



Final Admitting Exam – Module 12

May 2014

There are six questions and eight 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: Three Hours.

Section A

Question 1

Part A

There is a common public perception that the auditor is responsible for detecting fraud. In light of many high profile cases in recent years where many have suffered financial losses but few have been held accountable, the role of the auditor has been questioned. Outline the procedures an auditor should take to reduce the likelihood of fraud in an organisation.

(4 marks)

Part B

Tom Jones is auditing ABC Limited and it has come to his attention that the company are not very meticulous at keeping records. Some items appear to be recorded and others appear to be transactions agreed over the phone but not recorded. He knows this is not right and wants your advice on what he should do.

(4 marks)

Part C

White Limited is a new client of your firm Brown & Co and you have been assigned as an audit manager to oversee the audit. You are pleased to learn that White Limited has an internal audit department. Your audit team asks you to explain to them what benefit the internal audit department is to you as a team of external auditors?

(4 marks)

Part D

Computer Assisted Audit Techniques (CAATs) were developed to address specific problems that arise in the audit of computerised accounting systems. Outline two principal techniques of CAAT and give two examples of the use of a computer assisted audit programme in the audit of a retail company.

(4 marks)

Part E

You are the audit manager on the audit of a jewellery shop "Gems are Us limited" and you realise very early on in the audit that you will find it difficult to value the inventory of jewellery. If you are honest with yourself you cannot recognise one precious stone from another. You decide to call in professional valuers. Explain to your audit team the general principles to be followed in using the work of a firm of professional valuers of precious metals to assist with the audit of closing inventory. **(4 marks)**

Total Marks 20

Question 2

Part 2A

In respect of the following three 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.

(i) Company Clint Limited.

In carrying out the audit of inventory you determine that for a number of categories of inventory the net realisable value is less than cost. You estimate that the downward adjustment required to state the inventory figure at the lower of cost or net realisable value would be €300,000. The directors of the company refuse to adjust the accounts to correct for this overstatement of inventory on the basis that they disagree with the accounting treatment of reducing inventory value to net realisable value where net realisable value is less than cost.

(4 marks)

(ii) Company Sligo Limited

Sligo Limited is currently involved in a legal dispute with Galway Limited. Galway Limited is claiming that Sligo Limited has infringed certain of its patent rights. Galway Limited has instituted court proceedings against Sligo Limited claiming royalties and punitive damages. Sligo Limited 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 2014. Sligo Limited has a number of legal opinions from 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 have fully disclosed 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 Sligo Limited, you have considered the adequacy of the disclosures made in relation to this matter in the financial statements of Sligo Limited and are of the opinion that the financial statements show a true and fair view.

(4 marks)

(iii) White Limited.

White Limited carries on a retail business in Main Street, Sligo. The company has provided a loan of €100,000 to the spouse of a director of the company. The net assets in the last audited accounts presented to the members of the company at the annual general meeting amounted to €11,563,020. The directors have not disclosed the existence of the loan in the financial statements for the year to 31 December 2013.

(4 marks)

Part 2B

Set out the procedures that International Standards on Auditing (UK and Ireland) 500 identifies for gathering audit evidence and illustrate the application of these procedures by way of examples. **(4 marks)**

Part 2C

International Standard on Auditing 540 – Audit of Accounting Estimates establishes standards and provides guidance on the audit of accounting estimates.

Required :

Explain what is meant by the term “accounting estimate” and outline the guidance provided by International Standard on Auditing 540 on the audit of accounting estimates. **(4 marks)**

Total Marks 20

Question 3

Small and Medium sized enterprises (SMEs) are the backbone of the Irish economy. They provide most of the employment and are at the heart of every Irish Community. The audit of SMEs presents unique challenges for auditors and different procedures are needed to address these challenges. You are the audit manager for Shells Limited, a company that employs 15 staff in Wicklow for the manufacture of pottery. They had a turnover of €1m for the year ended 31 December 2013. You are allocating the audit of sales revenues to your audit senior Mary and need to explain to her what is required. Mary is thrilled as she heard from her friend Sharon (who is also employed by your accounting firm) that Shells Limited has wonderful staff. Sharon should know as she spent nine months last year seconded to Shells Limited and indeed prepared their year-end financial statements and helped them with management decisions.

Required:

- a) Describe five unique challenges the auditor of a small company is likely to face and appropriate audit procedures to respond to these challenges. **(5 marks)**
- b) Outline and explain the audit evidence which the auditor should seek in order to determine the completeness of recording sales in Shells limited. **(5 marks)**
- c) Assuming that a management threat arises from Sharon preparing the accounts for Shells Limited and being involved in management decisions. Outline two provisions the auditor could avail of under the Ethical Standards. **(6 marks)**
- d) The pottery business has two business risks that can significantly affect the level of profitability – a high rate of defects in the manufacturing process and fluctuating selling prices when pottery designs go out of date. Draft a short memo to Mary to highlight these potential risks and to instruct her on what additional audit steps she should take for these risks in the audit. **(4 marks)**

Total Marks 20

Section B

Question 4

Help the Children is a charity established in 2007 by Mary Monaghan after her daughter Elizabeth went missing aged three from a playground in County Galway. Elizabeth was found six years later living in a community in the UK. She was traumatised and hardly recognised her mother and it came to light that she had been used by the community for begging purposes. Mary set up the charity to provide counselling to parents and children while missing and after they have been found in order to try and combat the mental and physical torment many had suffered. The charity receives no governmental support and is dependent on raising all its income from volunteer efforts and mainly from an annual monster fete. Your firm Smith, Brown and Co have been appointed as auditors of Help the Children for the year ended 31 December 2013.

It has come to light during the course of the audit that Mary has been using some of the donations to top up her underfunded pension scheme. She wants to make sure she is comfortable in retirement

Required:

- a) Outline and describe three key areas that must be focused on when conducting the audit of a charitable organisation. **(6 marks)**
- b) Describe any action that you are obligated to take as a result of Mary topping up her pension. **(8 marks)**
- c) At the end of the audit, you decide to issue a letter to Mary Monaghan to suggest ways to improve the governance arrangements of the charity. Draft a working paper setting out 3 steps you would recommend to Mary and providing supporting arguments for your recommendations.

(6 Marks)

Total Marks 20

Question 5

Wellbuild Limited are a construction company specialising in developing hotels and apartments. Their next year-end is 30 June 2014. They are completing the build of a hotel in Tipperary, referred to as “contract Tipp”. To date they have agreed a sales price of €6,000,000 for the completed hotel. There are minor costs of €50,000 to complete the project and so far they have spent €5,050,000 on the construction. A second contract they are working on is “contract Dub”, an apartment complex in Dublin. So far they have spent €1,050,000 on the work done to date with an estimated €850,000 to complete the project. The forecasted sales revenue it will generate is €1,700,000. The company have a great history of compliance with health and safety regulations so they were very disappointed when in late 2013 on an inspection visit to their site it was discovered that the construction workers were not all properly attired and had not been trained sufficiently in certain aspects of health and safety. Wellbuild Limited was fined €400,000 and had €155,000 in penalties imposed on them.

Required:

- a) Describe how the two contracts should be treated and accounted for in the books of Wellbuild Limited. **(5 marks)**
- b) Suggest five pieces of audit verification work that should be performed regarding the two contracts. **(10 marks)**
- c) Outline and explain 6 steps the auditor should undertake when they discover non-compliance with the regulatory framework of the client. **(5 marks)**

Total Marks 20

Question 6

You are an audit manager at Jones & Co with special responsibility for the quality of audits conducted under your direction. In August 2013 you were allocated the audit of Polar Bear Limited, a company that collects bins from householders each week. A team of five of your staff is assigned to the audit, comprising of two audit seniors and three audit juniors. Polar Bear Limited's draft accounts for the year ended 31 December 2013 show Sales Revenue of €3.2 million, up 10% from 2012 figures and total assets of €1.2m (up 20% from 2012). You are reviewing the audit working papers during your visit to the client and found the following:

- 1) At 31 December 2013, trade receivables were €750,000. One of the audit juniors has just sent out initial requests for direct confirmation of customers' balances as at the balance sheet date.
- 2) There is a contingent liability of €500,000 on the financial statements year ended 31 December 2012. One audit senior said they saw a letter showing the claim was settled in March 2013 for €250,000. The auditor's report on the financial statements for the year ended 31 December 2012 was unmodified and signed on 18 April 2013.
- 3) The junior auditor checking the bank reconciliation and the deposits and disbursements through the bank accounts has noted five round sum deposits in excess of €10,000 each which were received from the largest customer in September 2013 and returned to the same customer one month later. A satisfactory explanation for these transactions has so far not been received but there appears to be no overall effect on the financial statements.
- 4) The Directors' report shows that disposal of an investment property forms a part of sales revenue but this is not disclosed in the notes to the financial statements.

Required:

- a) Accountants need ethical guidance on money laundering. Explain why guidance is necessary. **(4 marks)**
- b) Identify and comment on the implications of the findings for Jones & Co's quality control policies and procedures. **(16 marks)**

Total Marks 20

End of paper