



The Institute of  
Chartered Accountants  
of Nigeria (ICAN)

**SKILLS LEVEL EXAMINATION**

**2019**

**Mock Exam**

**(3 hours)**

## **Audit and Assurance**

1. This paper consists of **SIX** written test questions of which you must answer **FOUR** questions in total.
  - Section A (40 marks) consists of **one compulsory** question
  - Section B (60 marks) consists of five 20-mark questions.  
You must **answer three 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: 40 marks (compulsory)

### Question 1

You are an employee of Wazobia & Co, a firm of Chartered Accountants. One of the firm's clients is Trotters, a car rental company whose shares are not traded on a stock exchange. The company has a large fleet of vehicles which it hires out on a contract basis.

The duration of a contract varies from one day to three months. Anybody wishing to hire a car must possess a valid driving licence. In addition, they must take out insurance with Trotters.

You are involved in the audit of non-current assets for the year ended 31 December 20X8.

The company's main non-current assets are:

- Freehold land and buildings
- Office equipment (mainly computers for office staff)
- Motor vehicles

The company was formed ten years ago and all non-current assets (except for land and buildings) are maintained on a non-current asset register. The company depreciates non-current assets at the following rates:

- Freehold land and buildings – 2% on cost
- Office equipment – 20% on cost
- Motor vehicles – 50% on cost

The company has recently revalued its buildings upwards by ₦200 million. The directors believe that they have fallen victim to a fraudster who has disappeared with a number of the company's vehicles.

#### Required:

- (a)
- (i) Explain the difference between an audit and a review. **(3 marks)**
  - (ii) Explain why an audit is necessary. **(3 marks)**
  - (iii) Briefly explain the meaning of the following terms:
    - A true and fair view **(2 marks)**
    - Materiality **(2 marks)**
- (b) What is the difference between the responsibilities of management and the auditor for the prevention and the detection of fraud? Explain how these responsibilities are carried out. **(6 marks)**
- (c) Describe how you would verify the ownership of:
- (i) Freehold land and buildings
  - (ii) Computers
  - (iii) Motor vehicles. **(6 marks)**

- (d) Comment on the appropriateness of the depreciation rates of the non-current assets and their respective effect on the income statement. **(6 marks)**
  - (e) List the contents of a non-current asset register and describe its usefulness for Trotters **(6 marks)**
  - (f) Explain the accounting effect of the revaluation of the buildings to the financial statements and the audit work you would perform in this matter. **(6 marks)**
- (Total: 40 marks)**

## Section B: 60 marks – answer three out of five questions

### Question 2

Dreamers, a limited liability company, is a new audit client and you are at the planning meeting for the forthcoming audit. The company has grown rapidly and has a 30 June year-end. The financial statements have not been audited in previous years since the organisation has only just converted from a partnership to a company.

The company's bankers have requested that an audit is undertaken on the financial statements for the year ending 30 June 20X8. Higher levels of inventory required to meet the increasing demand for its products have necessitated a request for an increase in the bank's overdraft facility.

The company makes beds. It buys in the materials direct and manufactures the beds. At the year-end, inventory comprises raw materials, work-in-progress and finished goods. The company does not undertake continuous inventory counting but does intend to perform a full inventory count on 30<sup>th</sup> June 20X8. The company uses a standard costing system to value finished products and work-in-progress.

#### Required

- (a) What are the objectives of the planning stage, with particular attention being paid to those areas that will assist the auditor in obtaining a sound knowledge of the business? **(10 marks)**
- (b) What are the audit risks of Dreamers and how would you address those risks? **(10 marks)**
- (Total: 20 marks)**

### Question 3

You have recently been appointed to be the auditor of Spider plc, a company whose shares are traded on a stock exchange. The directors of Spider plc have recommended that you perform the following services:

- the statutory audit of the annual financial statements;
- taxation services; and
- consultancy services in respect of the implementation of a new information technology system.

Your firm has not acted for Spider plc before but does act as auditor for one of its major competitors.

#### Required:

- (a) Identify and explain the professional and ethical issues that should have been identified by your firm in relation to the provision of the services, outlined above, to Tetra and describe the safeguards that should be in place in order to address these issues. **(11 marks)**
- (b) What are the five fundamental principles of ethics? Briefly explain their meaning. **(5 marks)**
- (c) A client's affairs should not be disclosed to third parties. However where a client has been guilty of an unlawful act, to whom should the auditor disclose this information, and in what order? **(4 marks)**
- (Total: 20 marks)**

## Question 4

You are carrying out the audit of the revenue system of Blue Naija, a company that manufactures office furniture. The company has annual revenue of ₦150 million. All the shares are owned by Sherifat and her husband Usman. Neither is involved in the running of the business. The chairman is responsible for running the business, but does not own any of the company's shares.

The bookkeeper maintains all the accounting records and prepares the annual financial statements.

A stand-alone computer is used to maintain the accounting records including those of the revenue system. Standard accounting software is used, which was purchased from an independent supplier. For the revenue system, a sales ledger is maintained to which sales invoices, credit notes, cash and discounts are posted. When sales invoices are posted and credit notes are input to the computer, the value of the invoice or credit note is posted to both the sales ledger and the nominal ledger.

You have determined that the documents and personnel involved in the sales ledger are as follows:

- When an order is received by telephone it is recorded by the sales clerk in the sales department. This is usually done on a note pad.
- The sales clerk will then pass the sales order to the stores, to the goods outwards department where the office furniture is kept.
- If the goods ordered are in inventory, then the goods will be loaded onto one of the vehicle delivery trucks. A two-part despatch note will be prepared to accompany the sales order. This is usually done before the stores have received the sales order from the sales department.
- The goods are delivered to the customer together with the top copy of the goods despatch note.
- The driver on his return will inform the sales department that the delivery has been a success and will maintain the bottom copy of the goods despatch note in the stores.
- At the end of the week, the sales department prepare a sales invoice for the customer.
- When the post is received, it is opened by one of the sales department. The person opening the post will both make a list of all the cheques received and that same person will then go to the bank and bank the cheques. Upon return, the remittances and cheque paying-in book are passed to the bookkeeper for updating the receivables ledger.
- The receivables ledger is reviewed by the bookkeeper on a monthly basis to see which customers are over their credit terms and will inform the sales staff who to telephone and chase up about their debt.

**Required:**

- (a) Identify the weaknesses in the internal control in the revenue system in Blue Naija. Propose one control to address each weakness you identify **(12 marks)**
- (b) It has been suspected that Usman and Sherifat are looking to manipulate the financial statements. In which case, which assertion would you pay more attention to in the audit of receivables – completeness or existence? **(1 mark)**
- (c) Explain your answer to part (b) and give a substantive test that would test your suspicion. **(3 marks)**
- (d) A receivables' circularisation frequently doesn't produce the same quality of audit evidence as a supplier statement reconciliation. Why do you think this is? **(4 marks)**
- (Total: 20 marks)**

**Question 5**

ISA 530 *Audit Sampling* defines audit sampling as:

'The application of audit procedures to less than 100% of the items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.'

**Required:**

- (a) Define sampling risk. **(1 mark)**
- (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 misstatement'. **(1 mark)**
- (e) List five situations where sampling may not be appropriate. **(5 marks)**
- (Total: 20 marks)**

### Question 6

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 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 20X8. You are not required to consider presentation and disclosure:
  - (i) Patents
  - (ii) Research and development **(7 marks)**

**(Total: 20 marks)**

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