Institute of Incorporated Public Accountants

Final Admitting Exam – Module 12

28th May 2013

2pm – 5pm

There are six questions and thirteen pages in this examination 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.

Section A

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

Set out the general principles you would follow in using the work of an expert in valuing closing inventory.

(4 marks)

Part B

Explain what is meant by the term computer assisted audit techniques (CAATs) and give two examples of where it would be appropriate to use such techniques in the audit of a chain of grocery retail stores.

(4 marks)

Part C

You are auditor to Hydro Limited. During the course of the audit of the financial statements for the year ended 31 December 2012 you ascertain that there is an addition to premises of €350,000. The premises are classified as leasehold improvements in non current assets as the company does not own the site on which the premises are built. The site is owned by a director of the company and no written lease agreement is in existence in respect of the lease of the site to Hydro Limited by the director.

Required:

Prepare a file note setting out the audit and company law issues arising and how you would propose to deal with same.

(4 marks)

Part D

There have been several publicly reported high profile cases of company bankruptcies or suspected irregularities in financial reporting in Ireland and internationally in the last 10 years. Discuss the role, if any, that auditors have played in any one case that you are aware of.

(4 marks)

Part E

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)

Total 20 marks

Question 2

Save on Heat Limited manufactures energy efficient solar panels for the export market. The panels are made from a range of components purchased from electronic suppliers in Sweden and the UK. The company operates a standard cost system for both raw materials and finished goods. The company's inventory system allows for accurate quantity and standard cost records to be maintained for both raw material inventory and finished goods. The 2012 standard cost of a finished solar panel is:

Materials	€33.00
Direct labour	€12.50
Overheads	€12.00

Due to sharp increases in labour costs in Ireland, UK and Sweden very large price variances for materials were recorded in the second half of 2012. In December 2012 a negative materials price variance of €15,450 was incurred. In addition the company experienced problems with a critical production machine in December 2012 that resulted in the output volume for December 2012 being 50% less than normal. This has given rise to a negative quantity variance of €127,546 in the month of December 2012. At the 31 December 2012 the closing inventories in the draft financial statements submitted for audit were:

Raw material at standard cost	€287,659
Finished goods at standard cost	€728,958

The quantity of inventory at year-end was determined by a physical count of the inventory and a comparison of the physical count to the book inventory records. The book inventory is adjusted to the actual inventory on hand at 31 December 2012.

Required:

1. Based on the information provided, draft an audit working paper for the audit risk considerations that might apply to inventories in the above situation. You should deal in particular with the impact (if any) of the large volume and price variances experienced by the company in December 2012 on both the valuation of finished inventory and raw materials.

(10 marks)

2. Draft a detailed audit programme for:

   i. Your attendance at the company's year-end inventory count.

   (6 marks)

   ii. The audit of the valuation of finished goods.

   (4 marks)

Total 20 marks

Question 3

Your client Watch your Euros Limited operates a chain of discount shops in Ireland's major cities selling a diverse range of small stationery items, disposable goods, toys, household goods and food snacks. The company was established in 2005 and quickly expanded through the acquisition of city centre retail units in the first three years of trading and the opening of discount stores in these premises. The objective of the founders of the company was to grow a company with an annual turnover of in excess of €10 million. The founders believed that if they could develop a business with a large market share, it would become an acquisition target for large UK retailers seeking an entry into the Irish market.

The company made accumulated losses in the years 2005 to 2007. It experienced severe cash flow problems in 2008 and at that time the total bank borrowings were restructured. All bank loans were amalgamated into one loan of €15,000,000 repayable over 20 years commencing in 2009. The interest rate payable on the loan is the European Central Bank rate plus the bank's margin of 2.5%. The Bank has a fixed and floating charge over the assets of the company.

In April 2010 the company failed to make the scheduled loan repayments and faced the threat of the appointment of a receiver by the Bank. On reviewing the bank loan agreement you noted that the bank loans become repayable on demand if the terms of the loan agreement are breached during the loan term. The Managing Director of the company has informed you that the threat of appointment of a receiver is now lifted and that the company has re-established a very good working relationship with the Bank. You are informed that the company has entered into discussions with the bank to arrange additional finance. If these negotiations are successful the company will then be in a position to pay all arrears of taxes and bring trade payables back within approved credit terms.

The company has not received any takeover approaches from potential acquirers and the downturn in the global economy makes it unlikely that such an approach will be received in the near future. The summary financial statements for the year ended 31 December 2012 are as follows:

Statement of Financial Position of Watch your Euros Limited as at 31 December 2012

Non Current assets	€	€
- Buildings		15,700,000
- Fixtures and fittings		1,200,000
		16,900,000
Current assets		
Inventories	5,780,000	
Cash on hand	25,000	5,805,000
Total Assets		**22,705,000**
Equity and Reserves		
Share capital	3,500,000	
Revenue deficit	(300,000)	3,200,000
Creditors falling due within one year		
Trade payables	4,100,000	
Bank loans	200,000	
VAT	1,200,000	5,500,000
Creditors falling due after one year		
Bank loans	13,500,500	
Shareholder loans	504,500	14,005,000
Total Equity and Liabilities		**22,705,000**

A summary of the Income Statement for the year ended 31 December 2012 is as follows:

	€
Sales Revenue	10,080,000
Cost of sales	4,040,000
Gross profit	6,040,000
Less	
Administration expenses	(4,500,000)
Distribution expenses	(3,200,000)
Operating loss for year	**(1,660,000)**

Notes:

1. The Sales Revenue has fallen by 20% in 2011 and by a further 15% in 2012. The stock turnover ratio has fallen proportionately which means that the proportion of stock on hand for more than one year has increased from 10% to 25% of the total inventory value.
2. Included in administration overheads is a depreciation charge of €1,200,000.
3. The buildings are included in the accounts at cost less accumulated depreciation. Some recent sales of other shop premises would indicate that the valuation of retail businesses is declining due to the difficulties experienced in the economy. The company has never undertaken an impairment review of assets.
4. The financial statements as currently drafted do not disclose the fact that there is a degree of uncertainty in respect of the ability of the company to continue to trade in the future. Your discussions with the Managing Director indicate that the Board of Directors will consider disclosures in the financial statements in relation to the uncertainty pertaining to going concern.

Required:

1. As the Audit Manager responsible for the 2012 audit of Mind your Money Ltd, prepare a short summary for the audit partner, Mr N.M. Jones of the key audit assertion risks that you have identified based on the information provided.

(6 marks)

2. Based on the information provided in the question prepare an extract from the audit plan dealing with specific customised audit tests you would apply to address any two of the risks identified in 1 above. The extract should include the audit risk identified and the planned audit response to the stated risk. Marks will be rewarded for the use of relevant information provided in the question and appendix

(**8 marks)**

3. Draft a note to the Audit Partner to alert him to the potential effect that the issues may have on the final audit report issued on the financial statements of Save your Euros Limited for the year ended 31 December 2012 and your view of the likely audit opinion that will be required. The note should identify the disclosures needed in the notes to the financial statements and the effect on the potential audit opinion that should be considered if the disclosures are not made. (The draft audit opinion is not required)

(6 marks)

Total 20 marks

Section B (Only two questions from this section should be attempted)

Question 4

As a member of the Institute, you are a Sole Practitioner and Registered Auditor. Solid Homes Limited has been one of your audit clients for the last six years. The company operates a property development and construction business in Gorey, Co. Wexford. The draft financial statements of Solid Homes Limited for the year ended 30 September 2012 have been submitted for audit together with the accounting schedules. At the audit planning meeting with the management of the company, you established the following information about the company:

1. Management expect that the company will show a loss of €450,000 in the year ended on 30 September 2012;
2. The company built an apartment complex with fifty apartments in two phases in Dundrum, Dublin 14 at a total cost to date of €19.8 million. Phase one, consisting of 40 apartments, was completed in June 2012 and 20 of these apartments were sold for €400,000 each but the remaining twenty completed apartments remain unsold due to the recession in the economy and are carried in the books at construction cost. Phase two, consisting of the remaining 10 apartments were 40% complete at the financial position date. The estimated cost to complete phase two is €0.7 million and the potential selling price is €300,000 for each apartment. The company has not decided what to do next with this development and has no plans for any further residential developments. The unfinished units are recorded in inventory as construction work in progress.

3. The company owns a substantial land bank consisting of twenty acres on the outskirts of Gorey. This land was purchased in 2007 at a cost (inclusive of stamp duty) of €10,970,000. The land is zoned residential in the Wexford County development plan. This land is carried at cost in inventories on the company's Statement of Financial Position.

4. The company invested €700,000 in Bank of Ireland shares in 2006. These shares are carried in the company's financial statements at cost.

5. The company has no bank borrowings and has cash reserves of €2,000,000. The management believe that these funds combined with a cost reduction scheme they have implemented will allow the company to continue to trade and meet its obligations over the next two years.

Required:

1. In relation to Solid Homes Limited, set out an extract from the audit briefing you would make to the audit team showing the significant audit risk areas that need to be considered, based only on the information provided. Include any reasonable calculations and assumptions in your answer

   (12 marks)

2. Prepare an extract from the audit plan showing the proposed audit response to the risks identified in (1) above. **(8 marks)**

Total 20 marks

Question 5

You are the **auditor** to the Wood as you Like it Corporation Limited (WLC). WLC imports wooden furniture from five different locations in China, India, UK, Sweden and USA and sells it to large furniture stores and direct to the public from one of their three warehouses.

Each business customer is given different credit terms with retail customers being offered no credit. The sales are 90% to businesses and 10% to private consumers. They have a trade receivables balance for the year ended 31 December 2012 of €540,000. All the data is stored on their computer system. The computer software used has not been updated since 2003. WLC plans to sell online from mid-2013 and will update its operating systems then. Copy files will be provided to the auditors as the WLC Directors do not want any internet threats to be introduced to the current files stored on the computer systems.

Required:

1. Explain five audit procedures including a reason for each procedure that should be carried out by the auditors using audit software on the trade receivables balance for the year ended 31 December 2012.

   (10 marks)

2. Write a short letter to the WLC Directors pointing out any four problems that the specification for the new accounting software for the on-line sales accounting system should address. **(10 marks)**

Total 20 marks

Question 6

You are an audit partner in the firm of Smith Jones Byrne since 2006. In the past your firm has prepared and audited the financial statements of Garden Services Limited, a company with a turnover of €10 million and has 32 employees. The finance director of Garden Services Limited was speaking to a friend and has raised concerns that it may no longer be appropriate for you to perform both an accounting and audit role for the company. Draft a memorandum to the finance director dealing with the following matters:

a. Outline the rules set out by Ethical Standard No 5 in respect of the provision of non-audit services to audit clients.

(8 marks)

b. Outline three factors the auditor must consider when assessing threats to the auditors objectivity and independence.

(6 marks)

c. List and explain three threats to an auditor's objectivity.

(6 marks)

Total 20 marks

End of Paper