



The Institute of  
Chartered Accountants  
of Nigeria (ICAN)

**SKILLS LEVEL EXAMINATION**

**2014**

**Mock Exam 1**

**(3 hours)**

## **Audit and Assurance**

1. This paper consists of **SEVEN** written test questions of which you must answer **FIVE** questions in total.
  - Section A (30 marks) consists of **one compulsory** question
  - Section B (40 marks) consists of three 20-mark questions.  
You must **answer two questions only**.
  - Section C (30 marks) consists of three 15-mark questions.  
You must **answer two questions only**.
2. Ensure your candidate details are on the front of your answer booklet.
3. Answer each question in black ballpoint pen only.
4. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
5. The examiner will take account of the way in which answers are presented.

### **IMPORTANT**

Question papers contain confidential information and must **NOT** be removed from the examination hall.

**DO NOT OPEN THE QUESTION PAPER UNTIL INSTRUCTED**

Enter your candidate number in this box

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## Section A: 30 marks (compulsory)

### Question 1

Your firm has recently been appointed auditor of Snowden Company ('Snowden'), a limited liability company whose shares are not traded publicly. The company operates a chain of 25 Nigeria-based retail stores. Snowden is a gentlemen's outfitter specialising in dinner suits. One warehouse supplies all 25 stores with inventory. This is based in the West of Nigeria.

Snowden's suppliers are principally based in Spain. The majority of inventory items are the previous year's designs, which the wholesalers supply to Snowden at discounted prices. All orders are bought to ensure inventory is present for the fashion seasons of March, June and December.

Cheque, credit card or cash is the usual method of payment for sales. To ensure competition with other retailers is maintained, the company offers a returns policy to its customers, which allows goods to be returned to the store for any reason with a full refund offered. Goods returned under this policy are then sold on in bulk through the trade, sometimes at less than their original cost to Snowden.

The company's employees include monthly paid head office staff and store managers and a weekly paid core number of other store staff. In addition, the company employs a number of casual staff in peak periods. Permanent staff are paid weekly/monthly by direct bank transfer and casual staff in cash.

Snowden's managing director, aged 58, is also the company's main shareholder. He is a particularly dominant managing director and is involved in all major decisions and rarely delegates. He seeks each year to grow the business and improve upon the previous year's profitability. This is also to fund his own expensive lifestyle.

The company has recently acquired new offices near to its central warehouse. The purchase was financed by large bank borrowings under term loans, which call for annual capital repayments.

#### Required

- (a) State and briefly describe the five principles of professional ethics for chartered accountants per ICAN's Code of Conduct. **(5 marks)**
- (b) Describe the different elements of audit risk and explain why the auditor needs to consider risk when conducting an audit. **(5 marks)**
- (c) Identify possible factors that will increase the level of inherent risk of an audit client. **(8 marks)**
- (d) Identify, from the circumstances outlined above, the factors which indicate high audit risk in respect of the audit of Snowden. **(12 marks)**

**(Total: 30 marks)**

## Section B: 40 marks – answer two out of three questions

### Question 2

ISA 530 Audit Sampling and other Means of Testing defines audit sampling as:

‘The application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population.’

#### Required:

- (a) Define sampling risk. (1 marks)
  - (b) List five methods of sample selection and explain how they function. (10 marks)
  - (c) Which of the above sample selection methods in part (b) would you use if you wanted to maximise the opportunity of having high-value items in your sample? Explain why. (3 marks)
  - (d) Define ‘tolerable error’. (1 marks)
  - (e) List five situations where sampling may not be appropriate. (5 marks)
- (Total: 20 marks)**

### Question 3

The basic principle of independence states that a member’s objectivity must be beyond question if they are to be an auditor. That objectivity can only be assured if the member is, and is seen to be, independent.

IFAC’s code of ethics states that there is a presumed dependency on fees and hence self-interest threat to independence where total fees from a public interest entity and its related entities represent 15% or more of the income of the audit practice for two consecutive years.

#### Required

- (a) What safeguards could be applied to reduce this threat to an acceptable level? (4 marks)

A further rule on independence covers goods and services. Goods and services should not be accepted by a practice or by anyone closely connected with it unless the benefit is clearly insignificant.

#### Required

- (b) How would you view the following with respect to goods and services in terms of acceptability, and why?
  - (i) The client offers the auditor a drink after the audit
  - (ii) The client offers to take the auditor on holiday after the audit.(4 marks)
- (c) The client offers the auditor discounted goods. What factors need to be considered in determining whether it is acceptable to purchase discounted goods? If the auditor was unsure whether the goods and services were acceptable, who might he consider contacting, outside his own firm? (5 marks)

Johnson is the audit manager of a team engaged on the audit of a listed company. During his initial discussion with the chief executive officer (CEO) of the company, he was informed that depressed economic conditions have badly affected the company and its liquidity. Due to uncertainty about the future of the company, certain key employees have left including several staff members of accounting and finance department.

Consequently, the accounting records are in a bad shape and the management is making efforts to complete the draft accounts quickly. He therefore requested Johnson to carry out necessary accounting work and to help prepare the annual financial statements at a fee to be agreed mutually.

**Required**

- (d) Briefly describe the guidelines contained in ICAN's Code of Conduct and the extent of support that can be offered by the auditors, in the above situation? **(7 marks)**

**(Total: 20 marks)**

**Question 4**

ISA 500 *Audit evidence* requires the auditor to obtain sufficient, appropriate evidence to be able to draw reasonable conclusions on which to base the audit opinion. That evidence should be relevant to the 'financial statement assertions'.

**Required**

- (a) Set out the main assertions about account balances (including relevant presentation and disclosure assertions) and provide an example of each one by reference to the audit of trade receivables. **(8 marks)**
- (b) Set out five of the seven main audit testing procedures (for example inspection) and give an example of how each might be used in the audit of plant and machinery. State the assertion that is being tested in each case. **(5 marks)**

'Pharma Delight' specialises in the development of drugs for the pharmaceutical industry.

**Required**

- (c) State how you could verify the following items appearing in the statement of financial position of Pharma at 31st December 20X4. You are not required to consider presentation and disclosure:
- (i) Patents
  - (ii) Research and development

**(7 marks)**

**(Total: 20 marks)**

## Section C: 30 marks – answer two out of three questions

### Question 5

The directors of Abracadabra, a newly-formed company, have written to you with a view to securing your services as auditor. Within their letter you note the following comments:

‘Your duties and rights as auditor will be determined by the board of our company. In the main, these duties are in line with the requirements of company law, but in the event of conflict or exclusion we will indemnify you against any legal action brought as a consequence of the position adopted. The board also retains the right to dismiss you at any time without necessarily disclosing the reasons for their action.’

#### Required

- (a) Describe your duties as auditor of Abracadabra. **(4 marks)**
- (b) As auditor, describe your relationship as the auditor to the directors of Abracadabra. **(3 marks)**
- (c) Outline your rights under company law as auditor of a limited company. **(4 marks)**
- (d) Consider whether or not the directors have the authority to dismiss you. **(2 marks)**
- (e) Set out the initial steps you would take prior to accepting the appointment as auditor of Abracadabra. **(2 marks)**

**(Total: 15 marks)**

### Question 6

You are auditing the purchases system of Sprout Ltd. in which:

- (1) purchase orders are raised by the purchasing manager and signed by the managing director
- (2) goods are received by the goods receiving department, which prepares a goods received note
- (3) purchase invoices are posted to the purchase ledger by the book-keeper. The purchase ledger is maintained on a small microcomputer
- (4) cheques paying suppliers are signed by the managing director

A junior member of the audit staff has asked you a number of questions on the subject of internal control.

#### Required

- (a) Define the term ‘internal control’ and set out the five elements which make up an internal control system. **(4 marks)**
- (b) Describe the impact that a sound system of internal controls may have on an audit **(4 marks)**
- (c) List the stages you would go through in carrying out the audit of the purchases system and briefly describe how these involve consideration and testing of the system of internal control. **(4 marks)**

- (d) Describe the effect on your audit work, and the action you would take if you concluded that weaknesses in the system of internal control in the purchases system were so serious that you would not be able to rely on internal controls in your audit work on purchases **(3 marks)**

**(Total: 15 marks)**

### Question 7

You are the external auditor of Izzard Electronics.

A written representation letter has been prepared in which the directors have been asked to confirm that all sales income has been included in the financial statements and that when there is weak evidence of expenditure, the expenditure has been for the benefit of the company and not for the personal benefit of any employee or director.

#### Required

- (a) Discuss the reliability of audit evidence provided by directors in the written representation letter and whether you should rely wholly on the representations of the directors or whether you should obtain other evidence. **(5 marks)**
- (b) Describe the action you would take and the conclusions you would reach if the directors refused to sign a written representation letter. Your answer should specifically consider the statements in the letter concerning completeness of sales income and validity of expenditure. **(5 marks)**
- (c) Explain the usefulness of the internal audit function to the management of a business. Illustrate your answer with practical examples. **(5 marks)**

**(Total: 15 marks)**

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