

**JULY 2023 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.

PERFORMANCE OF CANDIDATES

This diet saw an under performance over the March 2023 session. A pass rate of 82% was achieved in the July 2023 diet as compared to the March 2023 diet which was a 97%.

Tuition providers are encouraged to keep up the good work. They should continue to encourage candidates to pay attention to the provisions of the new ICAG Act and other governance acts, such as, IAA act and PFM act.

Question 4(a) was a high scoring question because it is popular with candidates. Question 4(b) (i) also saw a good performance by candidates and (ii) was a mixed up because candidates could not demonstrate a good understanding of BVA. Question 3(a) was not well handled by most candidates. Question 3(b) was well attempted by most candidates. Provisions of sec 141 of act 992 was considered in the solution of question 2 (a).

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

The strength of most candidates was demonstrated in question 1(a), (b) and (c), question 2(a)(b) and (c), as well as, question 3(b) and question 4(a), (b)(i) and question 5(a) and (b).

Areas of weakness identified with candidates were question 3(a) and 4(b) (ii), as well as question 5(c)(ii). Some candidates could not demonstrate adequate understanding of the modification of audit opinion. Hence, their inability to answer question 5(c) (ii) very well.

QUESTION ONE

- a) Boards rely on the Audit Committee to offer effective oversight of the financial reporting process, making it one of the cornerstone for effective corporate governance. Effective Audit Committee is vital for protecting investors and the health of the capital markets.

Required:

- i) Identify **THREE (3)** requirements in the composition of Audit Committees in accordance with the best practice in Corporate Governance. **(3 marks)**
ii) List **TWO (2)** functions of an Audit Committee. **(2 marks)**
- b) Understanding the client's business environment is critical to understanding the client's business. There is a need for this because the objectives of commercial organisations are different from that of not-for-profit organisations (NFPOs). The inherent control weaknesses for both forms of organisations may not be the same.

Required:

In relation to the comments above, explain **FIVE (5)** control weaknesses inherent in NFPOs. **(10 marks)**

- c) *ISA 240 (Redrafted): The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* requires the Auditor to perform procedures to identify the risk of material misstatement due to fraud. The Auditor must evaluate information obtained from other risk assessment procedures to see if any fraud risk factors are present.

Required:

Explain **FIVE (5)** risk factors in risk assessment procedures with regard to fraud. **(5 marks)**

(Total: 20 marks)

QUESTION TWO

- a) AWS Bank Plc has one of their non-executive directors as a partner with their external auditors. This was known after a due diligence was conducted by Bank of Ghana (BoG) and later reported to the directors of AWS Bank Plc. BoG has advised the directors of the bank to take the necessary action within a month.

Required:

What procedures should the Directors of AWS Bank Plc take in appointing the new Auditor. **(5 marks)**

- b) What are the safeguards to be applied by an auditor in relation to the following?
- i) Financial interest in the client.
 - ii) Loans and Guarantees to or from the client.
 - iii) Business relationship with the client.
 - iv) Family and personal relationship with the client.
 - v) Employment with an Assurance Client.
- (5 marks)**
- c) Reasonable assurance is the highest level of assurance auditors may provide. However, due to the limitations of auditing, it is impossible to guarantee 'absolute' assurance. Some users of financial statements however, have the misconception that an audit provides absolute assurance; that the audit opinion guarantees that the financial statements are 'accurate.' The 'Expectations Gap' refers to these and other misunderstandings regarding the work of an auditor.

Required:

- i) State **FOUR (4)** inherent limitations of an audit that makes it impossible to provide 'absolute' assurance. **(6 marks)**
- ii) State **THREE (3)** misconceptions about the role an auditor plays. **(4 marks)**

(Total: 20 marks)

QUESTION THREE

- a) Abbey Ltd is a medium-sized manufacturing company that produces various products for consumers. The company has a large amount of confidential data, including financial records, trade secrets, and personal information of employees and customers. The company has recently become concerned about cyber security risks and has hired an external auditor to conduct an audit of their data security controls.

Required:

Explain **FIVE (5)** procedures the External Auditor would need to perform to obtain evidence to evaluate the effectiveness of Abbey Ltd's data security controls. **(10 marks)**

- b) Fritz Insurance is a large insurance company that provides a wide range of insurance products to individuals and businesses. As part of their annual audit, the external auditor has engaged the services of an Actuary to assist with the evaluation of the company's reserves and the adequacy of its premium rates.

Required:

Explain **FIVE (5)** factors to be considered by External Auditors in engaging the services of an Actuary to assist with the evaluation of the company's reserves and the adequacy of its premium rates. **(10 marks)**

(Total: 20 marks)

QUESTION FOUR

- a) You are an Audit Assistant of Abinchi & Associate and your firm is planning the audit of a client. You have been provided with draft financial statements extracts and the following information is about your client, Kitchenhub Ltd, who is a kitchen equipment manufacturer. The company's year-end is 30 April 2022.

Kitchenhub Ltd has recently been experiencing trading difficulties, as its major customer who owes GH¢0.6 million to Kitchenhub Ltd has ceased trading, and it is unlikely any of this will be received. However, the balance is included in the financial statements extracts below. The sales director has recently left Kitchenhub Ltd and is yet to be replaced.

The monthly cash flow has shown a net cash outflow for the last two months of the financial year and is forecast as negative for the forthcoming financial year. As a result of this, the company is unable to settle suppliers whose payment are due and some are threatening legal action to recover the sums owing.

Due to its financial difficulties, Kitchenhub Ltd defaulted a loan repayment and as a result of this breach in the loan contract, the bank has asked that the loan of GH¢4.8 million be repaid in full within six months. In view of this, the directors have decided not to pay dividend for the period.

Below is the Financial Statement extract for Kitchenhub Ltd for the year ended 30 April:

	Draft 2022 (GH¢)	Actual 2021(GH¢)
Current assets		
Inventory	3.4	1.6
Receivables	1.4	2.2
Cash	-	1.2
Current liabilities		
Trade payables	1.9	0.9
Overdraft	0.8	-
Loans	4.8	0.2

Required:

- i) Explain **SEVEN (7)** factors that indicate that Kitchenhub Ltd may not be operating as a going concern entity. **(7 marks)**
 - ii) Identify **THREE (3)** stages of an audit when analytical procedures can be used by Abinchi & Associate. **(3 marks)**
- b) Modern approach to Internal Auditing has broaden the scope of the function of the Internal Audit. The focus has shifted from pure financial audit to cover other important areas of operation. These include performance audit, Value for Money audit and performance information audit.

Required:

Write short notes on the following:

- i) Value for money audit. **(5 marks)**
- ii) Best value audit. **(5 marks)**

(Total: 20 marks)

QUESTION FIVE

- a) As a member of the International Federation of Accountants (IFAC), the Institute of Chartered Accountants, Ghana (ICAG) subscribes to code of ethics prescribed by the International Ethics Standards Board for Accountants (IESBA).

Required:

Explain each of the **FIVE (5)** fundamental principles of the Code of Ethics of the Institute of Chartered Accountants, Ghana (ICAG). **(5 marks)**

- b) *ISA 230: Audit Documentation* deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements.

Required:

State **FIVE (5)** benefits of documenting audit work. **(5 marks)**

- c) According to *ISA 705: Modification of the auditor's report*, the auditor's opinion on financial statements other than unmodified opinion depends on his/her judgement on two major circumstances.

Required:

- i) State the **TWO (2)** circumstances that may result in an audit opinion being modified. **(2 marks)**
- ii) Discuss the types of opinion that may be issued under each of the two circumstances. **(8 marks)**

(Total: 20 marks)

SOLUTION TO QUESTIONS

QUESTION ONE

a)

i) Requirement of composition of audit committee in line with the best practice includes;

- The Audit committee should comprise at least three directors, the majority of whom should be non-executive
- The appointed directors should ideally comprise directors with an adequate knowledge of Finance accounts, basic elements in Law under which the corporate body operates.
- The Chairman of the committee should be a non-executive director.
- The managing Director, Finance Director, Chief Internal Auditor and external auditor representative should be invited to attend meetings.

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

ii) **Functions of Audit committee**

- Recommend the appointment of external auditors of the corporate body.
- Review with the auditors their report on the financial statements of the corporate body.
- To assist the board in developing policies that would enhance operations of the corporate body.

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

b) Keys areas of internal control weakness inherent in an NFPO might include:

- Segregation of duties (this may be difficult in a small NFPO with only a few employees)
- Authorization of spending is centered on one person or few people.
- Controls over cash disbursement is sometimes absent.
- Controls over income (donations, cash collections, membership fees, grants)
- The use of funds sometimes for purposes not related to the growth of the entity.

(5 points @ 2 marks each = 10 marks)

c) Fraud risk factors might include the following:

- The need to meet the expectations of third parties (for example, the entity is trying to obtain additional finance).
- Management being remunerated via profit-related bonuses.
- An ineffective control environment
- The entity's profitability being under threat (for example, due to increased competition or rapid changes in technology)
- The nature of the industry or the entity's operations providing opportunities for fraud (for example, complex transactions or significant accounting estimates)
- Low morale amongst staff or poor communication and/or enforcement of ethical standards by management.
- Personal pressure on staff to misappropriate assets (for example, personal financial problems or the threat of redundancy)

(5 points @ 1 marks each = 5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Performance by the candidates was satisfactory, because the question is popular and practical.

QUESTION TWO

- a) Procedures the Directors of AWS Bank Plc should take in appointing the new Auditor
- An auditor of a bank or specialised deposit taking-institution shall be appointed at an annual general meeting of the bank or specialised deposit taking institution and be approved by the Bank of Ghana in the manner and on the terms that may be prescribed.
 - The directors of a bank or specialised deposit-taking institution may appoint the first auditor to act in place of the auditor who is for any reason unable or unwilling to act until a new auditor is appointed at an annual general meeting or until the Bank of Ghana appoints an auditor.
 - A person shall not be appointed an auditor of a bank or specialised deposit-taking institution unless that person is a member of the Institute of Chartered Accountants (Ghana) under the Chartered Accountants Acts, 1058 (Act 2020) and is not disqualified by an enactment in force in this country or in any other country from being appointed as an auditor of a body corporate.
 - An auditor of a bank or specialised deposit-taking institution shall hold office for a term of not more than six years and is eligible for re-appointment after a cooling off period of not less than six years.

(5 marks)

b) Safeguards to be applied by an auditor in relation to

i) **Financial interest**

- Disposing off the interest
- Review of the work of an audit team member by a professional accountant
- Removing the individual from the audit team

ii) **Loans and Guarantees**

- Any loan taken by audit team members from the client that is not on normal terms is not allowed. The member should not be allowed to participate in the audit.
- If the audit firm has taken a loan from the client, the loan must be immaterial to both the firm and the client. If it is material, an external review of the audit should be performed by a third party assurance provider.

iii) **Business relationship**

- Removing the individual from the audit team
- Structuring the responsibilities of the audit team so that a member does not deal with matters that are within the responsibility of the close relation

iv) **Family and personal relationship**

- If an audit team member or key audit partner has family or personal relationships with an employee of the client, the individual should either be removed from the team or the audit engagement structured in such a way so that the individual does not deal with the matters of the employee. The threat is significant where the employee's actions/decisions have a direct impact on the financial statements.

v) **Employment with an Assurance Client**

- Modifying the audit plan
- Assigning individuals to the audit team who have sufficient experience in relation to the individual who has joined the client.
- Review of the work of a former audit team member by a professional accountant.

(Any 1 point for each @ 1 mark each = 5 marks)

c)

i) The greatest level of assurance auditors can provide is reasonable. The limitations of an audit mean that it is not possible to provide 'absolute' assurance. These limitations include:

- Financial information includes subjective and judgemental matters.
- Inherent limitations of controls used as audit evidence.
- Representations from management may have to be relied upon as the only source of evidence in some areas.
- Evidence is often persuasive not conclusive; and auditors
- Do not review 100% of the transactions and balances, they test on a sample basis.

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

ii) Some users incorrectly believe that an audit does provide absolute assurance; that the audit opinion is a guarantee the financial statements are 'correct'. This and other misconceptions about the role an auditor plays are often referred to as the 'Expectations Gap.' Other examples of these misconceptions include:

- a belief that auditors test 100% of transactions and balances: they test on a sample basis;
- a belief that auditors are required to detect fraud; auditors are required to offer an opinion that the financial statements are free from material misstatement, which may be caused by fraud;
- auditors are responsible for preparing the financial statements; this is the responsibility of management.

(Any 3 points @ 1.33 marks each = 4 marks)

(Total: 20 marks)

EXAMINER'S COMMENT

Question 2(a) was well answered by most candidates because the question is practical. Question 2(b) quite a straightforward question was well answered by most candidates. Performance for question 2 (c) was very good.

QUESTION THREE

- a) The external audit will need to obtain evidence to evaluate the effectiveness of Abbey Ltd's data security controls. Here are some of the ways that the external audit can obtain evidence:
- **Review of Policies and Procedures:** The external audit can review the company's policies and procedures related to data security, such as the information security policy, access controls policy, and incident response plan. The auditor can evaluate whether the policies are comprehensive, up to date, and consistent with industry standards.
 - **Interview with Management and Staff:** The auditor can conduct interviews with management and staff to understand their roles and responsibilities related to data security. The auditor can also inquire about any incidents or breaches that have occurred and evaluate the company's response to these incidents.
 - **Review of System Logs:** The auditor can review system logs to evaluate whether the company's systems are functioning as intended and to identify any potential vulnerabilities or suspicious activity.
 - **Testing of Controls:** The auditor can perform testing of controls to evaluate the effectiveness of the company's data security controls. For example, the auditor can perform penetration testing to identify vulnerabilities in the company's network and applications.
 - **Review of Third-Party Contracts:** The auditor can review contracts with third-party vendors and suppliers to evaluate whether the company has appropriate data security controls in place with these parties.

Conclusion

In conclusion, the external audit can obtain evidence through a combination of methods to evaluate the effectiveness of Abbey Ltd's data security controls. By evaluating the company's policies and procedures, interviewing management and staff, reviewing system logs, testing controls, and reviewing third-party contracts, the external audit can provide assurance to Abbey Ltd that their data is secure and protected from cybersecurity risks.

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

- b) The external auditor will need to carefully evaluate the work performed by the actuary and determine how this work can be used in the audit. Here are some of the ways that the external auditor can respond:
- **Understanding the Actuary's Work:** The external auditor will need to gain an understanding of the actuary's work, including the methods and assumptions used, the data sources, and any limitations or uncertainties in the results.

- **Assessing the Competence and Independence of the Actuary:** The external auditor will need to assess the competence and independence of the actuary to determine whether their work can be relied upon. This may involve evaluating the actuary's qualifications, experience, and adherence to professional standards.
- **Evaluating the Relevance and Reliability of the Actuary's Work:** The external auditor will need to evaluate the relevance and reliability of the actuary's work to determine how it can be used in the audit. This may involve assessing the quality of the data used, the appropriateness of the methods and assumptions, and the reasonableness of the results.
- **Considering the Implications of the Actuary's Work:** The external auditor will need to consider the implications of the actuary's work on the audit findings and conclusions. For example, if the actuary's work indicates that the company's reserves are inadequate, the auditor may need to perform additional testing or modify the audit opinion accordingly.
- **Documenting the Use of the Actuary's Work:** The external auditor will need to document the use of the actuary's work in the audit, including the nature and extent of the work performed, the conclusions reached, and the implications for the audit findings and conclusions.

Conclusion

In conclusion, the external auditor can use the work of an actuary in insurance to provide assurance to Fritz Insurance that their reserves and premium rates are adequate. By carefully evaluating the actuary's work, assessing their competence and independence, evaluating the relevance and reliability of their work, considering the implications of their work, and documenting the use of their work in the audit, the external auditor can provide a comprehensive and reliable audit opinion.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

Most candidates did not do well in the (a) part of the question because they provided general auditing knowledge instead of answering the question. Question 3(b) had a very good performance.

QUESTION FOUR

a)

i) Going concern indicators

- A major customer of Kitchenhub Ltd has ceased trading owing them GHS 0.6m. This will result in a significant loss of future revenues and profit, and unless this customer can be replaced then there will be a reduction of future cash flows.
- The sales director has recently left the company and is yet to be replaced. Loss of a key director will impact on the company's sales, as Kitchenhub Ltd has already lost a major customer, then without an experienced sales director to generate new sales the company will face significantly reduced sales and cash flows.
- Kitchenhub Ltd is experiencing negative monthly cash flows and this is expected to continue. If the company continues to have cash outflows then it will increase its overdraft further and will start to run out of available cash.
- The company has been late in paying some of its suppliers. If suppliers are being paid late then they may refuse to supply Kitchenhub Ltd with goods or impose 'cash on delivery' terms which will disrupt service or sales to customers.
- A number of the suppliers are threatening legal action. If this occurs then Kitchenhub Ltd will have legal costs on top of the amounts owed already and this will further increase the pressure on cash flows. In addition, other suppliers may hear about the legal action and, as a result, stop supplying goods to Kitchenhub Ltd.
- Kitchenhub Ltd has missed a loan repayment which is a breach in the loan covenant and hence the loan of GHS 4.8 million is now all repayable. The company only has six months to raise GHS 4.8 million; as it currently stands they do not have this level of cash available and unless they are able to raise alternative finance or sell non-current assets, it is difficult to see how they will be able to raise this amount.
- In order to conserve cash Kitchenhub Ltd has decided not to pay a final dividend for 2022. This may result in shareholders losing faith in the company and they may attempt to sell their shares; in addition, they are highly unlikely to invest further equity, and Kitchenhub Ltd urgently needs to raise finance to repay their loans.
- The current ratio has significantly declined from 4.55 $(1.6 + 2.2 + 1.2 / 0.9 + 0.2)$ in 2021 to 0.64 $(3.4 + 1.4 / 1.9 + 0.8 + 4.8)$ in 2022. The current ratio is showing that the current assets are not sufficient to pay the current liabilities. This is another indication of the worsening liquidity position of the company, which has mainly occurred due to the loan becoming repayable.

(7 marks)

ii) Analytical procedures stages

Analytical procedures can be used at all stages of an audit; however, ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and ISA 520 *Analytical Procedures* identify three particular stages.

- During the planning stage analytical procedures must be used as risk assessment procedures in order to help the auditor to obtain an understanding of the entity and assess the risk of material misstatement.

- During the final audit analytical procedures can be used to obtain sufficient appropriate audit evidence. Substantive procedures can either be tests of detail or substantive analytical procedures.
- At the final review stage the auditor must design and perform analytical procedures that assist him when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.
(3 points @ 1 mark each = 3 marks)

b)

i) **Value for money**

Value for money audit is a financial management tool originated in public sector organization as a way of assessing financial performance in absence of profit-based measure. This was because the objectives of public sector organizations were not usually to make profit. The concept has been adopted by commercial entities as a means of assessing performance on a broader basis than just profit.

The term means getting good value from the money that an entity spends. Value for money is obtained from a combination of three factors commonly referred to as "3Es":

- (a) Economy
- (b) Efficiency
- (c) Effectiveness

Economy - means not spending more than is necessary to obtain the required resources. Simply put, buying the cheapest materials of the desired quality but avoiding excessive cost.

Efficiency - means getting a high volume of output from the resources that are used. The efficiency of employees is often referred to as productivity. Efficiency can be achieved by making better use of equipment and machines (eliminating idle time), improving employee productivity, making better use of available accommodation or getting better use of out of marketing spending etc.

Effectiveness - means achieving the objective of the entity with the resources that it uses. Using resources efficiently is of no use if it does not achieve the objective of the enterprise.

(5 marks)

ii) **Best value audit**

Best value audit is about ensuring that there is good governance and effective management of resources, with a focus on improvement, to deliver the best possible outcomes for the public. For most government organizations, it is crucial to prioritize the welfare of the general public ahead of everything else. Best value provides a framework for that.

Best value audits work similarly to value for money audits. Value for money audits looks at three aspects. These include efficiency, effectiveness, and economy. Best value audit looks at how government bodies use the best possible combination to provide the best possible outcomes. For example, it may include the most advantageous combination of quality, sustainability, whole-life cost, etc.

The fundamental concept of best value is continuous improvement. Organization can attempt to achieve continuous improvement by focusing on the 4Cs' as set out below:

- Challenge – Challenge the need for providing a service and where it is found that there is no need withdraw it.
- Compare – compare the cost being provided with others and investigate how to improve
- Consult- discuss the service with users and make sure their needs are met
- Compete – use fair competition as a means of improving performance

(5 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

For question 4(a), many candidates did quite well here, because it is popular and practical with candidates. There was a mix up for question 4(b)(ii) because, many candidates could not explain the Best Value Audit well. Question 4(b)(i) was answered well by most candidates because it is popular.

QUESTION FIVE

a) Fundamental principles

- **Integrity.** A professional accountant should be honest and straightforward in performing professional services.
- **Objectivity.** A professional accountant should be fair and not allow personal bias, conflict of interest or influence of others to override objectivity.
- **Professional competence and due care.** When performing professional services, a professional accountant should show competence and duty of care by keeping up-to-date with developments in practice, legislation and techniques.
- **Confidentiality.** A professional accountant should respect the confidentiality of information acquired during the course of providing professional services and should not use or disclose such information without obtaining client permission.
- **Professional behaviour.** A professional accountant should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession.

(5 points @ 1 mark each = 5 marks)

b) Documenting audit work

- Provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the audit.
- Provides evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.
- Assists the engagement team to plan and perform the audit.
- Assists members of the engagement team responsible for supervision to direct, supervise and review the audit work.
- Enables the engagement team to be accountable for its work.
- Retains a record of matters of continuing significance to future audits.

(5 points @ 1 mark each = 5 marks)

c)

i) Circumstances which may result in audit opinions other than unmodified are:

- Financial statements materially misstated
- Inability to obtain sufficient appropriate audit evidence

(2 marks)

ii) The following opinions may arise out of these.

Financial statement materially misstated (Adverse opinion – where the effect of the

	Material but not pervasive	Both material and pervasive
Financial Statement materially misstated	Qualified	Adverse opinion
Inability to obtain sufficient and appropriate audit evidence	Qualified	Disclaimer of opinion

(8 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

Performance of question 5(a), (b) was satisfactory because most candidates found it to be practical. Question 5(c) was not well handled by many candidates as they were not able to demonstrate their understanding of audit report modification.

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) and other governance acts like IAA Act (Act 658) etc, as they are now examinable materials.
- 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.