



Institute of Incorporated Public Accountants

Module 12

Audit Practice

Tuesday 28th. August 2012

2pm – 5pm

There are six questions in this paper

Instructions to Candidates:

- 1. Answer five questions in total**
- 2. All three questions in Section A and only two questions from Section B should be attempted.**
- 3. All questions carry equal marks.**
- 4. Include all workings with your answer.**

Candidates are reminded of the importance of the overall presentation of their answers.

Time Allowed: Three Hours.

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Section A: Answer all questions

Question 1: Answer all five short form questions. Answers should be brief and as a general rule should not exceed 100 words in length.

Part A : Explain what is meant by the terms "substantive test" and "tests of control" and illustrate your answer with two examples of each type of test. **4 marks**

Part B: Explain the context in which an auditor would add an emphasis of matter paragraph in his auditor's report to the members of a company. **4 marks**

Part C: An increasingly important theme within auditing is that of corporate governance. Explain what is understood by corporate governance and its relevance to audit planning. **4 marks**

Part D: When an auditor is considering accepting a new client, outline four factors the auditor should consider regarding the integrity of the client. **4 marks**

Part E: Describe four points that should be included in an audit engagement letter. **4 marks**

Total 20 marks

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Question 2

In respect of the following situations, you are required to state the audit report qualification (if any) or emphasis of matter paragraph (if any) that would be appropriate in the circumstances outlined and draft the text of the qualification /explanatory paragraph where appropriate.

Zero Ltd

Zero Ltd is currently involved in a legal dispute with Plus Ltd. Plus Ltd is claiming that Zero Ltd has infringed certain patent rights that Plus Ltd owns. Plus Ltd has instituted court proceedings against Zero Ltd claiming royalties and punitive damages. Zero Ltd denies any wrongdoing or liability and is mounting a robust defence. The matter is likely to be the subject of a full high court hearing in late 2012. Zero Ltd has a number of legal opinions from imminent Senior Counsel that supports their view that they are not liable for royalties or damages. Based on these opinions and the directors strongly held view that the company has no liability in respect of this matter no provision is made in the financial statements for royalties and / or damages. The financial statements fully disclose, by way of a note, the full details of the claim and the fact that the matter is likely to proceed to a full court hearing at which point the uncertainty relating to this matter will be resolved. As Auditor to Zero Ltd, you have considered the adequacy of the disclosures made in relation to this matter in the financial statements of Zero Ltd Limited and are of the opinion that the financial statements show a true and fair view. **5 marks**

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Hats Ltd

You were appointed Auditor to Company C on the 3 March 2012. You are auditing the financial statements for the year ended 31 December 2011. As you were not Auditor at the date of the annual stock count you did not attend the stock count. Stocks are valued at €376,587 in the audited accounts of the company and represent 55% of the company's net assets at 31 December 2011.

5 marks

Snuggles Ltd

Snuggles Ltd has an excess of liabilities over assets of €105,000. The company continues to trade because the principal shareholder and director Fred Jones has provided a financing facility to the company in the form of a shareholders loan of €145,000. He has confirmed to you in writing that it is his intention to continue to support the company in the future by the provision of this facility and additional facilities if required. The financial statements contain a note that fully explains the basis on which the accounts have been prepared on a going concern basis and details of the director's/ shareholders intentions in relation to the continued provision of finance to the company.

5 marks

Suits for Hire Ltd

Suits for hire Ltd carries on a tuxedo suit rental business on Mount Street, Dublin 2. The company has provided a loan of €700,000 to the spouse of a director of the company. The net assets of the company as per the last audited accounts presented to the members of the company at annual general meeting was €9,526,010. The directors have not disclosed the existence of the loan in the financial statements for the year to 31 December 2011.

5 marks

Total 20 marks

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Question 3

You are the audit manager of Books Limited and you have just completed the audit for the year ended 31 March 2012. The following has been uncovered.

- a) When you recalculated the depreciation charge you arrived at a figure of €175,000. The figure in the draft accounts is €155,000.
- b) You discovered from payroll testing that bank transfers of €125,000 to staff in respect of performance bonuses for the year-end 31 March 2012 were paid in April 2012, but the year-end bonus accrual was only €65,000.
- c) Prepayments of €15,000 have been included within the trade creditor balance in the trial balance.
- d) The provision for obsolete stock shows an opening balance of €75,000. The retail stock balance is €225,000. In the summer sales for 2012, 30% of the stock was offered for sale at discounted selling prices of 40%. The profit mark-up on stock is 25%.
- e) There is a suspense account in the trial balance showing a credit balance of €12,000. On enquiry, it is explained that the suspense account is used for small balancing adjustments in the reconciliation of debtor and creditor control accounts and for exchange differences arising from the sale of items on-line to overseas customers.
- f) The balance on the opening reserves in the trial balance was €174,000 whereas the balance on the opening reserves in the financial statements was €59,000. This has been explained by the client as the differences having been processed through the prior years financial statements, but were posted into the accounting system in the current year.

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Question 3 - Continued

The draft financial statements show a net loss for the year of €40,000 and net assets of €350,000. No adjustments for the above have been made by your client even though you did discuss them with him.

Requirement

- a) What further work would you carry out for each of the above. **10 marks**

- b) Draft a note for the audit partner that includes:
 - i) the schedule of unadjusted differences in respect of the above matters for review by the audit partner. **5 marks**
 - ii) a discussion of the cumulative potential distorting effect which the above items would have for an educated reader of the financial statements. **5 marks**

Total 20 marks

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Section B (Answer any two questions)

Question 4

Netcom Limited is a client of your firm. The company has experienced significant trading difficulties in recent years due to their supply of products to the construction sector. The audit fieldwork for the year ended 31 October 2011 has been completed and the following matters have been noted.

- 1) Netcom Limited has a ten year loan of €2.2 million and an overdraft of €220,000. It is a condition of the overdraft that the account go back into credit once a month and that the overdraft limit is not breached. In March and May 2011 the overdraft remained in use for the whole month and in June 2011 the overdraft went as high as €270,000. Management had a meeting with the company's bankers and they have been assured that none of the financial facilities will be altered by the bank.
- 2) A repairs provision of €170,000 is included in the statement of financial position for future repairs to a commercial premises on Merrion Square. No contracts have been signed.
- 3) A consultancy payment of €15,000 made to Mick Brown's brother (Mick owns 90% of Netcom Limited) has not been disclosed in the financial statements.

Requirement

- a) Draft the audit evidence you would require for 1) and the potential impact on the auditor's report. **6 marks**
- b) For points 2 and 3 set out in bullet point format the potential audit report implications of each. **8 marks**
- c) Draft the overall audit opinion paragraphs you would provide, if no further adjustment of disclosures were made for the points noted. (The paragraphs for the scope, objectives and audit approach are not required) **6 marks**

Total 20 marks

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Question 5

Hot Coals Limited has been an audit client of your firm for the last six years. Their trading position has deteriorated in the last two years. The audit for the year ended 31 March 2012 is to start in one week and you have just received the audit file. You are reviewing the inventory schedule provided by the client.

Product No.	Cost per item €	Quantity	Total €	Notes
A105*	100	100	10,000	Packaging damaged
A109	50	500	25,000	New supplier price: €35
A110*	70	1,000	70,000	500 with customer on sale or return basis
A111	80	10	800	
A112	93	29	2,967	Discontinued, do not reorder
A113	95	10	950	
A114*	96	100	9,600	New supplier price: €60
A115	72	60	4,230	Discontinued, do not reorder
A116	68	50	<u>3,400</u>	
* not counted			<u>€126,947</u>	

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Requirements:

- a) As the audit starts, the financial controller tells you there was a mistake in the inventory count and products A105, A110 and A114 were not counted. Outline what alternative audit procedures you would perform to handle this situation.

6 marks

- b) State the assertions of management in reporting the inventory figure of €126,947 in the current assets in the financial statements.

4 marks

- c) Prepare a working paper that assesses the potential effects of the information found in the notes on the inventory schedule and the potential further audit procedures that might be applied. (Note: marks are awarded for proper presentation of the working paper).

10 marks

Total 20 marks

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Question 6

Part A

The audit of small companies creates a unique and difficult challenge for the auditor.

Requirement

- (a) Outline the unique challenges that the audit of a small company poses for the auditor.

4 marks

- (b) Suggest appropriate responses to the challenges outlined above.

4 marks

- (c) Suggest arguments in support of the continued audit of financial statements of companies that qualify for exemption from having an audit under company law.

4 marks

Part B

You are planning the audit of your biggest audit client, the Bank of Hope Ltd for the year ended 31 December 2011. 80% of the bank's business consists of special savings accounts which fund domestic mortgage lending in East Munster.

Requirement:

What effect does the current global financial crisis have on your perception of audit risk for the bank? Draft your answer in the form of the briefing notes you would prepare for the initial audit planning discussion with the audit partner.

8 marks

Total 20 marks

End of Paper