



Institute of Incorporated Public Accountants

Audit Practice

26th. August 2014

2pm – 5pm

There are six questions and seven pages in this examination paper.

Instructions to Candidates:

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

Candidates are reminded of the importance of the overall presentation of their answers. Where appropriate, reference to the audit standards, ethics and company law should be clearly made.

Time allowed 3 hours

Section A

Question 1

Part A

Revenue recognition is a high risk area for an audit. Discuss.

(4 marks)

Part B

Duck & Brown auditors want to increase their revenue and are thinking of encouraging all staff to sell non audit services to clients and motivate the staff to do this by giving them commission of 40% on any sale they make. Comment on any ethical issues raised by this suggestion.

(4 marks)

Part C

Discuss four limitations of external audits.

(4 marks)

Part D

ISA 300 Planning an Audit of Financial Statements provides guidance to assist auditors in planning an audit. Explain the benefits of audit planning.

(4 marks)

Part E

ISA 705 Modifications to the opinion in the Independent Auditors report identifies modifications which result in the audit report being modified. Describe in detail two types of modified audit opinions.

(4 marks)

Total Marks 20

Question 2

Gems Limited is an Irish company that owns and operates a diamond mine in South Africa from which diamonds are extracted and sold on to jewellery wholesalers in Antwerp. They operate under a licence from the International Precious Stones Authority (IPSA), an organisation which monitors the environmental impact of the mining industry and requires all licensed mines to be operated in compliance with strict health and safety regulations. You are the audit manager at Swan Brown & Co, responsible for the audit of Gems Limited. You are reviewing the audit working papers for the year ended 30 April 2014. The draft financial statements recognise profit before tax of €20 million and total assets of €167 million. The mine has been valued at €10 million in the draft financial statements and was acquired in 2007. The audit senior has left file notes for you to review

On 10 April 2014, there was an accident at the mine where several hundred tonnes of rock collapsed and this in turn caused tunnels to flood. One quarter of the mine cannot be entered now and for safety reasons the affected tunnels will be permanently closed. The management of Gems Limited feel they can continue to operate in the rest of the mine as long as they make some health and safety improvements to ensure they comply with IPSA regulations.

One miner was killed in the incident and three are in intensive care in hospital. The tunnel collapse caused subsidence which damaged several homes in the village of Bubu located above the mine. A surveyor is examining the properties damaged to see if they can be repaired or must be demolished and rebuilt. In the meantime, fifty residents have been moved to hotel accommodation in the next town and Gem Limited are paying for this. The miner who died has no known relatives and so Gem Limited have decided since all other people are now safe they will not report the incident to the Precious Stones Authority.

Required:

- i)** Regarding the accident, prepare a briefing note for the audit partner on all matters which need to be considered in the audit.
(6 marks)
- ii)** In respect of the matters in (i) above, describe the audit evidence you would expect to find when you are reviewing the working papers and financial statements of Gems Limited.
(6 marks)
- iii)** Discuss Swan Brown & Co's responsibilities given the fact that Gems Limited have decided not to report the incident to the IPSA.
(8 marks)

Total Marks 20

Question 3

You are an audit manager of Jones, Lang, Taylor & Co (JLT) and have been asked by the audit partner you report to, Bill Smyth, to deal with the following matters that relate to existing or potential audit clients of the firm.

Holes Limited's managing director Bob Briscoe has invited JLT to tender for the annual audit. Holes Limited provides mortgages, debt and insolvency advice. The previous auditors left suddenly and according to Bob this was because they thought controls were very lax in the company and there was a disagreement regarding the way mortgage commission earned was accounted for. The Mortgage Regulatory Authority in Ireland last year fined Holes Limited for non-compliance with the regulations. Bob wants your firm to perform the audit, provide tax advice and also help grow the business.

Batty Goods Limited, a client of your firm for the last 15 years, has had liquidity problems over the last three years and despite letting three staff go and reducing the wages of remaining staff, profits continue to fall. The managing director, Simon Smith, asked that a JLT audit partner go with him to a meeting at the bank to help secure a new loan and explain the draft financial statements. Simon said if you do not help he will change auditors. JLT are owed €5,000, the balance due for last year's audit. The invoice is now over six months old.

The Bank van Dyke Limited (BvD) have asked JLT to perform an actuarial valuation on its defined benefit pension plan. You know Karl Doyle (an audit partner in your firm) is an expert in this area. BvD have a year end of 31 December 2014 and a meeting is scheduled for next week to plan the audit work needed. Their financial statements for the year ended 31 December 2013 showed total assets of €40 million and pension liability of €230,000. Last year's audit report was modified.

Required:

Identify and discuss any ethical and other issues arising from the information outlined for each of the three clients and make appropriate recommendations on the actions to be taken. Draft your answer in the format of a memo to the audit partner.

Total Marks 20

Section B

Question 4

Part A

You are the newly appointed audit senior to Debt Recovery Limited. Debt Recovery Limited is a company that have been set up during the recent recession in order to recover debts that are overdue. Their clients include mobile phone providers, banks and credit card companies. They are assigned lists of debtors from these companies and pursue them within the law and get paid a commission on what they recover. Your team assigned to the audit includes Mike Smith (the audit manager and a brother in law of Tom Brown the CEO of Debt Recovery), and Sally Wright the audit junior. Sally is thrilled as she confides in you that she will get to know the company better as her boyfriend has shares in Debt Recovery limited and she is keen to get a chance to understand the inner workings of the company. You, on the other hand, are a nervous wreck. You have just that morning received a notification from your credit card company that due to non-payment the debt has been passed to Debt Recovery for collection. You are terrified the client will recognise your name and put you in a compromised position. This most likely means you will feel ill every morning for the two weeks of the audit.

Required:

Outline and evaluate the matters that need to be considered you as the audit senior and any implications for the audit. **(10 marks)**

Part B

You are also responsible for the audit of Verysafe Limited, an alarm installation company. Verysafe Limited use agents to call on householders and to sell alarms to them. The sales agents get paid a basic salary of €10,000 per year and 10% commission on every alarm they sell. Verysafe Limited recently discovered that Tom Robinson, one of the sales agents, was submitting claims for commission for non-existent sales. Your firm has been hired to estimate the losses arising from this fraudulent activity.

Required:

Draft a letter to Verysafe outlining the procedures you propose for the investigation to quantify the amount of the fraud and the steps to strengthen controls to avoid a recurrence of this fraudulent activity.

(10 marks)

Total Marks 20

Question 5

International Auditing Standard 520 states that *“the auditor should apply analytical procedures as risk assessment procedures to obtain an understanding of the entity and its environment and in the overall review at the end of the audit. Analytical procedures may also be applied as substantive procedures.”*

Required:

- i) Set out the nature and purpose of analytical procedures.
(6 marks)
- ii) Outline the dangers for the Auditor of over relying on analytical procedures as a way of gathering audit evidence
(4 marks)
- iii) Give at least three specific examples of different kinds of indicators within a company that would identify a concern for a high risk environment within the company.
(5 marks)
- iv) Describe the analytical procedures you would apply to the final audit of the income statement of a chain of chemist shops.
(5 marks)

Total Marks 20

Question 6

You are currently auditing the financial statements of Path Stone Limited for the year ended 30 June 2014. The board of directors approved the financial statements for the year ended 30 June 2014 on the 25 August 2014. You have set your guide to materiality for this audit assignment at €50,000. You complete your audit work on the 25 October 2014 and sign the audit report on that date. The report is an unqualified opinion. The financial statements and audit report are to be issued to the members of the company on the 5 November 2014.

On the 27 October 2014 you become aware that Gravel Limited, a major customer of Path Stone Limited has ceased to trade and that the High Court has appointed a liquidator to the company at the request of the Collector General. Path Stone Limited is owed €200,000 by the customer and €156,890 of this amount was due as at the 30 June 2014. It is not expected that the unsecured creditors will receive any payment on completion of the liquidation.

Required:

- i) Set out the responsibility of the auditor in relation to obtaining sufficient and appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified. Include in your answer the potential effects on your auditor's report. **(7 marks)**
- ii) What audit procedures would be appropriate to discharge the responsibility of the auditor as outlined at (i) above. **(8 marks)**
- iii) Comment on the responsibility of the Auditor when informed of the liquidation of the Gravel Limited and what action the auditor should take. **(3 marks)**
- iv) How would your answer to (iii) above differ if the auditor became aware of the liquidation of Gravel Limited on the 10th November 2014 **(2 marks)**

Total Marks 20

End of paper