on the basis of these assumptions.
- Perform sensitivity analyses on the cash flow forecast by varying the key assumptions (in particular, in relation to growth rates and payment periods) and assessing the impact of these variations on the company's forecast cash position.
- Agree the salary payments to the latest payroll records and cash book payments analyses to confirm accuracy and completeness.
- Obtain and review a breakdown of the forecast overhead payments and compare it to historical management accounts and current budgets. Review the schedule to ensure that non-cash items such as depreciation, amortisation and bad debts have not been included.
- For a sample of overhead costs, review the supporting documentation such as invoices and utility bills and agree the amount paid each month to the cash book.
- Obtain and review budgets and analyses of costs to date for the new shops and the online marketing campaign ensuring that the forecast includes all of the budgeted costs and does not include any costs which have already been incurred. Agree a sample of costs to supporting documentation such as invoices, quotations and lease agreements.
- Review board minutes for discussion of the new shops and the marketing campaign.
- Review the outcomes of previous management forecasts and assess their accuracy compared to actual data.
- Assess the competence and experience of the preparer of the forecast.

- Obtain written representations from management confirming the reasonableness of their assumptions and that all relevant information has been provided to Makafui & Associates .
- Request confirmation from the bank of the potential terms of the additional finance being negotiated, to confirm the interest rate.
- Consider whether the finance charge in the forecast cash flow appears reasonable.

(Any 8 points @ 1.25 marks each = 10 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Q2a

Candidates were asked to discuss five matters to be considered before accepting the engagement to review and report on a prospective financial information from a given scenario. This is to be in line with ISAE 3400: The examination of prospective financial information. Knowledge in ISQCI Quality control for Firms that Perform Audits and Reviews of Financial Information and other Assurance and Related Services Engagements is also relevant in answering this part of the question. This part of the question was well attempted by candidates.

Q2b

Candidates were asked to recommend eight (8) procedures to be performed in respect of a cash flow forecast. This was well attempted by candidates as well.

QUESTION THREE

Evaluation of quality control issues, implications for audit completion and further actions

a) Controls testing on payables

The absence of evidence of authorisation by the procurement manager in relation to the three purchase orders represents an exception to the effective operation of an internal control on which the auditor intends to place reliance. The review of the supporting documentation and the conclusion that the items were legitimate business expenditure do not resolve the exception in the effective operation of the control. There is a risk that other exceptions and further unauthorised purchases may have occurred which may not have been for legitimate business purposes. The audit procedures therefore appear to have been inadequate. The audit assistant should have reported the matter to the manager and partner for them to decide if further work or risk analysis was required and who it should be reported to, i.e. those charged with governance, etc. This should have also been picked up during the review of the working papers.

Prior to finalising the audit, the audit team needs to assess the extent and significance of the internal control deficiency and should consider increasing the original sample size and extending the audit testing. If the extended testing identifies further exceptions in the effective operation of the control, the auditor should review whether a controls based approach is appropriate and consider whether more substantive testing on the payables component is required. The auditor should also consider including the matter in the report to management.

In line with ISA 260 *Communication with Those Charged with Governance*, the auditor is required to communicate significant findings from the audit to those charged with governance. These include significant difficulties encountered during the audit and any extensive unexpected effort required to obtain sufficient appropriate audit evidence. The absence of authorisation by the procurement manager in relation to the three purchase orders requires extended audit testing and represents a potentially significant deficiency in the operation of internal controls. It therefore represents a potentially significant audit finding which should be communicated to those charged with governance.

One mark each for any four valid point

(4 marks)

b) Petty cash fraud

The personal taxi fares represent a fraudulent transaction by the petty cashier and should be reviewed in the light of the auditor's and management's respective responsibilities in relation to the prevention and detection of fraud. *ISA 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

states that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. The existence of the fraud may also be further indication of a weak control environment. The auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The amount of GH¢ 175 is clearly immaterial to the financial statements and therefore does not represent a potential source of material error caused by fraud. The auditor should review the petty cash records for evidence of any further irregularities and discuss the matters identified with management. However, if the auditor concludes that the matter increases the overall assessment of fraud and control risk, management should be informed.

In spite of the immateriality of the amounts involved, however, the relationship of the audit assistant to the petty cashier represents a familiarity threat. The failure of the audit assistant to highlight the matter prior to the discussion with the engagement quality control reviewer may indicate a lack of professional integrity on the part of the audit assistant. In line with *ISA 220: Quality Control for an Audit of Financial Statements*, the auditor, primarily the audit engagement partner, has responsibility to monitor ethical requirements throughout the audit process. The firm's procedures for assigning staff to audit teams and for reporting personal relationships with client staff should be reviewed in light of this responsibility.

If the auditor concludes that the petty cash fraud and any additional issues identified on review of the petty cash records increases the overall assessment of fraud and control risk, the matter should be reported to management with a recommendation that all petty cash transactions should be adequately reviewed and authorized.

One mark each for any six valid point

(6 marks)

c) **Cut-off testing on revenue**

IFRS 15: Revenue from Contracts with Customers requires that an entity recognises revenue when or as the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when or as the customer obtains control of that asset. On this basis therefore, revenue has been recognised too early and as a result revenues, receivables and profits are overstated. The error identified is in isolation immaterial to the financial statements at 0.2% of revenue (17,880/8.7 million). The error should be extrapolated based on the incidence of errors identified and the level of sales to this particular customer in order to assess the potential for a material misstatement. Based on this assessment, the auditor should extend cut-off testing in order to assess further the potential for a material error. The auditor should also confirm with management that the invoicing procedure is isolated to this particular customer and consider extending their assessment and testing to any

other customers as necessary. The auditor should also review last year's cut-off procedures in order to investigate whether there were any compensating errors in the prior year.

All misstatements identified should be communicated to management and the auditor should request that they are corrected. ISA 260 requires the auditor to communicate to those charged with governance his or her views about significant qualitative aspects of the entity's accounting practices including accounting policies. The non-compliance with the recognition criteria of IFRS 15 represents a significant finding from the audit and should be communicated to those charged with governance according to ISA 260.

Two marks each for any two valid points

(6 marks)

d) Tax advice

The auditor has responsibility to monitor ethical requirements throughout the audit process. The provision of assistance in calculating the company's income tax payable for the year represents a self-review threat as the tax calculation forms the basis of the tax payable in the statement of financial position and the tax charge in the statement of profit or loss for the year. This risk is increased by the listed status of Nkwa Ltd and according to the IESBA *Code of Ethics for Professional Accountants* (the *Code*), the auditor should not prepare tax calculations for listed clients. Nkwa Ltd is a listed client and therefore, as auditors, the firm should not undertake any tax services as the threats to the auditor's objectivity and independence which would be created are too high to allow the audit firm to undertake an engagement to prepare calculations of current or deferred tax liabilities (or assets) for the purpose of preparing accounting entries which are material to the relevant financial statements, together with associated disclosure notes.

According to ISA 260, the significant audit findings which the auditor is required to communicate to those charged with governance include matters which, in the auditor's professional judgement, are significant to the oversight of the financial reporting process. The auditor should therefore report the lack of skill and up to date knowledge of the finance director and the implications of this for the recruitment and training procedures at the client. The auditor should also report the independence issues identified above in relation to the finance director's request for the auditor to calculate the tax payable.

Two marks each for any two valid points

(4 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question is made up of a four scenarios. That is ABCD. Candidates were required to evaluate the quality control issues and the implications for the completion of the audit including any further actions which should be taken by an audit firm. Candidates answer was to include the matters to be communicated to management and those charged with governance.

A. Control Testing On Payables

Candidates' knowledge in ISA 260: Communication with those charged with governance is also required to answer this part of the questions. Most of the candidates were able to answer this question well.

B. Petty cash fraud

Candidates' knowledge in ISA 240: The Auditors Responsibilities Relating to Fraud in an Audit of Financial Statement is required to answer this part of the question. Knowledge in ISA 220: Quality control for an Audit of Financial statement is also relevant in answering the question. Candidates' performance was encouraging.

C. Cut-off testing on revenue

Knowledge in IFRS 15: Revenue from Contracts with Customers is also needed in answering this question. Knowledge in ISA260: Communication with those Charged with governance is also relevant in answering the question. Candidates were able to answer the question fairly well.

D. Tax Advice

Knowledge in IESBA: Code of Ethics for Professional Accountants (the code) is important in answering this question. Also relevant to answering the question is ISA 260. Most candidates were able to answer the question well.

QUESTION FOUR

a)

i) Issues that should be considered in Professional Skepticism assessment.

- Consider integrity of management – looking at control environment of the business, how Management handles internal control issues, past history of management, etc.
- Question the accuracy of responses to inquiries and other information obtained from management and those charged with governance.
- Revising risk assessment as a result of identified material or significantly inconsistent information.
- Be alert to audit evidence that contradicts other audit evidence obtained.
- Assess the risk of fraud and to be alert to the possibility of fraud throughout the audit.

(Any 4 points @ 1.25 marks each = 5 marks)

ii) Impediments to the exercise of professional skepticism at the engagement level may include, but are not limited to:

- Budget constraints, which may discourage the use of sufficiently experienced or technically qualified resources, including experts, necessary for audits of entities where technical expertise or specialized skills are needed for effective understanding, assessment of and responses to risks and informed questioning of management.
- Tight deadlines, which may negatively affect the behavior of those who perform the work as well as those who direct, supervise and review. For example, external time pressures may create restrictions to analyzing complex information effectively.
- Lack of cooperation or undue pressures imposed by management, which may negatively affect the engagement team's ability to resolve complex or contentious issues.
- Insufficient understanding of the entity and its environment, its system of internal control and the applicable financial reporting framework, which may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors or others, which may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.
- Overreliance on automated tools and techniques, which may result in the engagement team not critically assessing audit evidence.

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

b) The work of audit committee is done, as a team, by all the members of the committee with the chairman presiding. An appointed member should therefore, cooperate and collaborate with other members to ensure the following:

- That Internal Audit has a charter, that spells out internal audit mandate and responsibility of management which have been communicated to senior members of staff.

- That the condition of the internal audit and the staff are placed at the appropriate level of the organizational hierarchy to ensure that the unit has the appropriate leverage to do its work with recognition.
- That internal audit annual plan is in place, reviewed and approved by the audit committee for implementation.
- That internal audit work for each quarter is timely reviewed and submitted to Internal Audit Agency.
- That Auditor General's report on the institution has been attended to and any queries answered and submitted as required.
- That adequate training resources are given to the staff of internal audit to empower them to perform creditably.
- That audit committee meetings are held regularly to address internal audit's work issues expeditiously.
- That annual reports are prepared and forwarded to the appropriate authorities as timely as possible.
- That Internal auditor is given the appropriate respect and allowed to attend management meetings.
- That the head of the covered entity is educated to view the Internal Auditor as a facilitator of his work and not a traitor.
- To help the Internal Auditor to present efficient and effective report and any other.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

4 (ai) This part of the question required candidates to state issues that should be considered in professional skepticism assessment during performance audit. This was not well attempted by candidates.

4 (aai) This part of the question required candidates to state five (5) circumstances that can hinder Professional skepticism at the engagement level. This was not well attempted by candidates.

4b) This question required candidates to discuss five (5) responsibilities of being a member of an Audit Committee for their first year of tenure.

Some candidates were not able to answer this question well. "The first year of your tenure" in the question seemed to have confused some of the candidates.

QUESTION FIVE

a)

i) Factors giving rise to new Auditing Standards: International Standards on Auditing (ISAs) are produced by the International Auditing and Assurance Standard Board (IAASB), a technical committee of the International Federation of Accountants. New International Auditing Standards arise as a result of the following:

- **Response to new legal requirements:** When new laws are enacted which have global implications for auditing and assurance practice, the IAASB will review the existing standards to determine whether they can adequately address the new legal requirements. If the existing standards are not adequate, a new standard will be produced to replace the existing inadequate one.
- **Changes in the economic and business environments:** Changes are constantly taking place in the economic and business environment. To remain relevant to the business environment the Standard board on its own initiative or on the prompting of the IFAC governing council produces a new standard to respond to the new demands on the profession. For example the introduction of ICT into business processes and reporting of financial information electronically required the International Standards on Auditing to guide.
- **Demands from industry players and the general public:** Clients and other stakeholders continue to express dissatisfaction about the performance of their external auditors even though some of the demands may be informed by e.g. the expectation gap. To maintain the good will of the client and other stakeholders the board will respond by revising the existing standards or come out with a completely new standard for example the new book on International Standards on Auditing 700/701 to make the auditors' report on general purpose financial statements more user friendly.
- **Self-introspection:** The IFAC council itself may find that an existing standard has become inadequate or irresponsive to the needs of practitioners and their clientele and would initiate action for the standard board to revise the exiting standards or produce a completely new standard.

(4 points @ 1.25 marks each = 5 marks)

ii) The procedures for developing a new standard:

- When the need arises for a new standard the standard board is charged by IFAC council to initiate action
- The board will initially review the existing standards to determine its adequacy to address the need. The board may determine that the existing standard should be revised or a new standard should be produced.
- The board then produces an exposure draft
- The exposure draft is widely circulated to professional accountancy bodies, governments, industry players and regulators for comments
- The comments received are taken into account in producing a new standard for the attention of the IFAC Council.

- The Council studies the amended draft and suggest improvements which are incorporated.
- The final draft is debated and voted on by the Council.
- The approved version becomes the new standard after a waiting period.

(5 marks)

b) Audit procedures for CSR

- To determine the impact of CSR project on development indicator identified in the project report like on education/ health/ social/ economic conditions of the people in communities.
- To assess the changes in the quality of life among communities through CSR project interventions.
- To get objective description of social impacts than what people might perceive.
- To identify requirement of changes in the existing policies and projects to take care of the changing needs of the people.
- To enhance stakeholder engagement and the capacity of institutional setup.
- To improve and reliability of data management and reporting.

(Any 3 points @ 1.66 marks each = 5 marks)

iii) Management letter

Observation:

In the course of our audit, we observed that the following fixed assets were not embossed. See appendix...

Effect:

This could lead to theft and some assets not accounted for.

Management Response:

Management has taken note of observation and will ensure that all assets are embossed by (date).

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

ai) Candidates were required to discuss four (4) factors that influence the development of new Auditing standards. With exception of a few candidates who could not give the right answers, most of the candidates gave very good answers.

aii) Candidates were asked to identify the procedures for developing new auditing standards. This was very well attempted by most candidates.

b) Candidates were required to explain three (3) appropriate procedures for audit engagement for Corporate Social Responsibility (CSR). This question was fairly attempted by the candidates.

c) Candidates were to draft a management letter from a given control weakness. Some candidates presented this very well. However, some candidates wrote the importance of embossing the fixed assets, rather than the effects or implications of the weakness (i.e not embossing). Some candidates did not indicate the heading (eg, observation, effects or implication and recommendation) before writing the points.

CONCLUSION

- Candidate must learn the relevant standard very well in order to apply where necessary in answering questions.
- Candidates must also give themselves enough time to prepare well before writing the examination