

Fundamentals Level – Skills Module

Audit and Assurance

Thursday 4 December 2014



Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – ALL 12 questions are compulsory and MUST be attempted

Section B – ALL SIX questions are compulsory and MUST be attempted

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

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Paper

ACCA

Section A – ALL 12 questions are compulsory and MUST be attempted

Please use the space provided on the inside of the Candidate Answer Booklet to indicate your chosen answer to each multiple choice question.

1 Which TWO of the following should be included in an audit engagement letter?

- (1) Objective and scope of the audit
- (2) Results of previous audits
- (3) Management's responsibilities
- (4) Need to maintain professional scepticism

- A** 1 and 2
- B** 1 and 3
- C** 2 and 4
- D** 3 and 4

(2 marks)

2 Auditors have a professional duty of confidentiality under ACCA's *Code of Ethics and Conduct*; voluntary disclosure of information may be necessary in certain situations.

For which TWO of the following situations should an auditor make VOLUNTARY disclosure?

- (1) If an auditor knows or suspects his client is engaged in money laundering
- (2) Where disclosure is made to non-governmental bodies
- (3) Where it is in the public interest to disclose
- (4) If an auditor suspects his client has committed terrorist offences

- A** 1 and 4
- B** 1 and 3
- C** 2 and 4
- D** 2 and 3

(2 marks)

3 ISA 580 *Written Representations* require auditors to obtain written representations to support other evidence.

For which of the following matters would a written representation NOT be suitable as audit evidence?

- A** That all deficiencies in internal control known to management have been communicated to the auditor
- B** That subsequent events requiring adjustment or disclosure in the financial statements have been dealt with appropriately
- C** That the payroll charge for three months of the year when the accounting records were unavailable is correctly stated
- D** That management has fulfilled their responsibility for the preparation and presentation of the financial statements

(2 marks)

4 Which TWO of the following substantive procedures provide evidence over the EXISTENCE of trade receivables?

- (1) Agreeing a sample of goods despatched notes to sales invoices and to the sales ledger
- (2) Undertaking a receivables circularisation
- (3) Review of post year-end cash receipts, if these relate to year-end receivables follow through to the sales ledger
- (4) Recalculating the allowance for uncollectible accounts

- A** 1 and 3
- B** 2 and 4
- C** 2 and 3
- D** 1 and 4

(2 marks)

5 Which of the following is NOT a responsibility of the auditor?

- A** To provide an opinion on the truth and fairness of the financial statements
- B** To conduct an audit in accordance with International Standards on Auditing
- C** To express an opinion on the company's going concern status

(1 mark)

6 Which of the following procedures are TESTS OF CONTROL an auditor should perform in testing the inventory cycle of their client whilst attending the inventory count?

- (1) Observe whether the client's staff are following the inventory count instructions
- (2) Review inventory present in the warehouse for evidence of damage or obsolescence
- (3) Obtain a sample of the last goods received notes and goods despatched notes and follow through to ensure inclusion in the correct accounting period
- (4) Inspect and review management's inventory count instructions

- A** 2 and 3
- B** 1 and 4
- C** 1 and 2
- D** 3 and 4

(2 marks)

7 Which of the following is NOT an advantage of a company outsourcing its internal audit function?

- A** There will always be a reduction in costs
- B** Provides access to specialist skills
- C** Can provide access to an internal audit team immediately

(1 mark)

8 Which of the following is NOT an audit software technique?

- A Using computer programs to extract a sample for a receivables circularisation
- B Running a computer program to test the addition of the cash book
- C Using a computer to perform an analytical review comparison of administration expenses against the prior year
- D Entering a sample of dummy sales orders through the computer system which takes customers over their credit limit to ensure the system rejects the orders

(2 marks)

9 Which of the following is a DISADVANTAGE of recording accounting and control systems using internal control questionnaires?

- A They may contain a large number of irrelevant controls
- B It can be difficult to identify missing controls
- C They are time consuming to complete

(1 mark)

10 Which of the following statements, if any, is/are correct?

- (1) Internal auditors should report to the finance director as they understand internal controls and are best placed to implement any recommendations in a timely manner
- (2) Companies are not required to establish and maintain an internal audit function

- A 1 only
- B 2 only
- C Both 1 and 2
- D Neither 1 nor 2

(2 marks)

11 Is the following statement true or false?

Audit risk is a function of two components, inherent risk and control risk.

- A True
- B False

(1 mark)

12 Which of the following statements, relating to the auditor's reporting responsibilities for going concern, if any, is/are correct?

- (1) Where management is unwilling to make their assessment of the company's ability to continue as a going concern, the auditor should include an emphasis of matter paragraph in the audit report
- (2) Where the use of the going concern assumption is inappropriate, the auditor should include a qualified opinion in the audit report

- A 1 only
- B 2 only
- C Both 1 and 2
- D Neither 1 nor 2

(2 marks)

Section B – ALL SIX questions are compulsory and MUST be attempted

- 1 (a) ISA 300 *Planning an Audit of Financial Statements* provides guidance to auditors. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways.

Required:

Explain the importance of audit planning.

(5 marks)

- (b) You are the audit senior in charge of the audit of Swandive Co (Swandive), and have been informed by your audit manager that during the year a fraud occurred at the client. A payroll clerk set up fictitious employees and the wages were paid into the clerk's own bank account. This clerk has subsequently left the company, but the audit manager is concerned that additional frauds have taken place in the wages department.

Required:

Describe procedures which should be undertaken during the audit of wages as a result of the manager's assessment of the increased risk of fraud.

(5 marks)

(10 marks)

- 2 You are the audit supervisor of Seagull & Co and are currently planning the audit of your existing client, Eagle Heating Co (Eagle), for the year ending 31 December 2014. Eagle manufactures and sells heating and plumbing equipment to a number of home improvement stores across the country.

Eagle has experienced increased competition and as a result, in order to maintain its current levels of sales, it has decreased the selling price of its products significantly since September 2014. The finance director has informed your audit manager that he expects increased inventory levels at the year end. He also notified your manager that one of Eagle's key customers has been experiencing financial difficulties. Therefore, Eagle has agreed that the customer can take a six-month payment break, after which payments will continue as normal. The finance director does not believe that any allowance is required against this receivable.

In October 2014 the financial controller of Eagle was dismissed. He had been employed by the company for over 20 years, and he has threatened to sue the company for unfair dismissal. The role of financial controller has not yet been filled and so his tasks have been shared between the existing finance department team. In addition, the purchase ledger supervisor left in August and a replacement has been appointed in the last week. However, for this period no supplier statement reconciliations or purchase ledger control account reconciliations were performed.

You have undertaken a preliminary analytical review of the draft year to date statement of profit or loss, and you are surprised to see a significant fall in administration expenses.

Required:

Explain FIVE audit risks, and the auditor's response to each risk, in planning the audit of Eagle Heating Co.

(10 marks)

- 3 Bluebird Enterprises Co (Bluebird) is a retail company planning to list on a stock exchange within the next six months, and management has been advised by the company's auditors about the need for compliance with corporate governance provisions. In particular, the finance director is looking to recruit non-executive directors as he understands that Bluebird will need to establish an audit committee.

The finance director has two potential non-executive directors whom he is considering approaching to join the board of Bluebird. Antony Goldfinch is currently an executive sales director of a listed multi-national banking company; he sits on an audit committee of another company as a non-executive director and is agreeable to being paid a fixed fee which is not related to profits. Jacob Mallard is currently a finance director of a small retail company, which does not compete with Bluebird; he has expressed an interest in a fixed seven year contract and he is the brother of Bluebird's chief executive.

Required

- (a) **Explain the benefits to Bluebird Enterprises Co of establishing an audit committee.** (4 marks)

- (b) **Discuss the advantages and disadvantages of appointing:**

- (i) **Anthony Goldfinch; and**
(ii) **Jacob Mallard**

as non-executive directors of Bluebird Enterprises Co.

Note: The total marks will be split equally between each part. (6 marks)

(10 marks)

- 4 (a) *ISA 700 Forming an Opinion and Reporting on Financial Statements* requires auditors to produce an audit report. This report should contain a number of consistent elements so that users are able to understand what the audit report means.

Required:

Describe FOUR elements of an unmodified auditor's report and for each explain why they are included. (4 marks)

- (b) Bullfinch.com is a website design company whose year end was 31 October 2014. The audit is almost complete and the financial statements are due to be signed shortly. Revenue for the year is \$11.2 million and profit before tax is \$3.8 million. A key customer, with a receivables balance at the year end of \$283,000, has just notified Bullfinch.com that they are experiencing cash flow difficulties and so are unable to make any payments for the foreseeable future. The finance director has notified the auditor that he will write this balance off as an irrecoverable debt in the 2015 financial statements.

Required:

- (i) **Explain whether or not the 2014 financial statements require amendment; and**
(ii) **Describe audit procedures which should be performed in order to form a conclusion on any required amendment.**

Note: The total marks will be split equally between each part. (6 marks)

(10 marks)

- 5 Hummingbird Scents Co (Hummingbird) manufactures and sells luxury toiletries; they have been trading for over 20 years and the company's year end is 30 September 2014. Hummingbird sells products to trade customers via its own website; this represents 60% of revenue. Remaining revenue is generated by contracts to supply toiletries to hotels. Below is a description of the sales system.

Hotel revenue

The hotel revenue is made up of four key customers. Hummingbird has one sales clerk, Brenda, who maintains all aspects of this revenue stream; Brenda receives customer orders, raises sales invoices and processes payments. In raising invoices, the sales system automatically inserts the online trade customer prices for products. However, each hotel customer has contracted prices which are lower than the online prices and hence Brenda manually edits the invoices prior to despatch.

Online revenue

New trade customers are set up in the sales ledger master file upon passing suitable credit checks, and a credit limit is set at this stage by the finance director. Customers place online orders up to their pre-set credit limit; they receive an email confirmation and the sales order interfaces into the despatch system. The order number is linked to the customer account number. Goods are despatched daily with a goods despatched note which is referenced to the sales order number but are not sequentially numbered. Hummingbird used to despatch goods via a reliable national courier company. However, to reduce costs they have changed to a cheaper local courier and some orders have been delivered to customers late.

Trade customers' sales invoices are automatically generated by the system on the day the online order is placed. The prices are inserted in accordance with the website rates. Occasionally Hummingbird makes special offers or discounts sales; when this occurs the master file data has to be amended to ensure that the correct prices are used on invoices. This task is usually performed by a senior sales ledger clerk.

Revenue and receivables records

On a monthly basis statements are sent to the hotel customers; a number of trade customers have been requesting monthly statements and Hummingbird is considering this request. The company only reconciles the sales ledger control account at the end of September in order to verify the year-end balance.

Required:

- (a) As the external auditor of Hummingbird Co, write a report to management in respect of the sales system described above which:**

- (i) Identifies and explains SEVEN deficiencies in the sales system; and**
- (ii) Provides a recommendation to address each of these deficiencies.**

A covering letter IS required.

Note: Up to two marks will be awarded within this requirement for presentation and the remaining marks will be split equally between each part. (16 marks)

- (b) Describe substantive procedures the auditor should perform to confirm Hummingbird Co's revenue.**

(4 marks)

(20 marks)

- 6** Jackdaw Motor Cars Co (Jackdaw) manufactures a range of motor cars and its year end is 31 January 2015. You are the audit supervisor of Puffin & Co and are currently preparing the audit programmes for the year-end audit of Jackdaw. You have had a meeting with your audit manager and he has notified you of a number of issues identified during the audit risk assessment process.

Land and buildings

Jackdaw have a policy of revaluing land and buildings, this is undertaken on a rolling basis over a five-year period. During the year Jackdaw requested an external valuer to revalue a number of properties, including a warehouse purchased in May 2014. Depreciation is charged on a pro rata basis.

Work in progress

Jackdaw undertakes continuous production of cars, 24 hours a day, seven days a week. An inventory count is to be undertaken at the year end and Puffin & Co will attend. You are responsible for the audit of work in progress (WIP) and will be part of the team attending the count as well as the final audit. WIP constitutes the partly assembled cars at the year end and this balance is likely to be material. Jackdaw values WIP according to percentage of completion, and standard costs are then applied to these percentages.

Required:

- (a) Explain the factors Puffin & Co should consider when placing reliance on the work of the independent valuer.** (5 marks)
- (b) Describe the substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to:**
- (i) The revaluation of land and buildings and the recently purchased warehouse; and** (6 marks)
- (ii) The valuation of work in progress.** (4 marks)
- (c) During the audit, your team has identified an error in the valuation of work in progress, as a number of the assumptions contain out of date information. The directors of Jackdaw have indicated that they do not wish to amend the financial statements.**

Required:

Explain the steps Puffin & Co should now take and the impact on the audit report in relation to the directors' refusal to amend the financial statements. (5 marks)

(20 marks)

End of Question Paper