Institute of Chartered Accountants – Ghana (ICAG)
Paper 2.3
Audit and Assurance

Final Mock Exam 1

<table>
<thead>
<tr>
<th>Question paper</th>
<th>Time allowed</th>
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<tbody>
<tr>
<td></td>
<td>3 hours</td>
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Instructions:
All five questions in this exam are compulsory and must be attempted.

DO NOT OPEN THIS PAPER UNTIL YOU ARE READY TO START UNDER EXAMINATION CONDITIONS
ALL FIVE questions are compulsory and MUST be attempted

Question 1

(a) Explain what analytical procedures are and explain how the auditor uses analytical procedures during the course of the audit.

You are planning the audit of Star Co, whose principal activity is the manufacture, sale and distribution of tableware and cookware. You are preparing for your planning meeting with the financial director and have obtained, in advance of the meeting, a copy of the draft accounts for the year ended 31 March 20X2. Your initial review of the draft accounts identified the following significant changes over the 20X1 figures.

<table>
<thead>
<tr>
<th>Statement of profit or loss</th>
<th>Draft 20X2</th>
<th>Actual 20X1</th>
<th>Increase/ (decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>16,759 GHS'000</td>
<td>13,298 GHS'000</td>
<td>26%</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(8,039)</td>
<td>(7,114)</td>
<td>13%</td>
</tr>
<tr>
<td>Gross profit</td>
<td>8,720</td>
<td>6,184</td>
<td>41%</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Statement of financial position</th>
<th>Draft 20X2</th>
<th>Actual 20X1</th>
<th>Increase/ (decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td>5,479</td>
<td>2,379</td>
<td>130%</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td>3,459</td>
<td>2,127</td>
<td>63%</td>
</tr>
<tr>
<td>Trade receivables</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>1,891</td>
<td>503</td>
<td>276%</td>
</tr>
<tr>
<td>Bank overdraft</td>
<td>918</td>
<td>1,134</td>
<td>(19)%</td>
</tr>
<tr>
<td>Trade payables</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

During a telephone conversation the finance director informed you that the company had had a good year, mainly due to securing a new contract to supply a number of major new customers in the United Kingdom.

He also stated that there has been no revaluation of non-current assets but there has been extensive refurbishment and improvement of the company’s manufacturing facility and its plant and machinery.

You have also learned that the company introduced a new accounting system three months before the year end. All balances were transferred from the old system to the new one which will form the basis of the numbers in the financial statements. Training for accounts staff on this new system is ongoing.

Required

(b) Using the information provided, identify and describe six audit risks and explain the auditor’s response to each risk in the planning of the audit of Star Co. (12 marks)

(c) Following your initial planning visit you receive a letter from the finance director of Star Co which expresses grave concern that a previously undetected fraud has been discovered. Over the last few years, office staff have taken between GHS50 and GHS100 each month from petty cash and used the funds for non-business use. He demands to know why the auditors have not picked this up on previous audits and is considering replacing your firm.

Describe the auditor’s responsibilities in relation to fraud and explain why your firm are unlikely to detect a fraud such as the one described by the director during the course of the audit. (4 marks)

(Total = 20 marks)
Question 2

Garcia Co is a manufacturing company with a large number of customers. The sales ledger is managed by Amy Jones, who prepares invoices on the basis of orders passed to her by Joe Jones, the Sales Manager. Amy is also in charge of credit control. You are an audit senior observing and recording the system during the external audit. Amy has told you about the system in detail. It is obvious that staff members are intent on keeping the controls that are in place. The system is as follows:

Orders are taken by Joe Jones or his assistant, Mary Smith and recorded on a two part document, one of which is sent to production and the other they keep in an outstanding orders tray until the order is fulfilled. When the order is fulfilled, production send a goods outward note to the customer with the order and send a copy to Joe and Mary. Joe or Mary then file the order in an orders fulfilled file and send the second copy of the order to Amy. Amy raises invoices on the basis of the orders sent to her and enters the details on the sales ledger and daybook.

Post is opened by Jane Goose, the receptionist, with Amy in attendance and receipts are listed. Amy then lodges the cheques in the safe while she posts the receipts to the sales and cash ledgers.

Amy reviews the ledger monthly and rings customers who have debts building up. If a debt has been on the ledger more than one year, Amy writes it off.

During the time you were observing, you saw Amy amend the address of a customer on the master file as a result of a phone conversation with that customer. In addition, you saw the printer spoil an invoice print run. The spoilt invoices were thrown into the recycling bin.

Required

(a) Identify four inherent limitations of any internal control system. (2 marks)

(b) (i) Identify and explain four deficiencies in Garcia Co’s system of internal control over revenue and receivables. (8 marks)

(ii) For each deficiency, suggest an internal control to overcome that deficiency.

(c) Describe the control environment at Garcia Co and explain how it will affect your audit approach. (4 marks)

(d) Describe three substantive procedures the auditor of Garcia Co should perform at the year end in confirming each of the following areas:

(i) The completeness of sales revenue (3 marks)

(ii) The valuation of receivables (3 marks)

(Total = 20 marks)
Question 3

X Co (X) is a retailer which sells items such as glasses, crockery, cookware (saucepans etc.) and kitchen storage units to the general public. It has five stores across the south east of its home country, Homeland. The company’s year end was 30 June 20X1.

The information below describes the process used by X for its purchases. All stores use the same process, but hold their own accounting records. X does not have an internal audit department.

**Ordering goods**

Each store operates a re-order level system such that when the inventory reaches the re-order level the inventory manager sends a sequentially numbered requisition form to the purchase ledger department requesting the quantity of inventory required. The purchase ledger clerk maintains a list of approved suppliers, but likes to use each supplier on a rotational basis, so they place the order with the next supplier on the list after the one they used for the previous order.

The monetary value of orders can vary considerably between GHS1,000 and GHS50,000.

The order forms are also sequentially numbered and use the same numbering system as the requisition forms.

**Goods received and invoicing**

It can take between 1 and 3 weeks for inventory to arrive once the order is placed. If goods arrive with a supplier’s goods despatched note (GDN), the quantity on the GDN is checked to the actual delivery and any discrepancies noted and signed by the inventory manager. The inventory manager then forwards the GDN to the purchase ledger department. Upon receipt of the purchase invoice from the supplier, the purchase ledger clerk matches the invoice details back to the signed copy of the GDN received from the inventory manager. Any differences are followed up with the supplier. The invoice is then entered into the accounting records.

**Payment**

The company’s cash flow can often vary from month to month and so the purchase ledger clerk makes a regular monthly payment to each supplier. This can mean that for some months the company over pays the supplier whilst in other months the full balance may not be paid.

**Required:**

(a) As the external auditors of X, write a report to management in respect of the purchasing system which:

(i) Identifies and explains four deficiencies in that system
(ii) Explains the possible implication of each deficiency
(iii) Provides a recommendation to address each deficiency

A covering letter is required.

*Note*: up to two marks will be awarded within this requirement for presentation.  

(14 marks)

(b) Describe three examples of specific tasks an internal audit department could undertake which would benefit X.  

(6 marks)

(Total = 20 marks)
Question 4

Sparz Co is a new client of Count and Co, an audit firm. Sparz Co runs a spa, trading as Sparz. The spa is open to non-members and members. Members pay an annual membership fee that entitles them to 50% off spa rates for individual treatments and sessions. The spa employs lifeguards, masseuses, beauty therapists and nursery nurses for its crèche facilities. In addition, there is also administrative staff, including a finance controller, who reports to the managing director, Leigh Smith (who is also the major shareholder).

The spa has been in business five years, but this is the first time it has required an audit. Its major local competitor is Revitalise, a large members-only spa, which started business two years ago. Count and Co has just been invited to tender for the audit of the company which owns Revitalise.

The finance controller at Sparz is Eva Davidson. She was employed 18 months ago, since when she has:

- Instituted control procedures outlined in a controls manual;
- Formalised a budgeting system so that budgets are now prepared and approved annually; and
- Identified the need for an audit to Leigh Smith.

Eva introduced Count and Co to Leigh through her husband, Anthony Davidson, who is a manager at Count and Co. The audit engagement partner assigned to Sparz is Carol Lamb. Since agreeing audit terms with Count and Co, Leigh has:

- Invited Carol to advertise to employees of Count and Co a staff membership rate, which is 50% of standard membership rates and then entitles the member to 75% off spa rates
- Asked Carol if she will sit on the board of directors at Sparz Co as a non-executive director
- Asked Carol if the firm will confirm the figures on an insurance claim to be submitted in respect of a fire in the treatment centre just prior to the year end

Required:

(a) (i) Explain the ethical threats which may affect the independence of Count and Co’s audit of Sparz Co; and

(ii) For each threat explain how it might be avoided.

(b) Explain five procedures you would carry out to obtain an understanding of Sparz Co in order to conduct the first year audit.

(c) Explain the benefits of a company having an audit committee.

(Total = 20 marks)
Question 5

Card Co is a recycling company with a year end of 31 August 20X1. It has suffered a series of floods in the last year. The company manufactures recycled cardboard to order in its own premises. Card Co keeps raw board and finished goods of recycled board in its stores. It is now late November 20X1, nearly three months since Card Co’s year end, and your annual audit is nearly complete. The following events have just come to your attention:

(1) You arrived at the client this morning to discover that heavy rain overnight has flooded the stores and part of the factory.

(2) The finance director has told you that the pay-out for an insurance claim in relation to a flood which occurred in June 20X1 has just been received. Details of the insurance claim were disclosed in the financial statements as a contingent asset.

Required:

(a) In respect of this morning’s flood:
   (i) State the additional audit procedures you will carry out. (4 marks)
   (ii) Explain whether the financial statements require amendment. (4 marks)

(b) In respect of the insurance pay-out:
   (i) State the additional audit procedures you will carry out. (2 marks)
   (ii) Explain whether the financial statements require amendment. (2 marks)

(c) You are now told that the directors have not amended the financial statements in respect of either of these items. Your audit firm considers the effect of each of these to be material however, you are satisfied that there are no going concern issues arising from the two events.

Required:

Describe the impact on the auditor’s report of the November flood and the insurance pay-out. (6 marks)

(d) State how the auditor’s report would change if the auditors felt that the going concern basis was appropriate but that there was a significant level of concern over Card Co’s ability to continue as a going concern and the financial statements did not disclose this fact. (2 marks)

(Total = 20 marks)