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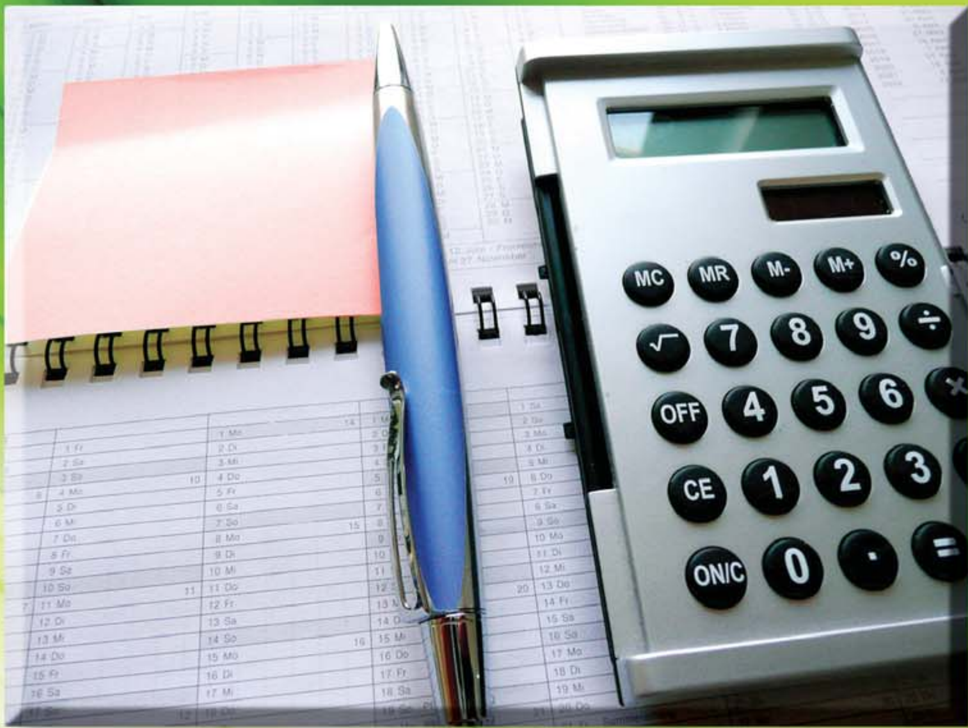

Understanding Statement Of Cash Flow

- ICAN Commissions Lecture Theatres In Two Federal Universities
- Undergraduate Qualifies As ICAN Member

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Tel: 7642294, 7642295,
Fax: 2610304
E-mail: info.ican@ican.org.ng
corporateaffairs@ican.org.ng;
ICAN Website: www.ican-ngr.org

Designed by Linix Services Limited, Lagos.
Tel: 0802 301 6590, 0816 059 8576

Editor's Note

To say that a company is established to make profit is an understatement as the primary objective of every business is to make as much profit as possible through its operating activities. A company is expected to generate sufficient fund to offset its liabilities as and when due, because failure to do this would lead to the risk of insolvency.

*In our lead article entitled **"Understanding Statement of Cash Flows: International Accounting Standards (IAS 7)"** Dr. Ben Ukaegbu opined that the profit figure reported in the income statement of any business is largely determined by the application of the accounting concept of accruals, which requires realised revenues to be matched with expenses incurred in the reporting period.*

He further posited that a company's accounting profit is usually different from the actual cash profit that it generates in the business in a given period.

According to him, the objective of IAS 7 Statement of Cash Flows is to require the presentation of information about historical changes in the cash and cash equivalents of a company by means of a Statement of Cash Flows which classifies cash flows during a given reporting period in relation to operating, investing and financing activities.

In continuation of its determination to improve the study of accounting in higher institutions, the Institute has commissioned another two lecture theatres at the Federal University, Birni-Kebbi and Michael Okpara University of Agriculture, Umudike, Abia state.

Our regular column - the examiner is also published to serve as guide to students on how to answer questions and pass their examinations. Your comments and contributions are welcome.

Write to: corporateaffairs@ican.org.ng or aoowolabi@ican.org.ng

ICAN Commissions Lecture Theatres In Two Federal Universities

In its bid to improve the study of accounting in higher institutions in Nigeria, the Institute has commissioned two 250-sitting capacity lecture theatres in the Federal University, Birni-Kebbi, Kebbi state and Michael Okpara University of Agriculture, Umudike, Abia state.

Performing the commissioning, the 52nd President of the Institute, Deacon Titus Soetan explained that the decision of ICAN Council to donate lecture theatres to some select institutions of higher learning was borne out of its conviction that the study of accounting should be encouraged and enhanced among the youths.

He urged the authority of the Universities to make proper use of the building and ensure that they are well maintained, so that the purpose for which they were donated would not be defeated.

In his remark, the Acting Vice Chancellor of the Federal University, Dr. Sahabi Jabo who was represented by the Dean, Faculty of Arts, Social and Management Sciences, Professor Abdullahi Bashir, described ICAN's gesture as unprecedented in the history of the Institution.

He said: "ICAN is making big history today as it is the first professional body that has ever made this kind of donation to this University. This is unrivalled and we are grateful to the President and Council of ICAN that counted this University worthy of this donation. We really appreciate this".

ICAN Lecture Theatre recently commissioned at Ahmadu Bello University, Zaria
INSERT: ICAN Lecture Theatre at Federal University, Birni-Kebbi

"On behalf of the management, staff and students of the University, I assure ICAN that this gesture would be reciprocated by taking good care of the building and keep it in good use for the purpose for which it was donated."

Also responding, the Vice Chancellor of Michael Okpara University of Agriculture, Professor Francis Otunta, said the department of accounting of the school has undoubtedly received much attention from ICAN.

He explained further that the accounting department of the University was recently accredited under the Institute's Mutual Co-operation Agreement with Tertiary Institutions (MCATI) which enables graduates to enjoy extended exemptions from ICAN examinations.

"What you are doing in Umudike today is a challenge to other professional bodies in Nigeria, as funding of public universities should not be the sole responsibility of governments alone," he concluded.

Undergraduate Qualifies As ICAN Member

An undergraduate of the Madonna University, Okija in Anambra State, Mr. Stanley Ezeruo has qualified as a Chartered Accountant having written all the stages of the Institute's examinations.

The final year student in the accounting department of the University had with zeal and hard work passed each of the subjects in just one attempt and now awaiting induction. Using his Association of Accounting Technician (AAT) certificate to register, he was able to claim exemption in Foundation and some subjects in Skill in the Professional level examinations.

In a brief conversation with him, Ezeruo disclosed that his flair for professionalism has made him to pursue the accounting course, noting that encouragement from professionals around him as well as his determination and hard work contributed to his success.

Meanwhile, the 52nd President of the Institute, Deacon Titus Soetan had encouraged students of the university to be focused and key into the Accounting Technician Scheme (ATS) of the Institute to pursue the accounting profession.

He reiterated that rather than allow the seemingly flashy things and ill gotten wealth associated with corrupt practices to entice them, students and youths should be encouraged by the examples of who have excelled through hard work and determination, adding that ICAN has enough programmes for accountability. He said, "We are in a society where people celebrate corruption because moral values are no longer held in high esteem. Do not be attracted to the vices."

UNICAL Seeks ICAN's Assistance On Lecture Theatre, Accounting Software

The authorities of University of Calabar has appealed to the Institute of Chartered Accountants of Nigeria (ICAN) to donate a Lecture Theatre and accounting software to the Accounting department of the Institution.

Making the appeal recently in Calabar was the Registrar of the Institution, Mr. Moses Obong who represented the Vice Chancellor when the 52nd President of ICAN Deacon Titus Soetan visited the University.

According to the Registrar, the Institution did not possess a particular lecture theatre for Accounting department and it would be appreciated if ICAN could assist in that direction.

ICAN President, Deacon Titus Soetan with the students of University of Calabar.

In his response, the ICAN President advised that for the requests to be granted, the Vice Chancellor should ensure that the accounting department of the Institution fully regains its accreditation status with the Institute.

The President also spoke on the relevance and advantages of getting into the Institute's Mutual Cooperation Agreement with Tertiary Institutions (MCATI) programme, explaining that the Governing Council has reviewed its policy on exemptions granted to students from Institutions under this programme.

Deacon Soetan also called on the senate of the Institution to consider ICAN's ATSWA certificate for direct entry admission into the university. He equally prevailed on the management of the University to consider the employment of members of the Institute who are qualified and meets the criteria of the University for employment as lecturers.

Our Collaboration With ICAN Has Produced Over 600 Chartered Accountants - NNDC

The Executive Director, Management Services at New Nigeria Development Company (NNDC), Mrs. Kaneng Adole has disclosed that the collaboration of NNDC and the Institute of Chartered Accountants of Nigeria (ICAN) in the training of chartered accountants has produced over six hundred chartered accountants across the country.

Mrs. Adole disclosed in Kaduna while receiving the 52nd ICAN President, Deacon Titus Soetan who paid a courtesy visit to NNDC recently. She said that the feat was achieved because of the mutual cooperation between the two organisations. She said: "Without ICAN's cooperation, NNDC couldn't have been able to do what it is doing today regarding raising chartered accountants. ICAN/NNDC cooperation has produced over 600 chartered accountants. I pray that other organizations could also borrow a leaf from NNDC and ICAN to do what we are doing,".

In his response, the ICAN President eulogized NNDC management for supporting the Institute, adding that the Company has also been a strong pillar to Kaduna District Society of ICAN.

While commending NNDC for sponsoring ICAN members in its employment to the Institute's programmes and events, Soetan also appealed for the organisation's sponsorship of undergraduates to write ICAN examinations.

Executive Director, Management Services, NNDC, Mrs. Kaneng Adole receiving a sovenir from the 52nd ICAN President, Deacon Titus Soetan during his visit to the Company in Kaduna.

ICAN Counsels UNIYO On The Advantages Of MCATI

The 52nd President of the Institute, Deacon Titus Soetan has advised the management of the University of Uyo to liaise with ICAN on how to get involved in the Mutual Cooperation Agreement with Tertiary Institutions (MCATI) scheme established by the Institute.

Soetan who gave the advice during his visit to the University recently explained that the Governing Council of the Institute has reviewed its policy on exemptions granted to students from institutions under the MCATI programme.

According to him, such students would be exempted from eleven subjects after graduation as they would enjoy exemption from the Foundation and Skills levels of the professional examinations and proceed to the final (professional) level. Soetan also called on the Senate of the Institution to consider the Accounting Technician Scheme West Africa (ATSWA) certificate of ICAN, for its direct admission into the university.

ICAN President, DeaconTitus Soetan(3rd left); Uyo Distict Chairman of ICAN, Dr. Mbo;(2nd left); Tayo Philips (r); Comfort Eyitayo (2nd right); Samuel Ukura (l); DVC, UNIYO, Prof. Goffery Udoh during ICAN's visit to the University.

In his response, the representative of the Vice Chancellor, Professor Goffery Udo reiterated the University's Senate support for the Institute's programme as well as its accreditation report which are usually crafted with details on areas that needed adequate attention by the Institution. He commended the catch them young programme introduced by the Institute as a means by which its membership base would always be enriched.

On the request of ICAN for the University to join the MCATI programme, the Don assured that the University Senate would look into the request and liaise with the relevant department coordinating the programme in ICAN.

My Success Story Is Incomplete Without ICAN - Vice Chancellor

The Vice Chancellor of Kaduna State University, Professor Mahmud Tanko, FCA has reiterated that the Institute of Chartered Accountants of Nigeria (ICAN) has contributed immensely to his success and his appointment as the Vice Chancellor.

Tanko made the declaration in Kaduna recently, when the 52nd ICAN President, Deacon Titus Soetan paid him courtesy visit in his office. He expressed gratitude to the Institute for granting him the opportunity to write its examinations which he described as a catapult to his success in life. "ICAN has contributed immensely to my success in life because its certificate is respected anywhere. The certificate gave me a milestone to my success and contributed to my appointment as the Vice Chancellor of this University. I am proud to be associated with the Institute," he declared.

ICAN President, Deacon Titus Soetan presenting ICAN publications to the Vice Chancellor of Kaduna State University, Prof. Mahmud Tanko in his office.

Speaking further, the VC urged the Institute to extend its gesture of donating Lecture Theatres to Kaduna State University just like it did to some northern higher institutions.

He requested that the Council of the Institute should always consider appointing members of Kaduna and District Society into its various committees and also ensure that study packs for examinations are sent down to students promptly to prepare them ahead.

Earlier in his speech, the 52nd ICAN President had intimated the VC that he was in the state to see and have first hand information on how members of the Institute in the state are faring with their employers. He thanked the VC for keeping the flag of ICAN flying in the University and the state as a whole, adding that the Institute will be glad if it could go into partnership with the University in the area of manpower development.

Understanding Statement Of Cash Flow

International Accounting Standards (IAS 7)

By Ben Ukaegbu

Introduction

The primary objective of every company is to make as much profit as possible through its business operating activities. It is also very important for a company to generate sufficient cash to pay its liabilities as and when they fall due for payment. A company that makes a large amount of profits but is unable to pay its debts would soon find itself facing the risk of insolvency. The profit figure reported in the income statement is largely determined by the application of the accounting concept of accruals which requires *realised* revenues to be *matched* with expenses incurred in the reporting period. Consequently, a company's accounting profit is usually different from the actual cash profit that it generates in the business in a given period.

Objective of IAS 7 Statement of Cash Flows

The objective is to require the presentation of information about historical changes in the cash and cash equivalents of a company by means of a Statement of Cash Flows which classifies cash flows during a given reporting period in relation to operating, investing and financing activities A statement of cash flows may be used by investors, creditors and other users of corporate financial statements to assist in:

- *evaluating a company's ability to generate cash and cash equivalents,* and the timing andcertainty of their generation.

- *evaluating a company's liquidity and solvency*, including its ability to meet its obligations and to pay dividends.

- *evaluating the quality of a company's earnings* (profits) by understanding the reasons for the difference between its net profit and the cash and cash equivalents generated from operating activities.

- *comparing the differences in the operating performance of companies*

- *developing models to assess and compare the present value of future cash flows of different companies.*

Cash and cash equivalents

IAS 7 provides definitions of what constitute cash resources of a company as follows:

- *Cash* – cash-in-hand and deposits in the bank that can be withdrawn on demand less overdrafts repayable on demand;

- *Cash equivalents* – short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. They are usually held for the purpose of meeting short-term (3 months or less) commitments and are not for investment or other purposes.

Classification of cash flows

Although IAS 7 does not prescribe a specific format for the statement of cash flows of a company, the standard requires cash flows to be classified under the following categories:

- **Operating activities**are the principal revenue-producing activities from operations and any other activities that do not fall within investing and financing activities. Such cash flows include receipts from customers, payments to suppliers and employees and corporate taxes. Operating cash flows may also include interest and dividends received (though these items may be classified as investing) and interest paid (though this item may also be classified as financing activities).

- **Investing activities** are the acquisition and disposal of non-current assets (such as property, plant and equipment, intangibles, subsidiaries and businesses) and other investments not included in cash equivalents (such as shares held in other companies).

- **Financing activities** are activities that result in changes in the size and composition of the equity capital and borrowings (such as the issue of new shares, buyback of shares, new borrowings, repayment of borrowings and the payment of dividends, though payment of dividends are sometimes classified as an operating activity).

The classification of *interest and dividends* as either operating, investing or financing activities is not specified under IAS 7. However, the standard does require them to be separately disclosed and classified consistently across reporting periods.

Operating activities – cash flows generated from operations

IAS 7 permits cash flows generated from operations to be reported using one of two methods: direct method and indirect method.

Under the **direct method** of presentation, classes of operating cash receipts and payments are disclosed, such as receipts from customers and payments to suppliers and employees, to arrive at cash generated from operations.

Under the **indirectmethod**, the starting point is the profit from operations and this is adjusted for the effects of transactions of a non-cash nature (such as depreciation of property, plant and equipment, amortisation and impairment of intangibles and profit or loss on disposal of property, plant and equipment). Then, further adjustments are made for changes in working capital components (increases or decreases in inventories, receivables and payables) to determine the cash flows generated from operations.

Both methods have their advantages and disadvantages. The direct method shows the gross inflows and outflows that will assist users in predicting future cash inflows and outflows and allows a comparison to be made of cash receipts from customers with reported revenues from customers. This comparison should assist users in evaluating the quality of revenues.

However, while the indirect method does not disclose the gross inflows and outflows arising from operations, it does report a complete reconciliation of the operating profit with the cash generated from operations. This is particularly useful in evaluating the quality of profits (earnings), especially if these profits are being manipulated through varying items of accruals and allowances.

Disclosure Initiative (Amendment to IAS 7)
The amendments come with the objective that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. To achieve this objective, IASB requires that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

IASB defines liabilities arising from financing activities as liabilities 'for which cash flows were, or future cash flows will be, classified in the cash flows as cash flows from financing activities'. It also stresses that the new disclosure requirements also relate to changes in financial assets if they meet the same definition.

Examination Approach
For examination purpose, the indirect method is likely to be used in preparing the statement of cash flows. In order to illustrate a typical examination approach, an illustrative Example and Suggested Solutions are provided below:

Illustrative example - Statement of cash flows
The following information relates to DEF Plc for the year ended 30 June 2016:

Summarised statement of comprehensive income
for the year ended 30 June 2016

	N000
Profit from operations	717
Finance costs	(35)
Profit before tax	682
Taxation	(326)
Total comprehensive income for year	356

Statements of financial position as at 30 June

	2016		2015	
	N000	N000	N000	N000
Assets				
Non-current assets				
Property, plant and equipment	2,711		2,160	
Less: Accumulated depreciation	663	465		
		2,048		1,695
Current assets				
Inventories	1,251		1,053	
Trade and other receivables	1,980		1,902	
Cash at bank	144	156		
		3,375	3,111	
		5,423		4,806
Equity and liabilities				
Capital and reserves				
Ordinary shares of 50 kobo each		1,350		1,200
Share premium account		360		245
Retained earnings	1,194	946		
		2,904		2,391
Non-current liabilities				
6% Loan Stock		644		486
Current liabilities				
Trade and other payables	1,414		1,597	
Taxation	275		179	
Bank borrowings	186	153		
		1,875	1,929	
		5,423		4,806

Additional information:

1. During the year ended 30 June 2016, plant and equipment costing N57,000 (with a carrying value of N42,000) were sold for N24,000.
2. Interest loans paid during the year ended 30 June 2016 amounted to N35,000.
3. There was an issue of ordinary shares for cash on 1 January 2016.
4. A dividend of 4 kobo per ordinary share was paid on 1 March 2016.

Required: Prepare a statement of cash flows for DEF plc for the year ended 30 June 2016 as required by IAS 7 *Statement Of Cash Flows*, using the indirect method.

Suggested Solution

DEF Plc

Statement of cash flows for the year ended 30 June 2016

	N'000	N'000
Operating activities		
Net cash flow generated from operations (Note 1)	489	
Interest paid	(35)	
Taxation paid *W2*	(230)	
Net cash flow operating activities		224
Investing activities		
Purchase of non-current assets *W1*	(608)	
Sale of non-current assets	24	
Net cash flow used for investing activities		(584)
Financing activities		
Issue of ordinary shares (including share premium)	265	
Issue of loan stock (644 – 486)	158	
Dividends paid	(108)	
Net cash flow from financing activities		315
Decrease in cash and cash equivalents		(45)
Cash and cash equivalents at 1 July 2015	3	
Cash and cash equivalents at 30 June 2016		(42)

Cash and cash equivalents comprise:

	30 June 2016	**30 June 2015**
	N000	N000
Cash in hand and at bank	144	156
Short-term bank borrowings	(186)	(153)
	(42)	3

Note 1 – Net cash flow generated from operations	N'000
Profit from operations	717
Adjustments for:	
Depreciation on plant and equipment *W1*	213
Loss on sale of plant and equipment *W1*	18
Changes in working capital	
Increase in inventories (1,251 – 1,053)	(198)
Increase in trade and other receivables (1,980 – 1,902)	(78)
Decrease in trade and other payables (1,414 – 1,597)	(183)
Net cash flow from operations	489

W1 **Plant and equipment account**

	N000	N000
Balance at 30 June 2015	2,160	
Plant and equipment disposal	57	
Cash – additions	608	
Balance c/d	2,711	
	2,768	2,768
Balance at 30 June 2016	2,711	

Accumulated depreciation on plant and equipment account

	N000	N000
Plant & equipment disposal	15	
Balance at 30 June 2015	465	
Balance c/d	663	
Depreciation charge	213	
	678	678
Balance at 30 June 2016	663	

Plant and equipment disposal account

	N000	N000
Plant and equipment	57	
Accumulated dep on P&E	15	
Cash – disposal	24	
Loss on disposal	18	
	57	57

W2 **Taxation account**

	N000	N000
Cash – payment	230	
Balance at 30 June 2015	179	
Balance c/d	275	
Income statement	326	
	505	505
Balance at 30 June 2016	275	

References:

IASB Publications, IAS 7 (1976, 1977, 1991, 1992, 994, 2007, 2009 (April) 2009 (July), 2010, 2016, 2017 (January).

Ben Ukaegbu, *PhD, FCIS, FCMA, FTII, FHEA, CPA (Aust), ACA.*
ICAN Director, Technical & Education.

I C A N

ACCURACY & INTEGRITY

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

(Established by Act of Parliament No. 15 0f 1965)

List Of Recognised Tuition Centres

1 **Able God Professional Tutors**
47, Ikotun/Egan Road, Market B/stop, Igando, Lagos.

2 **Accountancy Tutors Nigeria Limited**
1-9, Ilorin/Katsina Road, By Independence Way, Marafa Estate, Kaduna State.

3 **Accountancy Trainining Centre , Makurdi**
Uni-Agric Road, Opposite First Gate, Makurdi, Benue State.

4 **Accuracy Tutors, Aba**
No 76, St Michael's Road, Aba, Abia State.

5 **Alphamarshall Professional Limited**
72, Mbano Street, Phase 3, Kubua, Abuja.

6 **Atlas Professionals Limited, Ota, Ogun**
BELLS University of Technology, Ota Ogun State.

7 **Best Option Tuition Centre, Makurdi**
9, kashim Ibrahim Road, Makurdi, Benue State.

8 **Bratim Training Centre Limited**
Ground Floor, National Library Building, Adjacent Reiz Continental Hotel, Central Area, Abuja.

9 **Career Intelligent Professionals**
New Capital School, 17/30 Kwame Nkrumah Crescent, Asokoro Abuja.

10 **Crest Professional Tutors**
Plot 238/240, Apapa Oshodi Expressway, Odo-Olowu Bus stop, Ijeshatedo, Lagos.

11 **Deo-Gratia Professional Tutors, Oshogbo**
25, Oyedokun Street, Ago-Wande, Oke -Onitea Road, Oshogbo, Osun State.

12 **Edge Educational Services & Logistics**
47, Athur Eze Avenue (Emmaus House), Awka, Anambra State.

13 **Edo Wyse School of Professional**
75/98, Arthur Eze Avenue, by Unizik Temp-Site Junction, Awka, Anambra state.

14 **Excel Professional Centre**
11, Queen Elizabeth Road, Mokola, Ibadan, Oyo State.

15 **Excellent Associates Tutors**
African Church Model College, College Road, Ifako-Ijaiye, Ogba Lagos.

16 **Execellent Tutors, Abakaliki**
7, Water Works Road, Abakaliki.

17 **Foresight Professional Institute**
24 Road Opposite H Close, Festac Town, Lagos.

18 **Gusau Business School**
Off Sokoto Road, Opp. Janyau Primary School, Gada Biyu, P.O.Box 315, Gusau, Zamfara State.

19 **Galaxy Professional Tutor & Consultant**
L.E.A Primary School, by Mopol Junction, Opposite Diamond Bank Plc, Nyanya, Abuja.

20 **Global Focus Initiative Consulting Co.**
Junior Secondary School, Apo Legislative/National Assemply Quarters, Zone B,Apo, Abuja.

21 **Integrity Professional Academy, Warri**
253 Warri Sapele Road, Warri.

22 **IQ Bryte, Ipaja Lagos**
Towergate Private School, Falola Street, Off Church B/Stop Ipaja, Lagos.

23 **JK Consulting Co. Ltd, Abuja**
4th Floor, Wing B, City Plaza; Plot 596, Ahmadu Bello way, Garki II, Abuja.

24 **Knight Business School, Oyingbo**
80, Murtal Mohammed Way, Ebute-Metta.

25 **Jodoc Accountancy Tutors**
St John Catholic Church Primary School, Rumuokwurushi, Portharcourt, Rivers State.

26 **Maximum Professional Associate**
27, Duduyemi Street(Salvation House) off Olugbede Market, Egbeda.

27 **Legacy Associate Limited**
Olatunji HSE/Legacy HSE, 299/295, Ikorodu Rd, Idiroko B/stop, Maryland, Lagos.

28 **MIKON Professional Tutor**
34A, Boundary Road, G.R.A. Benin City, Edo State.

29 **MSL, School of Accountancy & Mgt. Studies**
L8, Ahmadu Bello Way, Katsina Round-about, same building with Studio 24, Kaduna, Kaduna State

30 **Networth Professional Tutors, V/I**
1 Bishop Aboyade Cole Street, Opposite ExxonMobil House, Off Ozumba Mbadiwe, V/I

31 **Onitsha Business School, Onitsha**
19A Lady Regina Nwankwu Avenue, GRA, Onitsha, Anambra State

32 **Pass Associates Limited**
9 - 11, Ogunyade Street, Gbagada, Lagos

33 **Password Professional Tutors, Akoka**
Oluwole Pry School Complex, Beside Unilag Main gate, Akoka

34 **PLUM Academy Limited**
336, Lagos Abeokuta Expressway, Super B/stop, Abule-Egba, Lagos

35 **Portharcourt School of MGT & Economics**
6B, Abeokuta Street, D/Line Port Harcourt, Rivers State

36 **POSSE Associates Tutors, Enugu**
WTC Primary School Compound, Off WTC B/Stop, Near University of Nigeria, Enugu Campus (UNEC

37 **Potec Training Centre, Port-Harcourt**
1 Chinda Street, Off Stadium Road, Opposite BEKO Port-Harcourt

38 **Precept with Passion**
164, Iju Road,Opposite Fagba grammar school, Station Bus -Stop, Agege Lagos

39 **Professional Tutor for Success**
PTS Building, Opposite NUJ Secretariat, Iwo/Ibadan Road, Dada Estate, Oshogbo, Osun State

40 **Protrac Associates Limited**
1, Lagos Road, Ikorodu, Lagos

41 **Real Professional Tutors**
Wuse Zone 6, School Compound, behinde Oando filling Station, Abuja

42 **Risk Free Standards Associates Limited**
5, Olusoji Idowu Street, Off Association Avenue, Ilupeju, Obanikoro B/Stop, Lagos

43 **Safe Associate Limited**
31, Ore-Ofe Street, Gbaja, Off Barracks B/Stop, Onitolo, Opposite Laspotech Surulere Campus, Lago

44 **Salvage Professional School, Ibadan**
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45 **Sapati International School**
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48 **Starry gold Academy**
Suit D2 Alhaja Humani Shopping Mall, 82 Kudirat Abiola Way, Oregun , Lagos

49 **Students SWOT Associate, Enugu**
3, Independent Layout, PRODA office, Opposite Hotel Presidential, Enugu

50 **Students PYE Nigeria Limited**
14, Oweh Street, Jibowu Lagos

51 **Superiorpoints Associates Limited**
148 Olojo Drive, FCMB Building, Opposite Ojo Local Govt Secretariat, Ojo

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53 **SQUAD Associates**
Ojodu Junior Grammar School, Grammar School B/S Berger

54 **Synergy Professionals**
2, Afric Road, Off Funsho Williams Avenue, Iponri, Surulere, Lagos State

55 **Taraba Business School, Jalingo**
Opposite Civil Service Commission, 183 Hammaruwa Way, Jalingo

The Examiner

Our goal is to ensure success in ICAN exams. We have, therefore, provided solutions to some past questions to guide candidates in future exams. Although these suggested solutions have been published under the Institute's name, they do not represent the views of the Council of the Institute. ICAN will, therefore, not enter into any correspondence about them.

Audit And Assurance (SKILLS LEVEL EXAMINATION - November 2016)

Question 1

KEMTA Nigeria Limited is a private electrical and mechanical engineering company. The company is one of the major players in the provision of cutting edge engineering construction services in the Nigerian electrical, mechanical and communication engineering industry. The company has sites in the 36 States of the Federation, including Abuja. They also work for major financial institutions, educational institutions, Federal, States and Local Governments. The company has on its payroll over 500 professionals, skilled and unskilled workers.

You have been the auditor of the company for the past five years. During your audit, you observed some weaknesses in the internal control system of the company. Your review of the domestic reports showed that your firm has been recommending the establishment of an internal audit department for the past three years. However you observed that it appears that the Managing Director is not favourably disposed to this idea. He saw your suggestion as an additional cost to the company; because they have to furnish their new offices and employ qualified personnel for the new department. He requested to know more about the possibility of outsourcing the internal audit department.

Required:

a. State and explain the purpose and functions of internal audit in an organisation. *(5 Marks)*

b. Enumerate the fundamental differences between the internal and external auditors. *(10 Marks)*

c. Present:
   i. The main reasons for outsourcing internal audit. *(3 Marks)*
   ii. The benefits of outsourcing *(2 Marks)*
   iii. Possible problems of outsourcing *(4 Marks)*

d. Identify and explain the THREE main categories of risks usually considered by internal auditors. *(6 Marks)*
   (Total 30 Marks)

Question 2

Audit practice around the world is generally a business and its objective is to make profit. However, this does not mean that the practice should automatically accept every audit engagement that is offered to it in order to maximise profit. Circumstances may arise where it is appropriate to decline the offer of an audit engagement for either commercial or ethical reasons.

Required:

a. Discuss the ethical issues to be considered by an independent auditor in the following matters.
   i. Client Acceptance.
   ii. Engagement Acceptance. *(5 Marks)*

b. Explain in brief the measures to be taken by incoming Independent Auditors after accepting an appointment and when there is change in professional appointment. *(5 Marks)*

c. Discuss in details the content of an engagement letter to be issued to a new client. *(5 Marks)*

d. Explain briefly the technique used by an audit firm known as "low-balling" when it tenders for audit work. *(5 Marks)*
   (Total 20 Marks)

Question 3

Clear View Cinemas Nigeria Limited operates in the entertainment industry in five different locations. Access into the Cinema Hall is based on tickets purchased at the point of entry. The entity s ticketing process is manually driven. At the beginning of every day, the ticketing staff collects and signs for manual tickets from the Accountant. Unused tickets are returned to the Accountant, while the ticketing staff prepares sales report for the day which is reviewed and signed off by the Accountant. Concession items such as popcorn and soft drinks are also sold to customers. Both the ticketing and concession transactions are paid for in cash. All cash received are handed over to the Accountant who posts the transactions to SAGE Line 50 Application at the end of every day s transactions. In view of the Company s prime location and level of awareness, it records high volume of transactions daily.

To ensure there are no delays in payment of routine bills and also reduce exposure to bank charges, the Accountant disburses cash from daily collections and the balance is lodged into the bank on irregular basis. Bank reconciliation statements are prepared at the end of the financial year in readiness for the audit.

Required:

a. As the Auditor in charge of this engagement, identify and evaluate the relevant internal control issues in the above scenario. *(12 Marks)*

b. State and explain FOUR categories of control activities.
(8 Marks) ***(Total 20 Marks)***

Question 4

Polyet Nigeria Plc is into the manufacture of plastic materials. It has its factory in Apapa, Lagos, with distribution outlets spread across the country. A new Managing Director, Mr. KO has just been appointed. Shortly after the new Managing Director was appointed, your firm concluded the audit of the Company s Financial Statements. A request was made from the newly engaged Managing Director for a letter of representation. He informs you in no uncertain terms that the company engaged you as the auditor to take responsibilities for your audit opinion, and that he is not ready to repeat in writing the information that the Chief Finance Officer, other accounting staff and himself provided to you during the audit exercise. You tried to explain to him that it is the standard practice to request for a letter of representation from the Management but he remained adamant.

Required:

a. Explain the need for the auditor to obtain a letter of representation from the management. *(5 Marks)*

b. Itemise TEN contents of a Letter of Representation. *(10 Marks)*

c. What steps should you take as the auditor, if the Managing Director still persists in his refusal to sign the letter? *(5 Marks)*
(Total 20 Marks)

Question 5

The Nigerian Standard of Auditing (NSA 1) and International Standard on Auditing (ISA 200) deal with the objective and general principles governing an audit of financial statements. It sets out the overall objectives of the independent auditor and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives.

Required:

a) Explain the term "Audit of the financial statement". *(4 Marks)*

b) Describe the overall objectives of the independent auditor in conducting the audit of financial statements in accordance with NSA 1 and ISA 200. *(6 Marks)*

c) Sections 360 and 363 of Companies and Allied Matters Act CAP 20 LFN2004 stipulate the rights of the independent auditors in the conduct of the statutory audit. State these rights.
(5 Marks) ***(Total 15 Marks)***

Question 6

Hypermart Plc operates a chain of modern hyper stores, an on-line and real-time airline ticketing agency and a mail order section selling goods over the internet.

Required:

a. Analyse the controls that should be in place to minimise risks that may arise from the operations of the on-line and real-time airline ticketing system. *(7 Marks)*

b. Hypermart Plc operates Electronics Data Interchange (EDI) system for the transmission of business documents.
Required:
Analyse the problems the EDI system may create for the auditor and what controls are expected to be in place to minimise the risks in the EDI system. *(8 Marks)*
(Total 15 Marks)

Question 7

Savealife Nigeria is the local member of Savealife International, a Non-governmental Donor Agency.

Required:

a. Summarise the main audit areas to consider in relation to the audit of Savealife Nigeria. *(10 Marks)*

b. Highlight other factors peculiar to such not-for-profit organisations that the Auditor needs to consider. *(5 Marks)*
(Total 15 Marks)

Audit And Assurance

(SKILLS LEVEL EXAMINATION - November 2016)

Suggested Solutions

Solution to Question 1

a. Internal Audit is a function or department set up within an entity to provide an appraisal or monitoring process as a service to other functions or to senior management within an entity. It is an independent objective assurance and consulting activity designed to add value and improve an organisation s operations.

Functions of Internal Audit:

i. **Monitoring of internal control:** Internal audit is usually given specific responsibilities by the management for reviewing internal controls, monitoring their operations and recommending improvements via a report to the directors or those charged with governance.

ii. **Examination of financial and operating information:** This may include review of the means used to identify, measure, classify and report such information or specific enquiry into individual items including detailed testing of transactions, balances and procedures. Work in this area is very similar to that carried out by the external auditor.

iii. **Review of the economy, efficiency and effectiveness of**

operations: This could include a review of non-financial controls. The reviews are called Value for Money Audit.

iv. **Review of compliance:** Compliance with laws, regulations and other requirements such as management policies and directives.

v. **Special investigations:** Investigations into particular areas - such as suspected frauds. The majority of these activities here will be classified as operational internal assignments. The investigations are usually required by management or those charged with governance or the Audit Committee.

(b) Fundamental differences between the external and internal auditors

External Auditor	Internal Auditor
Role and work – To express an opinion on the truth and fairness of the annual financial statements.	To examine systems and control and assess risk in order to make recommendations to management for improvements.
Qualification to Act– Set out by statute. This ensures that the external auditor is independent of the entity and suitably qualified.	No statutory requirements – Management selects a suitably competent person to act as internal auditor.
Appointment – Appointed by share holders. This assures independence from Management	Employed by the Management in accordance with company s condition of service and may not claim total independence from management.
Duties – Set out by statute and the external auditor may not vary the scope	As set out by Management who approves the scope of duties
Report – Reports to shareholders or members at the Annual General Meeting	Reports to the highest level of management or those charged with governance and even the Audit Committee
Responsibility for fraud:- Has no primary responsibility for discovery of fraud and error other than to report the truth and fairness of the financial statements	The internal auditor may be given specific responsibility for investigating suspected fraud or error by management or those charged with governance or the Audit Committee.

c.

i. Outsourcing involves the transfer of management s day-to-day execution of an entire business function to an external service provider. The main reasons for outsourcing internal audit functions include:

- **Technical expertise:** The internal audit function can be contracted to external service provider in areas where the internal audit department does not have the required skills and expertise.
- **Cost:** The organisation may not have enough resources to establish an audit department hence arrangement can be made to outsource the entire functions to an external service provider
- **Company size:** A smaller company may need the services of an internal auditor but not on a permanent basis hence the functions can be outsourced to an external body.

ii. **Benefits of outsourcing:**

- **Staff recruitment:** There is no need for the company to recruit and train its own internal audit staff.
- **Audit skills:** The outside service provider is likely to have specialist staff available such as computer audit experts. Internal auditors with an IT skills may be difficult and expensive to recruit as full time employees.
- **Cost and flexibility:** The cost of an internal audit function outsourced is a variable cost rather than a fixed cost. The entity therefore pays for the audit time that it uses.
- **Quantum of audit work :** Outsourcing may be more economical for a small entity that does not have enough audit work to justify full time internal audit team.

iii. **Possible problems of outsourcing:**

- **Changing personnel:** The internal auditors provided by an external firm may change continually and there may be lack of continuity as a consequence. The internal auditors being used may not have an immediate understanding of the clients business.
- **Cost:** An accountancy firm could charge high fees for internal audit services.

- **Confidentiality:** The internal auditors provided by an external firm will be expected to maintain complete confidentiality about the client s affairs. However, the risk of a leak may be higher than if full time internal auditors are employed.

- **Control:** An entity may not have the same control over its internal audit work if the work is outsourced.

- **Conflict of interest:** If internal audit work is carried out by the entity s firm of outsourced auditors, there is likely to be conflict of interest bordering on loyalty which in turn affects independence and objectivity in reporting. The hired auditors and external auditors may have a conflict of interest (on independence and objectivity in reporting).

d. **Three main categories of risks usually considered by internal auditors**

i. Operational risk: These are the risks that the operating activities of an entity may be disrupted, either deliberately or unintentionally. Employees may make mistakes, and do something wrong or forget to do something necessary. Machines may break down, there may be poor security arrangement, poor supervision, weak management or an ineffective organisation structure. Operational risk refers to anything that might go wrong with operational activities.

ii. Financial risk: These are the risks of what might happen if there are changes in the financial environment, such as interest rates, taxation law or exchange rates. Financial risk also includes credit risk which is the risk of non-payment or late payment by customers.

iii. Compliance risks: These are risks that the entity may fail to comply with relevant rules and regulations, resulting in penalties being imposed by regulatory authorities or fines being paid to injured parties. Examples of compliance risks include risks of non-compliance with health and safety laws, anti pollution laws, pension laws, employment laws and establishment laws.

	MARKING GUIDE	**Marks**	
(a)	For definition of internal audit	1	
	1 mark for each function (maximum of 4 points	4	5
(b)	1 mark for each point under heading	5	
	1 mark for each point under fundamental differences maximum of 5 points	5	10
(ci)	1 mark for each reason(Maximum 3 points)	3	
(ii)	1 mark each for benefit listed maximum of 2 points	2	
(d)	1 mark for each problem listed maximum of 4 points	4	9
(e)	2 marks for each category stated and explained	6	
Total marks			**30**

Examiners' Report

The question, in four parts, tests candidates knowledge on Internal Audit. Almost all the candidates attempted the question. Candidates showed good understanding of the question in parts (a) to (c), but limited understanding in part (d). Even though candidates performed generally well in this question, there is still a dire need for them to cultivate the habit of marshalling and presenting their points better to earn more marks.

Candidates should also interprete the specific requirements of questions before attempting them. Candidates are advised to pay special attention to ICAN Study Texts on this subject.

Solution to Question 2

a) Ethical issues to be considered by an Independent Auditor in the following matters.

i. Client acceptance

Before accepting a new client relationship, a Chartered Accountant in public practice should consider whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behaviour may be created from, for example, questionable issues associated with the client (its owners, management and activities).

Client issues that, if known, could threaten compliance with the fundamental principles include, for example:

- Client involvement in illegal activities (such as money laundering, fraud, dishonesty, or questionable financial reporting practices).

The significance of any threats should be evaluated. If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level. Appropriate safeguards may include:

- obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities

- securing the client s commitment to improve corporate governance practices or internal controls. Where it is not possible to reduce the threats to an acceptable level, a Chartered Accountant in public practice should decline to enter into the client relationship. Acceptance decisions should be periodically reviewed for recurring client engagements.

ii. Engagement acceptance

A Chartered Accountant in public practice should agree to provide only those services that he is certified and competent to perform. Before accepting a specific client engagement, a Chartered Accountant in public practice. should consider whether or not acceptance would create any threats to compliances with the fundamental principles.

For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.

A Chartered Accountant in public practice should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include but are not limited to:

- Acquiring an appropriate understanding of the nature of the client s business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- Acquiring knowledge of relevant industries or subject matters.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted, only when they can be performed competently.

  When a Chartered Accountant in public practice intends to rely on the advice or work of an expert, he should evaluate whether or not such reliance is warranted, by considering factors such as reputation, expertise, resources available and applicable professional and ethical standards, information which may be gained from prior association with the expert or from consulting others.

b. Procedures after accepting an appointment
After accepting the appointment as auditor, the following measures should be taken by him:

- He should ensure that the current auditor (if any) has resigned from the audit in a proper manner, or has been removed from office in accordance with any appropriate local legislation.
- He should ensure that his appointment his valid in law and is properly documented.
- He should prepare and submit an engagement letter to the board of the new client.

  Changes in professional appointment
  The incoming auditor should communicate with the current auditors to establish if there are any matters that he should be aware of when deciding whether or not to accept the appointment. Although this is partly a matter of courtesy between professionals, this will involve discussion of the appointment, the client and the audit work.

  Such discussion will allow the firm to decide if the client is someone for whom it would wish to act.

  The following points should be noted in connection with communicating with the current auditors:

- When a member is first approached by a prospective client to act or be nominated, he should explain that he has a professional duty to communicate with the existing auditor or advisor.
- Client permission is required for any such communication. If the client refuses to give its permission, the appointment as auditor should not be accepted.
- If the client does not give the current auditor permission to reply to any relevant questions, the appointment as auditor should not be accepted.
- If the current auditor does not provide any information relevant to the appointment, the new auditor should accept or reject the engagement based on other available knowledge.
- If the current auditor does provide such information, the new auditor should assess all the available information and take a decision about whether or not to accept the audit work.

c. Having accepted an appointment of a new client, the Auditor should submit an engagement letter to the board of directors of the client organistion. An engagement letter can be regarded as the basis for the contract between the client and the Auditor. The contents of an engagement letter to be issued to a new client are briefly explained as follows:-

   The objective and scope of the audit: The Auditor should state in the letter the objective of the audit work to be carried out and the scope of the assignment which must have been jointly agreed upon, as relevant, during the preliminary meeting held with the Management of the entity.

   The responsibilities of the Auditor: The Auditor will state his responsibilities in this paragraph to include, to express an opinion on the true and fair view of the financial position and performance of the entity.

   The responsibilities of the directors: The directors (or those charged with governance) are responsible for the preparation of the financial statements. In addition to this, the directors must ensure that:

- Internal controls are instituted to safeguard the assets, prevent and detect fraud and other irregularities.
- Proper accounting records are maintained.
- Applicable accounting and reporting standards are followed.
- Suitable accounting policies are adopted and consistently applied.
- Judgments and estimates made are reasonable and prudent
- The going concern basis is used unless it is inappropriate

to presume that the entity will continue in business.

Identification of the underlying financial reporting framework: Any financial framework to be adopted must be stated under this paragraph.

Reference to the expected form and content of any reports to be issued: The Auditor must have references to the format and content of the report to be used at the end of the audit assignment which will ensure adequate disclosure of the figures in the financial statements.

More details on scope of the audit work: Additional details of the scope of work to be done in the course of the audit assignment must be stated in this paragraph with reference to applicable legislations, regulations, standards, ethical and professional pronouncements.

Arrangement regarding the planning and performance: The Auditor must make adequate plan for the performance of the audit assignment. The highlights of the audit planning memorandum can be stated in this paragraph to enable the directors have insight on how the assignment will be carried out.

Inherent limitations: As a result of the inherent limitations of an audit and internal control, there is an unavoidable risk that some material misstatements may not be detected even though the audit was properly planned and performed in accordance with International Standards on Auditing.

The expectation that the Management will provide written representation: There is a need to state in this paragraph the need for obtaining representation letter to be signed by both the Managing Director and the Finance Director of the entity.

The basis on which fees are computed: The Auditor must state the agreed audit and other professional fees to be charged for the assignment and the basis used to arrive on the fees must be stated.

Request for Management to acknowledge receipt of the engagement letter: The Auditor should state in this paragraph that the engagement letter should be signed with date as evidence of their agreement with the contents of the letter.

Arrangements concerning the involvement of other auditors, experts or internal auditor etc: The paragraph must contain a statement on the need for an expert on certain areas of the audit assignment which the Auditor is not competent to handle. Anywhere there is restriction on the liability of the Auditor, it must be stated in this paragraph.

d) The term "low-balling" is a technique used by an Auditor when he tenders for audit work. It means deliberately quoting a low and perhaps an unprofitable fee in order to obtain the audit work. Low balling strategy may be linked to an intention to increase the fee to a more realistic level over a period of time or to make up for the shortfall in the fee for the basic audit work with more profitable fees for non-audit services. "Lowballing" itself is not considered unethical but it creates a potential self-interest threat to independence.

Marking Guide	**Marks**
a. 2½ mark each for client acceptance and engagement acceptance respectively.	5
b. 1 mark for each of the five points explained	5
c. 1 mark for each of the five points explained.	5
d. Explanation of low-balling technique.	5
Total Marks	**20**

Examiners' Report

The question is in four parts. It is on audit engagement. About 90% of the candidates attempted the question. Candidates exhibited shallow understanding of part (a), but understanding of parts (b) to (d) was average. Performance was therefore average in parts (b) to (d) and poor in part (a).

The commonest pitfall of the candidates was mixing up requirements of different question parts thereby giving answers of a question part to another and vice versa.

Candidates are advised to study well for examinations, interprete questions very well and proffer correct solutions to specific question parts.

Solution to Question 3

a. The relevant control issues in the scenario include the following:

i) **Custody of ticket booklets:** The custody is under the control of the Accountant who is also in charge of accounting and reporting on the sales of tickets. The custody of the tickets should have been under the control of another senior officer of the Company.

ii) **Manual ticketing process:** Fraudulent staff can take advantage of the manual ticketing process to defraud the Company. The ticketing process should have been automated to avoid too much of human intervention.

iii) **Returned unused tickets:** The unused tickets are returned to the Accountant who is also the custodian of the ticket booklets. The unused tickets are supposed to be submitted to another officer who should also be the custodian of the ticket booklets and not the Accountant.

iv) **Sales reporting:** The sales report prepared by the ticketing staff on daily basis is reviewed and countersigned by the Accountant instead of the Head of Ticketing department to whom ticket staff members report for control purpose.

v) **Cash payment:** Payment for both tickets and concession items bought is by cash and the cash is collected by the ticketing staff who hands cash collected over to the Accountant. This is a weakness in the system as it could encourage teeming and lading fraud by the Accountant.

vi) **Use of cash collections for expenses:** The disbursement of part of daily cash collections for expenses incurred is a weakness which can encourage fraud in the system. This practice negates the internal control system which requires all sales proceeds to be lodged intact into the bank and payment for expenses made from the cash withdrawn from the bank account and cash payments made on an imprest system.

vii) **Irregular lodgment of sales proceeds:** The irregular lodgment of sales proceeds could encourage teeming and lading fraud and as well expose the Company to loss of funds in case of any robbery incident. Sales proceeds are expected to be lodged timely into the designated bank account and this should be done on a daily basis to avoid accumulation of cash in the safe.

viii) **Bank reconciliation:** Bank reconciliation is done at the end of the financial year in readiness for the yearly audit. This is another weakness in the system which will not allow for early discovery of frauds and any other malpractices that might have been perpetrated in the system. The bank reconciliation should be done at least at the end of every month.

ix) **Posting of Transactions:** Posting not done on line and real time - posting of sales is delayed till later in the day. Posting should be done as transactions occur.

x) **Insurance Policies:** Even though there is an indication of high volume of transactions daily and high cash takings, there may not be in existence insurance policies on cash handling, cash-in-safe and staff fidelity policies.

b) The categories of control activities include:

i. Performance reviews

ii. Segregation of duties

iii. Physical controls

iv. Information processing controls

i. **Performance reviews:**
These include reviews and analyses of actual performance against budgets, forecasts and prior period performance. Most of these control activities are performed by management and are often referred to as management controls.

ii. **Segregation of duties:**
This control involves assigning different people the responsibilities of authorising and recording transactions and maintaining the custody of assets. This reduces the likelihood of an employee being able to carry out and conceal errors or fraud.

iii. **Physical controls:**
These include controls over the physical security of assets and records to prevent unauthorised use, theft or damage. Examples include limiting access to inventory areas to a restricted number of authorised personnel, and requiring authorisation for access to computer programs and data files.

iv. **Information processing controls:**
These are controls used to check the accuracy, completeness and authorisation of transactions. Information processing controls are categorised into two: General IT Controls and Application controls.

	MARKING GUIDE		**Marks**
3a	1mark for each control weakness identified (maximum of 4 Weaknesses)	4	
	2 marks for each weakness explained	8	12
3b	1 mark for each control activity listed	4	
	1mark for each control activity explained	4	8
			20

Examiners' Report
The question is in two parts. Part (a) requires candidates to identify and evaluate Internal control issues in a given scenario and part (b) requires candidates to explain four categories of control activities. About 90% of the candidates attempted this question. The candidates showed poor understanding of the question, hence the performance was generally below average.

The major undoing of the candidates was their inability to identify and evaluate the internal control issues in the given scenario. Candidates should learn how to apply their knowledge to given practical scenarios.

Solution to Question 4

a. An auditor is expected to obtain relevant and reliable audit evidence sufficient to enable him to draw reasonable conclusions therefrom. The evidence which an auditor obtains will be drawn from many different sources, one of which will be the representation obtained from management. It is likely that oral representations will be made throughout the conduct of an audit in response to specific enquiries. Management representations will constitute valid audit evidence, however, an auditor should not in respect of his audit rely solely on the unsupported oral representations of Management as being sufficient reliable evidence. Corroborations of most representations will be possible by checking with sources which are independent of the entity or with other evidence generated by the auditor himself. However, adequate corroboration is not and could not reasonably be expected to be available. An auditor should ensure that there is no evidence which conflicts with the representations made by Management. Furthermore, the auditor should endeavour to see that the representations made by Management are confirmed in writing.

b. **Contents of Letter of Representation**
A written representation letter may include the following statements;

(i) The written representation letter relates to the audit of the client company.

(ii) The Management of the entity have fulfilled their responsibilities for the preparation of the financial statements and it gives a true and fair view and are free from material misstatements.

(iii) The assumptions made by Management to make accounting estimates and reach fair values are reasonable.

(iv) Related party relationships and transactions have been disclosed.

(v) All events after the reporting period have either been adjusted or disclosed.

(vi) The effect of any uncorrected misstatements (which should be attached to the letter) is immaterial.

(vii) The auditors have been provided with all relevant materials, including the books of account and unrestricted access to individuals within the entity.

(viii) All transactions have been recorded and are included in the financial statements.

(ix) Management has disclosed to the auditors all information that is relevant to fraud or suspected fraud.

(x) Management has disclosed all known instances of non-compliance with laws or regulations that are relevant to the preparation of the financial statements.

(xi) Representations may also be included that refer to specific assertions in the financial statements if the auditors require that such assertions should be made.

(xii) All plans or intentions that may materially alter the carrying value or classification of assets and liabilities in the financial statements have been accounted for or disclosed in accordance to International Financial Reporting Standards(IFRS).

(xiii) The entity has satisfactory title to or control over all assets disclosed in the financial statements and where appropriate, all liens or encumbrances on these assets have been disclosed in accordance with IFRS.

c. If the Managing Director persists in his refusal to sign the letter of representation, the auditor may himself prepare a statement in writing, setting out his understanding of the principal representations that they have made to him during the course of the audit and he should send his statement to the management with a request for a confirmation that his understanding of the representation is correct. If the Management disagrees with the auditor s statement of representations, discussions should be held to clarify the matters in doubt and if necessary a revised statement prepared and agreed. Should Management fail to reply, the auditor should follow up with the matter by ensuring that management understands the position set out in his statement. If he is unable to satisfy himself, even after discussion with management of their oral representations, the auditor may have to conclude that he has not received all the information and explanations that he requires and he will then need to consider qualifying his audit report to this effect on the grounds of limitation in the scope of his audit procedures.

MARKING GUIDE	**Marks**
(a) For explanation of need to obtain letter of representation	5
(b) 1 mark for each point (maximum of 10 points)	10
(c) for explanation of steps to be taken	5
	20

Examiners' Report
The question tests candidates knowledge on audit representations by management. About 40% of the candidates attempted the question. Performance was poor. The commonest pitfall was exhibition of lack of proper understanding of the requirements of the question.

Candidates are advised to adequately use the Institute's study texts in future when preparing for the examinations.

Solution to Question 5

(a) Audit of financial statement
Audit of financial statement is an independent examination of and the expression of an opinion on the financial statement of an enterprise by an appointed independent auditor in accordance with the terms of his appointment. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.

This is achieved by the expression of an opinion by the auditor on whether or not the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether or not the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with International Statements on Auditing (ISAs) and relevant ethical requirements enables the auditor to form that opinion.

The financial statements subject to audit are those of the entity, prepared by management of the entity with oversight from those charged with governance. ISAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

(b) **Overall objectives of the independent auditor in conducting the audit of financial statements**
In conducting an audit of financial statements, the overall objectives of the auditor are:

- To obtain reasonable assurance about whether or not the financial statements as a whole, are free from material misstatements, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

- To report on the financial statements and communicate as required by the Nigerian Standards on Auditing (NSAs) and International Standards of Auditing(ISAs), in accordance with the auditor s findings. In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor s report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the NSAs and the ISAs require that the auditor disclaims an opinion or resigns from the engagement.

(c) Rights of the Auditor
The main statutory rights of the auditor as provided by the Companies and Allied Matters Act Cap c20 LFN 2004 (Sections 360 and 363) include the following:

- The right of access to all accounting books and records at all times.

- The right to all information and explanations (from management) necessary for the proper conduct of the audit.

- The right to receive notice of all meetings of the shareholders (such as the annual general meeting) and to attend those meetings.

- The right to speak at shareholders meetings on matters affecting the auditor. This can be important when the auditors are in disagreement with the directors of the client entity and are unable to communicate with the shareholders effectively by any other method.

- If the company adopts written resolutions, the auditors should have a right to receive a copy of all such resolutions.

	MARKING GUIDE	**Marks**
(a)	For explanation of need to obtain letter of representation	5
(b)	1 mark for each point (maximum of 10 points)	10
(c)	For explanation of steps to be taken	5
		20

Examiners' Report
The question is in three parts. Parts (a) and (b) test candidates on audit of financial statements, while part (c) requires candidates to state the rights of auditors as given by Companies and Allied Matters Act CAPC20 LFN 2004.

About 90% of the candidate attempted the question.

The candidates generally exhibited poor understanding of parts (a) and (b), but comparatively good understanding of part (c). Performance is generally below average. The candidates main pitfall was lack of understanding of the question especially parts (a) and (b). Candidates are hereby advised to relate their solutions to the particular requirements of a particular question section and candidates should study hard and utilise the Institute s Study Text in the course of their study.

Solution to Question 6

(a) In the operation of the on-line and real time airline ticketing system, the controls the auditor should find established include:

General Controls:
These relate to the environment within which the computer-based accounting systems are developed, maintained and operated. The controls include:

- Access Controls - Access controls need to be robust especially because transactions are processed immediately by the on-line and real time system -passwords, access codes and restricted physical access are some of the controls applied here.

- Programming controls - Programming controls should be built in to prevent or detect unauthorised changes to programs and standing data. Program changes should be tested before being put to use.

- Transaction logs - Transaction logs should be used to create an "audit trail" which is the record of how the computer has processed any transaction. The "audit trail" may not be in paper-form in an online system but the computer program should be written so as to generate the audit trail on request for any transaction.

- Firewalls should be in use – the firewalls are software or hardware devices that protect the computer network server from unauthorized access via the internet.

- Physical security to safeguard against the dangers of fire or other physical risks.

- Standby arrangements – There should be in existence, standby procedures which should be established in that in the event of system breakdown, especially the computer equipment, the standby arrangements either by the use of another computer equipment or manual document preparation can be employed. The standby arrangement should incorporate their own controls which should be reviewed and tested periodically.

Application Controls
Application system that runs on online system should have application (input, processing, output and master file) controls that are suitable for the nature of the processing system. These include:

- Pre-processing authorization operators or individuals should be required to log on to the system before they can use the program.

- Data validation or editing or program checks.
  These checks which can be carried out on the input data include check digit verification, range or limit checks, existence and completeness checks. These programmed checks help to ensure the completeness and accuracy of the processing.

- "Balancing": This relates to the immediate checking of control totals of data submitted from a remote terminal before and after processing.

- File Maintenance Controls: Controls should be established to ensure the authorization and completeness of amendment to the master file and standing data.

(b) The Electronic Data Interchange (EDI) system allows the direct electronic transmission of documents like orders, invoices, payroll information and electronic funds transfer.

The likely problems the EDI system can create for the auditor include:

- Since there is a lack of paper audit trail, the EDI needs an electronic audit trail which only the computer system should be able to provide.

- There is much dependency on the computer systems. Any computer failure may have significant impact on the client organisation and its operations.

- There is a risk of loss or corruption of data during transmission.

- There are security risks in the transmission of data. Unauthorised persons may intercept or read transmitted data.

The controls the auditor expect to be in place to minimize risks in the EDI system include:

- General Information Technology (IT) controls.
- Controls of transmission (data encryption, acknowledgment systems, authentication codes).
- Virus protection systems.
- Contingency plans and back up arrangements.

	MARKING GUIDE	**Marks**
(a)	Explanation of the term	4
(b)	Objectives of the Independent Auditor	
	(3 marks for each maximum of 2 points)	6
(c)	1 mark for each point (Maximum of 5 points	5
		15

Examiners' Report
The question, in two parts, tests candidates on the applicable controls in an on-line and real-time environment and the problems Electronic Data Interchange System may create for the auditor.

About 45% of the candidates attempted the question. The understanding of the question was very poor and so was the performance. It is evident that candidates did not cover the syllabus very well nor used the Institute s Study Text.

Candidates are advised to make a good use of the Institute s Study Text which adequately covers the syllabus.

Solution to Question 7

a) The main audit areas to consider in the audit of Savealife Nigeria include the following:

i) **Planning**

The auditor should consider the following matters:

- Specific nature and features of Savealife.
- The objectives and scope of the audit work which should have been mutually agreed.
- Any local regulations that apply.
- The environment in which the organisation operates.
- The form and content of the final financial statements and the audit opinion.

ii) **Risk**

The auditor should carry out a risk analysis under the usual headings of inherent risk, control risk and inherent risk.

- Inherent risk - reflecting the nature of Savealife activities and the environment.
- Control risk - Internal controls and the risk that there may be inadequate controls over some control activities.
- Detection risk - the risk that the auditor will fail to identify any material error or misstatement on performing the audit.

iii) **Internal control**

The main areas of Internal Control in Savealife might include:

- Segregation of duties.
- Authorisation of spending.
- Cash controls.
- Controls over income - donations, grants, bequests, cash collections, levies, fees, etc.
- The use of funds only for authorized purposes.

iv) **Audit Evidence**

- A substantive testing approach will address key areas such as completeness of recordings of transactions, assets and liabilities
- Analytical procedures may be used, as appropriate
- Review of the financial statements and appropriateness of accounting policies

v) **Reporting**

- Since the audit of Savealife is on voluntary basis and in line with the parent body s policy, the report will be according to the agreed objective. It is though good practice for the report to follow the structure laid down by the International Standard on Auditing 700.
- Title
- Addressee
- Scope of the report
- Responsibilities of auditors versus the responsibilities of management.
- The audit work done
- The audit opinion
- Date, name and address of auditor

b. Other factors that are peculiar to such not-for-profit organisations and which the auditor needs to consider include:

- Cash may be significant in small Not-for-profit organisations and controls are likely to be limited.
- There may be a limitation on the scope of the audit if obtaining audit evidence in an issue.
- Income could be a risk area, particularly where money is donated or raised informally
- There may be a lack of predictable income or identifiable relationship between expenditure and income which should make analytical review less appropriate or useful.
- There may be sensitivity to key statistics such as the proportion of revenue used in administration especially in the case of a charity.
- Restricted funds may exist where the organisation is only allowed to use certain funds for specific purposes

	MARKING GUIDE	**Marks**
(a)	2 marks each for the 5 audit areas	10
(b)	Peculiar risk feature/area (maximum of 5 points)	5
		15

Examiners' Report

The question which is in two parts addresses the audit areas and other factors the auditor need to consider in the relation to the audit of a Not-For-Profit Organisation.

About 60% of the candidates attempted the question.

The general understanding displayed by candidates was poor, hence the performance. It is an indication of lack of covering all the relevant sections of the syllabus. Candidates should brace up and prepare well for professional examinations.

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