



## Advanced 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**

- (a) Your firm has recently been appointed the statutory auditor of Tapas, a limited liability company in Nigeria, for the year ended 31 December 20X4. The previous auditors, from whom your firm has received professional clearance, did not wish to be re-appointed as auditors.

The principal activities of the company are the distribution and retail of fine Spanish food products. All products are imported from suppliers based in Spain and delivered to Tapas's central warehouse in the south of Nigeria. The company has its own retail outlets but also supplies national supermarket chains and small independent retailers in Nigeria. Sales through Tapas's retail outlets are on a cash basis and sales to supermarkets and independent retailers are on a credit basis.

The company maintains computerised inventory records for inventories held at the distribution centre and retail outlets. The inventory records are supported by continuous counting procedures and as a result the company does not undertake a physical count at the year end.

Tapas's retail outlets are equipped with computerised tills. As each sale is recorded the computer updates the quantity sold and the inventory balance. The manager at each outlet is responsible for banking the takings on a daily basis.

During the year the company engaged consultants to design and implement the company's new website with online ordering facilities. Under the terms of the contract, the website was scheduled to be operational by the end of September 20X4 in order to take advantage of the high seasonal demand at this time of the year. Due to technical problems, the website was not launched until the end of November 20X4. The consultants have been paid in full for their work. However the company has commenced legal proceedings for breach of contract.

Despite failing to meet its revenue targets in respect of online revenue, the management accounts for the 11 months to 30 November 20X4 indicate an increase in revenue of 12% compared with the same period in 20X3. Inventory and receivables balances are significantly higher than the previous year as a result of the increased level of activity.

Management is planning to expand the retail activities of the business by opening additional retail outlets. It is hoping to fund the expansion with a bank loan and has approached the company's bankers to provide the funding. The bankers require the audited financial statements before making a decision. Management is keen to have the funding in place to progress with the expansion and would like to have the audit completed by 28 February 20X5.

**Required**

Identify, from the circumstances described above, the key business risks and for each risk:

- (i) List the factors which have led you to identify that risk; and **(10 marks)**  
(ii) Outline the audit work you would perform to address the risk. **(20 marks)**

- (b) Barnet Removals is a removals company. In the year ended 31 December 20X4 the company made a trading profit of ₦800k. You are the manager in charge of the audit. The following issues have arisen:
- (1) A customer is suing the company for ₦1m for damage caused to antique furniture. The company is defending the claim and believes that the furniture was reproduction as opposed to antique and therefore worth only ₦100k.
  - (2) A balance due from Safe Storage in respect of sub-contract work, of ₦300k, has been outstanding for over six months. Your firm has been asked by Barnet Removals' accountant not to write to Safe Storage for direct confirmation of this amount as the latter company objects to such letters. You have been assured by the accountant that the relationship between the two companies is good and that the outstanding balance will be paid.

**Required**

For each of the above issues:

- (i) State, with reasons, the audit work that you would expect to find in undertaking your review of the audit working papers for the year ended 31 December 20X4; and **(8 marks)**
- (ii) Draft the relevant sections dealing with these issues of the written representation letter you would wish the directors to sign. **(2 marks)**

**(Total: 40 marks)**

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

### Question 2

You are the audit manager in the audit firm of Light & Co. One of your audit clients is SportAfrica Co, a company specialising in the manufacture and supply of sporting equipment. SportAfrica have been an audit client for seven years and you have been audit manager for the past three years while the audit partner has remained unchanged.

You are now planning the audit for the year ending 31 December 20X4. Following an initial meeting with the directors of SportAfrica, you have obtained the following information.

- (i) SportAfrica is attempting to obtain a listing on a recognised stock exchange. The directors have established an audit committee, as required by corporate governance regulations, although no further action has been taken in this respect. Information on the listing is not yet public knowledge.
- (ii) You have been asked to continue to prepare the company's financial statements as in previous years.
- (iii) As the company's auditors, SportAfrica would like you and the audit partner to attend an evening reception in a hotel, where SportAfrica will present their listing arrangements to banks and existing major shareholders.
- (iv) SportAfrica has indicated that the fee for taxation services rendered in the year to 31 December 20X3 will be paid as soon as the taxation authorities have agreed the company's taxation liability. You have been advising SportAfrica regarding the legality of certain items as 'allowable' for taxation purposes and the taxation authority is disputing these items.

Finally, you have just inherited about 5% of SportAfrica's share capital following the death of a distant relative.

#### Required:

- (a) Identify, and explain the relevance of, any factors which may threaten the independence of Light & Co's audit of SportAfrica's financial statements for the year ending 31 December 20X4. Briefly explain how each threat should be managed. **(10 marks)**
- (b) Explain the actions that the board of directors of SportAfrica must take in order to meet corporate governance requirements for the listing of SportAfrica Co. **(6 marks)**
- (c) Explain why your audit firm will need to communicate with SportAfrica's audit committee for this and future audits. **(4 marks)**

**(Total: 20 marks)**

### Question 3

You are a manager in Jeffrey & Co., a firm of Chartered Accountants, with specific responsibility for the quality of audits. Jeffrey & Co. was appointed auditor of Scrubbed Co, a provider of waste management services, in July 20X4. You have just visited the audit team at Scrubbed's head office. The audit team comprises an accountant in charge (AIC), an audit senior and two trainees.

Scrubbed's draft accounts for the year ended 30 June 20X4 show revenue of ₦116 million (20X3 – ₦81 million) and total assets of ₦36 million (20X3 – ₦25.5 million). During your visit, a review of the audit working papers revealed the following:

- (a) On the audit planning checklist, the audit senior has crossed through the analytical procedures section and written 'not applicable – new client'. The audit planning checklist has not been signed off as having been reviewed. **(4 marks)**
- (b) The AIC last visited Scrubbed's office when the final audit commenced two weeks ago on 1 August. The senior has since completed the audit of tangible non-current assets (including property and service equipment) which amount to ₦6 million as at 30 June 20X4 (20X3 – ₦6 million). The AIC spends most of his time working from Jeffrey's office and is currently allocated to three other assignments as well as Scrubbed's audit. **(4 marks)**
- (c) At 30 June 20X4 trade receivables amounted to ₦21 million (20X3 – ₦9 million). One of the trainees has just finished sending out first requests for direct confirmation of customers' balances as at the end of the reporting period. **(4 marks)**
- (d) The other trainee has been assigned to the audit of the consumable supplies that comprise inventory amounting to ₦880,000 (20X3 – ₦530,000). The trainee has carried out tests of controls over the perpetual inventory records and confirmed the 'roll-back' of a sample of current quantities to book quantities as at the year end. **(3 marks)**
- (e) The AIC has noted the following matter for your attention. The financial statements to 30 June 20X3 disclosed, as unquantifiable, a contingent liability for pending litigation. However, the AIC has seen a letter confirming that the matter was settled out of court for ₦4.5 million on 14 September 20X3. The auditor's report on the financial statements for the year ended 30 June 20X3 was unmodified and signed on 19 September 20X3. The AIC believes that Scrubbed's management is not aware of the error and has not brought it to their attention. **(5 marks)**

**Required:**

Identify and comment on the implications of these findings for Jeffrey & Co's quality control policies and procedures.

**Note:** The mark allocation is shown against each of the five issues.

**(Total: 20 marks)**

## Question 4

The Hangem Art Gallery and Museum (HAGM) is in the centre of a city that is popular with tourists. About 65% of its revenue comes from admission fees and annual memberships, and about 30% of its revenue comes from sponsorship of special exhibitions by companies. Most of the remaining revenue comes from a small café and gift shop in the art gallery and museum.

Admission fees come from sales of tickets to daily visitors and from annual membership subscriptions from 'Friends of HAGM' who are entitled to free entry to the art gallery and museum at any time.

Day tickets can be purchased by credit card in advance, by a telephone 'hotline' or at HAGM's website on the Internet. Alternatively, day tickets can be bought with cash or credit card at the 'door' on the day of the visit. Reduced prices are available for children, students and individuals aged over 65, and there are also special reduced-price 'family tickets' for two adults and two children.

Sponsorship arrangements are agreed up to 18 months in advance. Some corporate sponsors, particularly transport companies (bus companies and railway companies) sell advertising to HAGM.

The management of HAGM have identified the following applicable risks that need careful attention. They believe that these risks should be managed actively.

1. There is a failure to attract more visitors because of the poor condition of many of the paintings in the art gallery and of the items in the museum. Paintings must be restored regularly because their condition deteriorates. HAGM has just one specialist restorer, who is unable to keep up with the required volume of work. The management of HAGM recognise that investment in new items and the restoration of existing items is inadequate, but blame the lack of revenue for the problem.
2. Some corporate sponsorship agreements may not be invoiced due to poor communication between the sponsors, HAGM's sponsorship managers and the accounts department of HAGM.
3. Some sponsorship agreements are not invoiced at their correct amount. This happens often when a sponsor is also a company that provides advertising for HAGM. Normal practice is for these sponsors to deduct their advertising charges from the amount they pay to HAGM in sponsorship. However, the accounts department in HAGM are not given the details of these set-off arrangements.
4. Some of the cash received from day visitors at the door may be stolen (or lost, or used by management for business expenses) and does not reach HAGM's cashier.
5. The on-line booking system for buying tickets in advance on the HAGM website is not always available because the website is 'down'.

### Required

- (a) Describe appropriate internal controls to manage each of the applicable risks described above. **(15 marks)**
- (b) Explain the financial statement risks that arise from each of these applicable risks. **(5 marks)**

**(Total: 20 marks)**

### Question 5

Dreams Yachting and Marina (DYM) have a marina on the South Coast of Nigeria and a large sales operation dealing in yachts and speedboats. You are responsible for the audit of DYM and have found some potential causes of concern that could indicate fraudulent activity or financial misconduct within the company. In particular:

- ❑ 30% of the yachts on sale by DYM are supplied through one of the major international boating companies with a special finance arrangement deal. However, DYM have also obtained separate finance on these yachts, which are therefore in effect being 'double financed'.
- ❑ Ten yachts shown as assets by DYM cannot be located, with no explanation other than that they have not been sold. These yachts together are worth approximately ₦50 million.
- ❑ Long delays have occurred in performing reconciliations with the last four months of reconciliations still not completed. At the time of the last reconciliation, material differences had been identified upon which no action appears to have been undertaken.
- ❑ Revenues have been overstated by ₦100 million in the current financial statements.

The finance director has been off sick with stress for the last five months and therefore has not been available to discuss any of the issues identified.

#### Required

- (a) Comment on the need for ethical guidance for accountants on money laundering. **(5 marks)**
- (b) Explain the difference between fraud and error and how the issues shown here could be categorised as fraud or error. **(6 marks)**
- (c) Discuss the role of management and the role of the auditor in the prevention and detection of fraud and error. **(3 marks)**
- (d) Describe what steps you would take to further investigate and then report on the matters referred to above. **(6 marks)**

**(Total: 20 marks)**

### Question 6

Portvale Co manufactures a range of dairy products (for example, milk, yoghurt and cheese) in one factory. Products are stored in a nearby warehouse (which is rented by Portvale) before being sold to 350 supermarkets located within 200 kilometres of Portvale's factory. The products are perishable with an average shelf life of eight days. Portvale's financial statements year-end is 31 July.

It is four months since the year-end at your audit client of Portvale and the annual audit of Portvale is almost complete, but the auditor's report has not been signed.

The following events have just come to your attention. Both events occurred in late November.

- (a) A fire in the warehouse rented by the company has destroyed 60% of the inventory held for resale.
- (b) A batch of cheese produced by Portvale was found to contain some chemical impurities. Over 300 consumers have complained about food



poisoning after eating the cheese. 115 supermarkets have stopped purchasing Portvale's products and another 85 are considering whether to stop purchasing from Portvale. Lawyers acting on behalf of the consumers are now presenting a substantial claim for damages against Portvale.

**Required:**

In respect of EACH of the events at Portvale Co mentioned above:

- (i) Describe the additional audit procedures you will carry out; **(8 marks)**
- (ii) State, with reasons, whether or not the financial statements for the year end require amendment; and **(6 marks)**
- (iii) Discuss whether or not the auditor's report should be modified. **(6 marks)**

**Note:** *The total marks will be split equally between each event. (Total: 20 marks)*

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