MARCH 2024 PROFESSIONAL EXAMINATIONS
ADVANCED AUDIT & ASSURANCE (PAPER 3.2)
CHIEF EXAMINER'S REPORT, QUESTIONS AND MARKING SCHEME

STANDARD OF THE PAPER

The standard of the paper was comparable to that of previous diets. The questions covered every aspect of the syllabus and the marks allocation was in line with the syllabus weightings. The amount of work required to answer each question were commensurate with marks allotted to the questions.

PERFORMANCE OF CANDIDATES

Candidates performance was above average. Performance in March 2024 is 59.23% compared to that of November 2023 of 52.97%.

There was no sign of copying by candidates. There were a few instances where candidates recorded wrong question numbers for answers provided. In some instances, some candidates did not write question numbers for answers provided.

NOTABLE STRENGTHS AND WEAKNESSES OF CANDIDATES

Candidates had shown strengths in areas that regularly feature in the examinations and straight forward questions.

Candidates, however, showed weaknesses in the following:

- Some candidates wrote across the margins.
- Some wrote wrong question numbers for answers provided. Some did not write the questions numbers.
- Some candidates handwriting was so bad that it took one a lot of time to make up what had been written. Some candidates did not read over their work to correct sentences to make them easy to understand.
- There were signs of inadequate preparation on the part of some candidates.
- The ability to relate answers to relevant information in the scenario.
- The application of relevant standards to answers
- A good number of candidates over elaborated on answers without considering marks allotted to the question.

QUESTION ONE

a) You are an audit manager of Afari & Partners and have been assigned to the audit of Jericho Plant Company Ltd (Jericho Plant), which has been an audit client for 6 years and specialises in manufacturing fertilizers in Ghana.

The company was introduced to the firm by Mr. Lartey 6 years ago when he was a Commissioner at the Ghana Revenue Authority (GRA). Mr. Lartey is not a member of the Institute of Chartered Accountants, Ghana. However, since his retirement from GRA, last year, he joined the firm as a tax partner to provide tax consultancy services. He has good relations with the client as his daughter is married to the son of the CEO for Jericho Plant.

Mr. Andani who has been the audit engagement partner for Jericho Plant for the past 6 years and has recently been rotated off the audit engagement. The current audit partner, Mr. Nti, has suggested that in order to maintain a close relationship with Jericho Plant, Mr. Lartey should undertake the role of an engagement quality reviewer this year. In addition, Jericho Plant has requested that Mr. Andani assist them by attending their audit committee meetings, as a non-executive director has recently left the company.

Jericho Plant has also asked Mr. Lartey and the other partners at Afari & Partners to help them in recruiting a new non-executive director.

Fees paid by Jericho Plant forms 35% of the firm's total fee income (both audit and non-audit fees) and the partners have anticipated that the fees for this year would be greater than last year. Since joining as a tax partner, Mr. Lartey has been aggressive in generating revenue for the tax department and does not keep records of his work. He argues that the most important issue is for the firm to generate revenue which he does. Some of the clients have complained about the cash collected by Mr. Lartey as part of his consultancy services.

The audit manager for Jericho Plant last year has just announced that he is leaving Afari & Partners to join Jericho Plant as the financial controller.

Required:
Using the information above:

i) Evaluate **FOUR (4)** ethical threats which may affect the independence of Afari & Partners; **(6 marks)**

ii) For each threat, advise on how it might be mitigated to an acceptable level. **(4 marks)**

b) Ayesu & Associates, a reputable auditing firm, was approached by Kumanji Ltd to conduct an annual financial audit for the fiscal year ending December 31, 2023. Below is the audit engagement letter.

Re: Engagement Letter for the Audit of Financial Statements of Kumanji Ltd

We are pleased to confirm the terms of our engagement for the audit of your financial statements for the year ended December 31, 2023. This letter will serve as our agreement with Kumanji Ltd and outlines the scope of our services, responsibilities, and fee structure. Please review this letter carefully and let us know if you have any questions or concerns.

Audit Period: The audit will cover the financial statements of Kumanji Ltd for the fiscal year beginning January 1, 2023, and ending on March 31, 2023.

Audit Fees: Our fee structure will be based on a fixed fee of GH¢5,000 for the audit, payable in two instalments. The first instalment of GH¢2,500 will be due at the commencement of the audit, and the remaining GH¢2,500 will be due upon completion of the audit.

Timeline for Reporting: We will deliver the audit report and financial statements to you within two months after the conclusion of our fieldwork.

Conflicts of Interest: We do not anticipate any conflicts of interest that may affect our independence or objectivity during the audit. If any conflicts arise, we will address them promptly.

Audit Scope: We will perform audit procedures in accordance with Generally Accepted Auditing Standards (GAAS) to obtain reasonable assurance about whether the financial statements are free from material misstatement. Specific audit procedures will be determined during the audit process.

Contingency Plan: We do not have a contingency plan in place for unexpected disruptions or events that may affect the audit process.

Please acknowledge your agreement to the terms outlined in this letter by signing and returning a copy to us at your earliest convenience. If you have any questions or require clarification on any aspect of this engagement, do not hesitate to contact us.

We look forward to working with you and providing high-quality audit services to Kumanji Ltd. Thank you for entrusting us with this important engagement.

Required:
In accordance with ***ISA 210: Agreeing the terms of audit engagements***, discuss **FIVE (5)** issues with the engagement letter. **(10 marks)**

(Total: 20 marks)

QUESTION TWO

a) You are in charge of the audit of Tatule Technologies, a software development company. The company has been involved in the development of several web applications in use by the Government of Ghana as part of its E-government agenda.

As part of the audit planning, you had a meeting with the audit team and the audit seniors presented the following as their estimation of materiality.

	Amount (GH¢)	**Percentage Applied**	**Possible Planning materiality (GH¢)**
Revenue	54,950,847.00	1.50%	824,262.71
Gross Profit	12,961,376.00	2.00%	259,227.52
Income after tax	427,175.00	10.00%	42,717.50
Total Asset	25,221,161.00	3.00%	756,634.83
Total Equity	9,388,000.00	5.00%	469,400.00

They were unable to provide reasons behind their estimation and explained that these applied percentages are based on the typical materiality thresholds.

Required:
As the Team Lead, advise your team members on other factors to consider when evaluating materiality. Your discussion should also cover the need for performance materiality.

(10 marks)

b) **ISA 300:** ***Planning an Audit of Financial Statements*** requires auditors to plan the audit so that the audit work will be performed in an effective manner. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan.

Required:
Discuss **FOUR (4)** specific matters **ISA 300:** ***Planning an Audit of Financial Statements*** requires the auditor to consider when establishing the audit strategy. **(10 marks)**

(Total: 20 marks)

QUESTION THREE

You are the senior manager responsible for the audit of Addin Expert, a listed company. This company has been performing very well since incorporation until it was affected by the Government of Ghana Domestic Debt Exchange. The Board decided to sell a division of the company.

You are in the process of completing the audit of the financial statements for the year ended 31 March 2023. The auditor's report is due to be signed in the next few days. The company's authorised nature of business is the publication of trade and scientific journals.

Below is the draft financial statements extract of Addin Expert for the years ended March:

	2023	**2022**
	GH¢'million	**GH¢'million**
Revenue	108.00	102.00
Profit before tax	9.30	8.20
Total assets	150.00	149.00

In reviewing the audit working papers, the following issues were identified:

Sale of division

Addin Expert is at the advanced stage of negotiations to sell its scientific publishing division to a competitor. This division contributed revenue of GH¢13 million and profit before tax of GH¢1.4 million during the year ended 31 March 2023. The draft sale agreement which is due to be finalised by 1 August 2023 shows an agreed sale price after costs of disposal of GH¢42 million. The division is a separate cash generating unit of Addin Expert. None of the assets of the division are held under a revaluation policy and depreciation is charged on a straight-line basis over the determined useful life of the assets.

The Finance Director of Addin Expert has not made any disclosures with respect to the upcoming sale in the financial statements for the year ended 31 March 2023 as he considers it to be part of next year's accounting transactions. However, the division has been written down from its current carrying amount of GH¢45 million to its estimated value in use of GH¢41 million in the financial statements for the year ended 31 March 2023.

First time adoption of IFRS 16: Leases

Addin Expert operates from leased premises and additionally holds leases for printing equipment for journals. These leases are material to the financial statements. The company has adopted IFRS 16 for the first time for the year ended 31 March 2023 and has adjusted the opening balances and equity without restating comparatives as permitted by IFRS 16. There is, however, no reference in the financial statements to the change in policy or the reasons for making the change to accounting policies. The adjustments have already been checked by the audit team and deemed appropriate.

Required:

i) Evaluate the matters relevant at the completion stage of the audit and recommend further actions necessary before the auditor's report can be signed. **(17 marks)**

ii) Assess the impact on the auditor's report if no adjustments are made to the financial statements. **(3 marks)**

(Total: 20 marks)

QUESTION FOUR

a) Accurate reporting especially with respect to Auditor-General's report submitted to Public Accounts Committee, is very critical to public trust in findings on the use of public funds. Reports full of errors and inaccuracies could question the integrity of the observations and findings made by the Auditor-General. Quality control measures should therefore be given priority before reports are submitted to stakeholders.

Required:
Discuss **FIVE (5)** Quality Control procedures or policies that the Auditor-General should consider in the Performance of Audit. **(10 marks)**

b) You have just been elevated to Audit Senior position in charge of first level audits. Your first assignment is to audit a civil society organisation (CSO) whose objective is to protect the environment. The CSO has been in operation for the past 10 years and operates with donations from foreign bodies. Particular interests of the foreign bodies are forestry and river bodies and they lay emphasis on performance.

Required:
Your engagement partner wants you to study the operations of the CSO and brief him on performance audit before the commencement of the audit work. Your work should be extensive enough to cover, the ***meaning, objectives, underlying principles and audit approach***. **(10 marks)**

(Total: 20 marks)

QUESTION FIVE

a) The new Companies Act of Ghana 2019, Act 992, requires auditor rotation for all companies every six years with a cooling period of six years. This has generated debate amongst members of the practice society. Empirical studies have questioned the effects of auditor rotation and have raised doubt about its benefits.

Required:
Discuss **THREE (3)** arguments in favour and **TWO (2)** arguments against audit firm rotation. **(10 marks)**

b) You are a partner for one of the big four auditing firms. Your client, People Bank Ghana, has disclosed to you their plan to phase out most of its manual processes and move all their operations online. As part of this plan, several of their branches will be closed down and customers are expected to adopt one of their many e-banking platforms. The Board is not clear on how to implement a full IT based system and has asked you for guidance. As part of your preparation, you saw the need to implement Control Objectives for Information and Related Technologies (COBIT) framework.

Required:
Describe to the board what COBIT is and explain its purpose in relation to their pending decision. **(5 marks)**

c) Apenteng Manufacturing Company is a medium-sized manufacturing firm that manufactures electronic components. The company has been experiencing declining profitability and increased operational inefficiencies. Your firm has been engaged as auditors to audit the company's financial statements for the year ending December 31, 2023.

As part of the audit, you noticed several flaws in the internal controls. During the exit meeting with the Finance Director, he indicated that he does not think these are issues that can be described as deficiencies. He promised that he would ensure that every issue is resolved and so you do not have to include them in the management letter.

Required:
In accordance with ***ISA 265: Communicating deficiencies in internal control to those charged with governance and management***

i) Explain the term ***deficiency*** to the Finance Director. **(2 marks)**
ii) Justify to the Finance Director, the need to include the issues in the management letter. **(3 marks)**

(Total: 20 marks)

SUGGESTED SOLUTION

QUESTION ONE

a)

i) **Ethical Threats**

- **Familiarity Threat** of independent review partner: The proposed engagement quality reviewer's daughter is married to the son of the CEO for Jericho Plant. Also, he has long standing relationship with the company.

- **Attending Audit committee meeting**: The company has requested that Mr. Andani assist them by attending their audit committee meetings, as a non-executive director. This exposes the firm to self-interest threat as the firm may be perceived as performing management roles of the company and also threatens the objectivity of the firm.

- **Assistance to Recruiting a non-executive director**: This represents a self-interest threat as the audit firm cannot undertake the recruitment of senior management, especially non-executive directors who have a key responsibility of appointing the audit firm.

- **Fees (35% of total income):** This exposes the firm to self-interest threat as the fees from the company makes up significant portion of the firm's income.

- **Professional Behaviour:** Mr. Lartey has been aggressive in generating revenue for the tax department and does not document his work. The approach adopted has led to complaints from some clients. A professional accountant shall comply with the principle of professional behaviour, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles. His approach might discredit the accounting profession.

- **Professional Competence:** Mr. Lartey has been recommended as the engagement quality reviewer. an engagement quality reviewer must have competence, independence, integrity, and objectivity. He is not a member of ICAG. Although the question does not state his qualification, not being a professional accountant indicates that his level of competence may be below that which is required for an engagement quality reviewer.

- **The audit manager is leaving** the firm to become the financial controller at Jericho Plant. This represents a self-interest and familiarity threat as the audit manager is familiar with the audit plan which is to be adopted at firm and he may also have commenced work on this year's audit.

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

Managing the Risk of the threat

- Mr. Lartey should not serve as the engagement quality reviewer. Similarly, Mr. Andani cannot serve as the engagement quality reviewer because he is too familiar with the client. The firm can consult a professional outside the firm to serve in the position.
- Mr. Lartey should be trained on the ethical principles of the auditing professions and admonished to follow ethical principles in raising revenue for the firm.
- The firm can assist the client to undertake roles such as reviewing a shortlist of candidates. However, they must ensure that they are not seen to undertake management decisions and so must not make the final decision on who is appointed.
- A new audit manager should be appointed to Jericho Plant Company Limited and any work already undertaken by the previous manager should be independently reviewed.
- In addition, it would be advisable to modify the audit plan so that the manager would not be overly familiar with the approach to be adopted.

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

b) **Issues with the engagement letter**

- The audit period mentioned is incorrect, spanning only three months instead of a full fiscal year. Financial statements are typically prepared over a period of 12 months. The client has indicated that the financial statement ends on 31 December and so there is a mistake on the date ending 31 March instead.

- The objective of the audit not clearly spelt out and the scope indicates that the audit will follow GAAS. GAAS is not applicable to Ghana. The audit needs to follow ISAs instead.

- The letter failed to indicate the responsibilities of the auditor. To reduce the audit expectation gap, ISA 210 recommends that the auditor's responsibility is clearly spelt out in the engagement letter.

- The letter failed to indicate the responsibilities of management. An audit in accordance with ISAs is conducted on the premise that management has acknowledged and understands that it has the responsibilities. The concept of an independent audit requires that the auditor's role does not involve taking responsibility for the preparation of the financial statements or for the entity's related internal control, and that the auditor has a reasonable expectation of obtaining the information necessary for the audit in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the audit engagement.

- The letter failed to identify the underlying financial reporting framework for the audit. In accordance with ISA 210 the auditor is required to determine whether the financial reporting framework, to be applied in the preparation of the financial statements, is acceptable. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used in the preparation of general purpose financial statements for certain types of entities. In the absence of indications to the contrary, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared by such entities.

- ISA 210 requires reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content. This is missing from the letter.

- The fee structure is vague, specifying a fixed fee but not indicating the basis on which the fees are computed.

- The timeline for reporting is unreasonably short, potentially causing delays and difficulties in completing the audit.

- The contingency plan is not addressed, leaving the engagement vulnerable to unforeseen disruptions.

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

(Total: 20 marks)

EXAMINER'S COMMENTS
Question one was made up of two sub-questions a) and b).
The a) i) required candidates to evaluate four (4) ethical threats which may affect the independence of Afari partners from a given scenario. Majority of the candidates were able to attempt the question well. However, some few candidates gave explanation to the various threats without relating them to the scenario.

The a) ii) part of the question required candidates to advise on how each of the threats mentioned in part i) might be mitigated to an acceptable level. This was well attempted by most candidates.

NB: Question 1a is made up of i) and ii) for which candidates were to answer accordingly, however, some candidates put both together.

Sub-question b) required candidates to discuss five (5) issues with a given drafted engagement letter in accordance with ISA 210.

Knowledge in **ISA 210: Agreeing the terms of audit engagements** is important to answer this part of the question. Candidates were to criticise the draft engagement letter. This had been well attempted by most candidates.

QUESTION TWO

a) The materiality threshold presents a simplistic measure of the materiality of items without considering important factors. Other factors to be considered include:

- **The nature of the item involved:** Some items in the financial statement are valued more subjectively than others depending on their estimation. The more subjective the item, the more flexible the auditor should be in assessing the materiality of possible misstatements. The auditor will have to take a very different view on materiality when considering a warranty provision (which is subjective estimate), compared with the approach taken when auditing stated capital, which is capable of precise measurement.

- **The significance of the Item:** some items may be insignificant in terms of their monetary amount but may nevertheless be of particular interest to the users of the financial statement. E.g. Bonus payment to directors.

- **The impact of the items on the view presented by the financial statements:** A small and apparently insignificant error or omission may be material if, by correcting it:
    - ✓ A reported profit is converted into a reported loss, or
    - ✓ The correction significantly alters the trend of profit (growth rate in profits) over the past few financial years.
- The existence of statutory or regulatory reporting requirements that affect materiality thresholds.

- The sensitivity of the circumstances surrounding the misstatement, for example, the implications of misstatements involving fraud and possible illegal acts, violations of contractual provisions, and conflicts of interest.

- The effects of misclassifications, for example, misclassification between operating and non-operating income or recurring and non-recurring income items.

- The motivation of management with respect to the misstatement, for example,
    - ✓ an indication of a possible pattern of bias by management when developing accounting estimates or
    - ✓ a misstatement precipitated by management's continued unwillingness to correct weaknesses in the financial reporting process.

Performance Materiality represent the "the amount or amounts determined by the auditor, based on the assessed level of risk at the financial statement level, which is less than materiality for the financial statements as a whole. The amount of performance materiality is considered necessary to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements is greater than materiality."

4 points @ 2 marks each = 8 marks
explanation of performance materiality = 2 marks

b) The audit strategy sets out in general terms how the audit is to be conducted and sets the scope, timing and direction of the audit. The audit strategy then guides the development of the audit plan, which contains the detailed responses to the auditor's risk assessment. ISA 300 requires the auditor to consider specific matters when establishing the audit strategy and provides a list of typical matters to be considered in its appendix. These matters are discussed below:

- **Identify the characteristics of the engagement that define its scope**: Some audit engagements have specific characteristics that mean the audit has a wider scope than the audit of other entities. For example, a group audit engagement or the audit of a multinational company will both have wider scopes than an audit of a small, owner-managed entity. Matters such as the ability to use the work of internal auditors, the need to liaise with external service organisations, and the effect of IT on audit procedures are also relevant. The scope is also affected by the applicable financial reporting framework, the nature of the audited entity's business and whether it operates business segments, the business activities conducted, and the availability of client personnel and data.

- **Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required:** Reporting requirements will vary from audit to audit. For example, some entities have additional reporting requirements to comply with corporate governance regulations or industry requirements, and the auditor must understand these requirements from the start of the audit. The nature of other communications that may be necessary during the audit should be considered, such as liaison with component auditors, and communications to management and to those charged with governance.

- **Consider the factors that are significant in directing the audit team's efforts in the auditor's professional judgment:** The strategy must consider issues to do with quality control, such as how resources are managed, directed and supervised, when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

- **Consider the results of preliminary engagement activities and knowledge gained on other engagements:** This includes the initial assessments of materiality, risks identified from preliminary activities such as fraud risks, significant events that have occurred at the entity or in the industry in which it operates since the last audit, and the results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them. The audit firm may also have performed other services for the client that may be relevant in determining the audit strategy, for example, reviews of business plans or cash flow forecasts.

- **Ascertain the nature, timing and extent of resources necessary to perform the engagement:** One of the main objectives of developing the audit strategy is to effectively allocate resources to the audit team, for example, the use of specialists on particular areas of the audit, or building a team of highly experienced auditors for a potentially high-risk audit engagement. If the audit is time pressured due to a tight deadline, then more resources will need to be allocated to ensure that all necessary audit work is completed and can be reviewed in time to meet the deadline.

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

(Total: 20 marks)

EXAMINER'S COMMENTS

This question was made up of two sub-questions, a) and b).

Sub-question a) required candidates, acting as Team Lead, to advise their team members on other factors to consider when evaluating materiality. The candidates were required to also cover the need for performance materiality in their discussion. Majority of the candidates could not answer the question well. They demonstrated weakness, regarding evaluating performance materiality. Those who attempted it did not exhibit an understanding of performance materiality.

The b) part of the question required candidates to discuss four (4) specific matters **ISA 300: planning an Audit of Financial statements**, requires the auditor to consider when establishing the audit strategy. This question was well attempted by most candidates. They were able to discuss matters to consider when establishing the audit strategy.

QUESTION THREE

a) **Matters, further actions and auditor's report implications**

Sale of division

The company is at an advanced stage of negotiations with a competitor to sell its scientific publishing division. Currently the finance director has not included any reference to the sale in the financial statements for the year ended 31 March 2023.

The revenue of the scientific publishing division of GH¢13 million represents 12% of total revenue and the profit of the division of GH¢1.4 million represents 15.1% of profit before tax. The division is therefore material to the statement of profit or loss. The assets of the division are also material, as they represent 27.3% of the company's total assets, based on their value in use which is recognised in the financial statements.

According to IFRS 5, a disposal group of assets should be classified as held for sale where management plans to sell the assets, and the sale is highly probable. Conditions which indicate that a sale is highly probable are:

- management is committed to a plan to sell
- the asset is available for immediate sale
- an active programme to locate a buyer is initiated
- the sale is highly probable, within 12 months of classification as held for sale (subject to limited exceptions)
- the asset is being actively marketed for sale at a sales price reasonable in relation to its fair value
- actions required to complete the plan indicate that it is unlikely that plan will be significantly changed or withdrawn.

In respect of the scientific publishing division, management has decided to sell the division and a buyer has been found. The advanced stage of negotiations would suggest the sale is highly probable.

IFRS 5 requires specific disclosures in relation to assets held for sale and discontinued operations, including that the assets are recognised as current assets and the results of the discontinued operation are presented separately in the statement of profit or loss and the statement of cash flows.

As a result, important disclosures are currently missing from the financial statements which could mislead users with respect to the future revenue, profits, assets and cash flows of the company. Failing to provide information about the sale of the division could be seen as a significant omission from the financial statements, especially given the materiality of the assets of the division to the company's assets as a whole.
There is therefore a material misstatement as the scientific publishing division has not been classified as held for sale and its profit presented as a discontinued operation and the necessary disclosures have not been made in the financial statements.

IFRS 5 provides further guidance regarding the valuation of the assets held for sale. Prior to classification as held for sale, the disposal group should be reviewed for impairment in accordance with ***IAS 36: Impairment of As***sets. This impairment review would require the asset to be held at the lower of carrying amount and recoverable amount where the recoverable amount is the higher of value in use or fair value less costs of disposal.

In this case the recoverable amount would be GH¢42 million representing the fair value less costs of disposal. Management has valued the disposal group based on its value in use at GH¢41 million which means that assets and profit are currently understated by GH¢1 million. This represents 10.7% of profit before tax and is material to the profit for the year.

After classification as held for sale, non-current assets or disposal groups are measured at the lower of carrying amount and fair value less costs which would continue to be GH¢42 million. Depreciation ceases to be charged when an asset is classified as held for sale.

(1 mark each for any 7 valid points)

Adoption of IFRS 16 and change in accounting policy
IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors permits a change in accounting policy where the change:

- is required by a standard or interpretation; or
- results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance, or cash flows.

Where the change in policy is due to the requirements of a new standard then the method of applying the change set out in the new standard should be followed. In this case, IFRS 16 permits a lessee to either apply IFRS 16 with full retrospective effect or alternatively not restate comparative information but recognise the cumulative effect of initially applying IFRS 16 as an adjustment to opening equity at the date of initial application. Therefore, the accounting treatment by Addin Expert is acceptable.

However, the lack of disclosure of the change in accounting policy is not in accordance with IAS 8 which requires the following disclosures in these circumstances:

- the title of the standard or interpretation causing the change
- the nature of the change in accounting policy
- a description of the transitional provisions, including those that might have an effect on future periods
- for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
    - ✓ for each financial statement line item affected, and
    - ✓ for basic and diluted earnings per share (only if the entity is applying IAS 33)
- the amount of the adjustment relating to periods before those presented, to the extent practicable
- if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.

As these disclosures have not been made, there is an omission of disclosure which is key to understanding the changes in deriving the lease balances in the financial statements which is likely to be a material omission given that leased assets are material to the financial statements.

(2.5 marks each for any 2 valid points well explained)

Further actions

- The auditor should request that management adjusts the financial statements to recognise the discontinued operation and to separately disclose the assets held for sale in accordance with IFRS 5 and to disclose the change in accounting policy for leases as required by IAS 8.

- In addition, the client should be requested to amend the carrying amount of the assets to the recoverable amount of GH¢42 million in line with IFRS 5 requirements.
- If management refuses to adjust the financial statements, the auditor should communicate the misstatements to those charged with governance. They should repeat the request and inform them of the modifications that would be made to the auditor's report if the adjustments are not made.
- If management still refuses to amend the financial statements, the auditor should request a written representation from management confirming their intent to proceed without amending the financial statements and that they are aware of the potential repercussions.

(2.5 marks each for any 2 valid points)

ii) **Auditor's report implications**

If the adjustments are not made, then there is a material misstatement in the financial statements. The matters above have resulted in an understatement of assets and profits by GH¢1 million which in isolation is unlikely to be pervasive as limited components of the financial statements are affected.

This would result in a qualified audit opinion in which the report would state that 'except for' the material misstatement in relation to the valuation of the assets held for sale the financial statements are fairly stated.

However, there are also several important disclosures omitted which would be required for users to understand both the current financial position of the company and its ability to generate future revenue and profits. As such, it would be a matter of judgement as to whether the lack of disclosures in conjunction with the material misstatement mentioned above have a pervasive impact on the financial statements.

Depending on the auditor's judgement on this issue, this may give rise to an adverse opinion if the auditor considered the impact of these issues to result in the financial statements being wholly misleading.

Depending on the opinion provided, a basis for qualified or adverse opinion paragraph would be added underneath the opinion paragraph to describe and quantify the effects of the misstatements.

1 mark each for any 3 valid points (3 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

This question is made up of two (2) scenarios with the following headings: Sale of division and First time adoption of **IFRS 16: Leases**. Candidates were required to:

I. Evaluate the methods relevant at the completion stage of the audit and recommend further actions necessary before the auditor's report can be signed.

II. Access the impact on the auditor's report if no adjustments are made to the financial statements.

SALE OF DIVISION
Candidates' knowledge in IFRS 5 and IAS 36: impairment of Assets, is relevant in answering this question. Knowledge of the concept of materiality and disclosure is also important.

FIRST TIME ADOPTION OF IFRS 16: leases: Candidates knowledge in IAS 8: Accounting Policies and IFRS 16: leases is relevant to answering this part of the question.

FURTHER ACTIONS
This section required certain procedures that the auditor would perform before signing the report. Knowledge in IFRS 5 and IAS 8 is relevant in answering this part of the question.

AUDITOR'S REPORT IMPLICATION
This part required candidates to indicate the opinion the auditors will form if the necessary adjustments and disclosures have not been made by management. Candidates should be able to indicate whether the absence of the adjustments and disclosures will lead to material misstatement or not in the financial statements.

Generally, the performance of the candidates in relation to this question was average. Most candidates spent time calculating materiality and commenting on it which attracted only a point.
The impact on auditor's report section was poorly answered by most candidates.

QUESTION FOUR

a) The following Quality Control procedures or policies must be considered:

- Auditor-General should ensure appropriate policies, procedures and tools, such as audit methodologies are in place for carrying out the range of work that is the responsibility of the SAI, including work that is contracted out.

- Auditor-General should establish policies and procedures that encourage high quality and discourage or prevent low quality. This includes creating an environment that is stimulating, encourages proper use of professional judgement and promotes quality improvements. All work carried out should be subject to review as a means of contributing to quality and promoting learning and personnel development.

- Where difficult or contentious matters arise, Auditor-General should ensure that appropriate resources (such as technical experts) are used to deal with such matters.

- Auditor-General should ensure that applicable standards are followed in all work carried out, and if any requirement in a standard is not followed, Auditor-General should ensure the reasons are appropriately documented and approved.

- Auditor-General should ensure that any differences of opinion within the SAI are clearly documented and resolved before a report is issued by the Auditor-General.

- Auditor-General should ensure appropriate quality control policies and procedures are in place (such as supervision and review responsibilities and engagement quality control reviews) for all work carried out (including financial audits, performance audits, and compliance audits). Auditor-General should recognize the importance of engagement quality control reviews for their work and, where an engagement quality control review is carried out, matters raised should be satisfactorily resolved before a report is issued by the Auditor-General.

- Auditor-General should ensure that procedures are in place for authorizing reports to be issued. Some work of Auditor-General may have a high level of complexity and importance that requires intensive quality control before a report is issued.

- If Auditor-General are subject to specific procedures relating to rules of evidence (such as Auditor-General with a judicial role), they should ensure that those procedures are consistently followed.

- Auditor-General should aim for timely completion of audits and all other work, recognizing that the value from the work of Auditor-General diminishes if the work is not timely.

- Auditor-General should ensure timely documentation (such as audit work papers) of all work performed.

- Auditor-General should ensure that all documentation (such as audit work papers) is the property of the Auditor-General, regardless of whether the work has been carried out by SAI personnel or contracted out.

- Auditor-General should ensure appropriate procedures are followed for verifying findings to ensure those parties directly affected by the Auditor-General's work have an opportunity to provide comments prior to the work being finalized, regardless of whether or not a report is made publicly available by the Auditor-General.

- Auditor-General should ensure that they retain all documentation for the periods specified in laws, regulations, professional standards and guidelines.

- Auditor-General should balance the confidentiality of documentation with the need for transparency and accountability.

- Auditor-General should establish transparent procedures for dealing with information requests that are consistent with legislation in their jurisdiction.

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

b) Performance audit

Meaning

Performance auditing is an independent, objective and reliable examination of whether government undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement.

(2 marks)

Audit approach

Performance auditing generally follows one of three approaches (or a combination of these approaches):

- **A result-oriented approach:** This assesses whether the outcomes or output objectives have been achieved as intended or whether programmes and services are operating as intended.

- **A problem-oriented approach:** This examines and analyses the cause of particular problems or deviations from the audit criteria of economy, efficiency and effectiveness.

- **A system-oriented approach:** This examines the proper functioning of a management system, such as a financial management system or a control system and considers whether the system is functioning efficiently and effectively or whether improvements can be made.

(3 marks)

Principles underpinning Performance audit

Performance audit intends to evaluate an organisation based on the principles of economy, efficiency and effectiveness. These principles are briefly explained below:

- The principle of economy means minimizing the costs of resources. The resources used should be available in due time, in and of appropriate quantity and quality and at the best price.
- The principle of efficiency means getting the most from the available resources. It is concerned with the relationship between resources employed and outputs delivered in terms of quantity, quality and timing.

- The principle of effectiveness concerns meeting the objectives set and achieving the intended results.

  Performance audits often include an analysis of the conditions that are necessary to ensure that the principles of economy, efficiency and effectiveness can be upheld. These conditions may include good management practices and procedures to ensure the correct and timely delivery of services. Where appropriate, the impact of the regulatory or institutional framework on the performance of the audited entity should also be taken into account.

(3 marks)

Objective

The main objective of performance auditing is constructively to promote economical, effective and efficient governance. It also contributes to accountability and transparency.

Performance auditing promotes accountability by assisting those with governance and oversight responsibilities to improve performance. It does this by examining whether decisions by the legislature or the executive are efficiently and effectively prepared and implemented, and whether taxpayers or citizens have received value for money.

It does not question the intentions and decisions of the legislature, but examines whether any shortcomings in the laws and regulations or their way of implementation have prevented the specified objectives from being achieved.

Performance auditing focuses on areas in which it can add value for citizens and which have the greatest potential for improvement. It provides constructive incentives for the responsible parties to take appropriate action.

Performance auditing promotes transparency by affording parliament, taxpayers and other sources of finance, those targeted by government policies and the media an insight into the management and outcomes of different government activities.

It thereby contributes in a direct way to providing useful information to the citizen, while also serving as a basis for learning and improvements.

In performance auditing, SAIs are free to decide, within their mandate, what, when and how to audit, and should not be restrained from publishing their findings.

(2 marks)

(Total: 20 marks)

EXAMINER'S COMMENTS

For the a) part of the question, candidates were to discuss five (5) quality control procedures or policies that the Auditor General should consider in the performance audit. Most of the candidates answered this part of the question well. However, a few could not explain their points well. Some deviated by writing on the techniques for obtaining audit evidence.

Candidates performance in the b) was average. Most candidates offered shallow explanations to the following:
Meaning: - this aspect of the requirement was not well explained by some of the candidates.

Objective: most of the candidates were not able to bring out clearly the objectives of performance audit. Some stated principles as objectives

Principles: a few candidates were able to state and explain this aspect of the requirement. However, majority of them were confused. Some candidates wrote on underlining principles of CSOs.

Approach: this aspect was poorly answered by most of the candidates.

QUESTION FIVE

a) Audit firm rotation
Argument in favour

- **Familiarity:** A long-term audit relationship creates to some extent familiar relationship between the auditors and the client. This may weaken the professional sceptism and independence of the auditors. Auditors may be more likely to compromise to preserve the relationship.

- **Public Perception of Independence:** The mandatory rotation of auditors improves the extent to which the public perceive the auditor-client relationship as independent. This will on a whole improve public confidence in the quality of audits.

- **Fresh Perspective:** Mandatory rotation is also argued to help auditors get a fresh perspective on their clients' financial statements. After a cooling period of six years required by the Company's Act, the auditor can gain fresh insights on the operations of the business.

- **Ineffective Audit approach:** After serving as auditors for a long time, the auditor's approach become predictable and ineffective, so does the audit programs used to evaluate a company's financial statements and internal controls. A new audit firm will bring greater alertness and might be able to detect things in statements that the previous auditor might have overlooked.

- **Peer level scrutiny:** Mandatory rotation allows audit firm to scrutinize other firm's actual work instead of just evaluating their controls and compliance with professional standards through the peer review program. An audit firm's awareness that another firm will follow it work and could very well detect its errors and fraud will motivate that firm to do its best work to avoid embarrassment. The successor firm is also motivated to do its best work because it does not want negative publicity due to its inability to detect the previous firm's errors.
- **Increase Competition among firms:** Mandatory rotation will increase competition between audit Firms. The frequency in which corporations would change auditors within the rotation system would require audit firms to constantly improve themselves to attract new clients. Rotation would require firm to better their services in order to differentiate themselves from the competition.

- **Economic Independence:** Auditor rotation also prevents corporate management from using termination of the engagement as a threat when an auditor disagrees with its representations. If an auditor knows that in the next six years the firm is required to rotate off the engagement, the auditor is not under as much pressure to compromise his integrity and comply with the demands of management. A firm cannot become too economically dependent on one client when every six years it must terminate the relationship.

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

Arguments against

- **Ineffective audits in first years:** There may be negative effects on audit quality and effectiveness in the first years following a change. This is because, the new auditors may take several years to familiarise themselves with their new client and its procedures. There is some evidence to suggest that there may be a higher instance of audit failures in the first years following a change of auditors.

- **Increased Cost:** There are substantial cost from changing auditors regularly, as auditors attempts to familiarise himself with the new client. More management time is also needed to assist the new auditor to learn about the client company, its operations, and its systems.

- **Lack of evidence of benefits:** There is no evidence that compulsory rotation of Auditors has a positive impact on auditor's independence and audit quality.

- **Domination by Big Fours:** The market for auditing listed companies is dominated by the "Big Four" accountancy firms. If this domination of the audit market continues, it may be difficult to change auditors easily. The other large firms may not have available resources to take other non-audit services that they already provide.

- **Short period for rotation:** The required period of six years for the engagement is not long enough. Since most modern businesses are large and complex, the six years may not give an audit firm enough time to get a thorough understanding of the company. Audits risks are reduced as the auditor becomes more familiar with a company and understand the entity and its environment.

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

b) COBIT is a globally accepted suite of tools that a client might use in order to ensure that IT is working effectively. Collectively they provide a framework for integrating industry standards and good practice in the development of IT systems. It is an IT governance tool that harmonises standards from prominent global sources into a critical resource for management control professionals and auditors.

COBIT applies to enterprise-wide information systems, including personal computers, minicomputers, mainframes and distributed processing environments. COBIT support self-assessment of strategic organisational status, identification of action to improve IT processes and monitoring of the performance of these IT processes. COBIT provides a reference framework for management, users and information systems audit as well as control and security practitioners.

The purpose of COBIT is to provide management and business process owners with information technology (IT) governance model that helps in understanding and managing the risks associated with IT. COBIT helps to bridge the gaps between business risks, control needs and technical issues. It is a control model to meet the needs of IT governance and ensure the integrity of information and information system.

(5 marks)
Meaning 2 marks
Purpose 3 marks

c)

i) A deficiency is defined by ISA 265 as where:

- a control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis, or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.
- A significant deficiency in internal control is one which merits the attention of those charged with governance.

(2 marks)

ii) ISA 265 requires the auditor to:

- Communicate significant deficiencies identified during the audit to those charged with governance in writing on a timely basis.
- Communicate any other deficiencies to an appropriate level of management.

JUSTIFICATION

- To document material matters which came to the auditors notice during the audit
- To afford management the opportunity to rectify matters which would otherwise lead to audit report qualification.

- To serve as a future reference in case of negligence action against the auditor
- To remind the auditor of areas that they may need special attention during such an audit

(1 mark each for any 3 valid points)

(Total: 20 marks)

EXAMINER'S COMMENTS

Candidates performance in this question was generally good with the exception of the b) part of the question (COBIT) which was not very well answered. The candidates were able to make concrete arguments for audit rotation. Likewise, most candidates were able to explain what deficiency is and justify why communicating same to those charged with governance.

CONCLUSION

- Candidates must ensure that their handwriting is legible.
- Candidates must read over their work before submitting answer booklet.
- Candidates must study the relevant standards very well in order to apply them where necessary in answering the questions
- Requirements must be made clear to make understanding easy to candidates.