



# Audit Practice Module 12 November 2009

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

Instructions to Candidates:

1. Answer five questions in total consisting of all three questions in Section A and only two questions from Section B.
2. All questions carry equal marks.
3. Include all workings with your answer.

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

Time Allowed: 3 Hours\_

**Section A – all questions in this section must be Attempted**

**Question 1**

Provide brief answers (not more than 100 words) to each of the following short form questions. Your answers should refer to the relevant International Standard on Auditing (UK and Ireland) and company legislation where applicable.

Part A

International Standard on Auditing (UK and Ireland) 240 deals with the auditor's responsibility to consider fraud in an audit of financial statements. Briefly outline the responsibilities of the auditor for detecting misstatements due to fraud as outlined in International Standard on Auditing (UK and Ireland) 240.

**[5 Marks]**

Part B

International Standard on Auditing (UK and Ireland) 505 establishes standards and provides guidance on the auditor's use of external confirmations as a means of obtaining audit evidence. Drawing on the guidance given in this standard, outline in details the process you would follow in undertaking a circularisation of debtors as part of the audit of a company.

**[5 Marks]**

Part C

In the context of International Standard on Auditing 700, the Auditor's Report and Financial Statements explain what is meant by the term

- a) Disclaimer of opinion
- b) Adverse opinion

Your answer should be illustrated an example of where each opinion would be appropriate.

**[5 Marks]**

Part D

Outline the likely audit procedures to be undertaken by an auditor during his attendance at the physical stock count of the stock owned by a manufacturing company.

**[5 Marks]**

**Total Marks 20**

## Question 2

In respect of the following situations, you are required to draft the audit report disclaimer or adverse opinion or qualified opinion or emphasis of matter paragraph that would be appropriate in the circumstances outlined.

### Company A.

In carrying out the audit of stocks, you determine that for a number of categories of stock the net realisable value of stock is less than cost. You estimate that the downward adjustment required to the stocks to state the figures at the lower of cost or net realisable value would be €300,000 (5% of the net assets). The directors of the company refuse to adjust the accounts to correct for this overstatement of stocks on the basis that they disagree with the accounting treatment of reducing stock value to net realisable value where net realisable value is less than cost.

### Company B

You are drafting the audit report on the financial statements of Company B for the year ended 31 December 2008. In considering the appropriateness of preparing the financial statements on a going concern basis, the directors have considered a period to 30th September 2009. This fact has not been disclosed in the financial statements for the year to 31 December 2008.

### Company C.

You were appointed Auditor to Company C on the 16th February 2009. You are auditing the financial statements for the year ended 31 December 2008. As you were not Auditor at the date of the annual stock count, you did not attend the stock count. Stocks are valued at €245,678 in the audited accounts of the company and represent 45% of the company's net assets at 31 December 2008.

### Company D.

Company D has an excess of liabilities over assets of €500,050. The company is able to continue to trade because the principal shareholder and director Joe Bloggs has provided a financing facility to the company in the form of a shareholder loan of €1,150,000. 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 that the financial statements are prepared on a going concern basis on the director's understanding that this support from the shareholder is and will continue to be available to the company.

## Company E.

Company E is a “not for profit” company that provides support services to people with disabilities in the Kildare region. The company is funded by a grant in aid from the Health Services Executive (HSE). You are drafting the audit opinion on the financial statements for the year ended 31 December 2008 in September 2009. Due to budgetary cutbacks within the HSE, it is not clear if the company will continue to receive funding after the 31 December 2009. The directors approved the financial statements on the 9th September 2009. The financial statements contain the following basis of preparation disclosure note:

***“The company receives funding from the Health Services Executive to fund its operational costs. The company has received confirmation from the Health Services Executive that continued funding is guaranteed up to the 31 December 2009. As at the date of approval of these financial statements the company had not received confirmation from the Health Services Executive that funding will be received in 2010. Should funding not be received in 2010, the company would not be able to continue to provide services to its clients and would be required to cease operations. Notwithstanding the uncertainty in connection with the receipt of funding for 2010, the directors have reasonable expectations that the company will receive funding in 2010 and on this basis that they have prepared these financial statements on a going concern basis. The financial statements do not include any adjustments that would be necessary should this basis not be appropriate.”***

**Total Marks 20**

**Question 3.**

You are auditor to Red Limited, a large wholesaler of machine parts. You are currently planning the audit of the financial statements for the year ended 31 December 2009. In prior years your firm has adopted a largely substantive based approach to the audit of the financial statements. In the current year it has been decided that the overall audit approach in the upcoming audit will be changed to one where reliance will be placed on the company's system of internal control.

**Required:**

- (a) Identify any pre-conditions that you would expect to exist within the company's system of internal control to allow the planned audit approach to be successful.

**[5 Marks]**

- (b) Set out the arguments for and against the two alternative audit approaches outlined.

**[5 Marks]**

- (c) Prepare a list of internal control objectives that you would expect to find in the wages accounting system.

**[5 Marks]**

- (d) Design "tests of control" that would be appropriate to test the operational effectiveness of the controls operating in the wages accounting system.

**[5Marks]**

**Total Marks 20**

**Section B -Answer two questions from this section****Question 4.**

You are auditor of KTL Limited, a construction company that in recent years has focused on the construction of private hospital buildings in the Republic of Ireland. The hospital buildings are constructed on the customer's own site. The duration of these construction contracts is normally in excess of one year.

You are currently planning the audit of the financial statements of the company for the year ended 31st October 2009. During the course of this work you have established the following facts in relation to ongoing construction contracts.

The company is currently involved in two construction contracts. Details of the status of these contracts as at 31 October 2009 are as follows:

	Mayo Contract €	Cavan Contract €
Costs incurred to 31/10/09	5,050,000	1,050,000
Expected additional costs to complete contract	50,000	850,000
Value of work certified by Customers Architect	6,000,000	750,000
Cost of work certified	5,000,000	900,000
Initial budgeted costs of entire contract (at cost)	5,200,000	1,500,000
Fixed price of contract at sales value	6,000,000	1,700,000

**Required:**

1. Drawing on the information provided and your knowledge of Generally Accepted Accounting Practice, discuss the audit risk issues that arise in relation to the audit of construction work in progress of KTL Limited for the year ended 31 October 2009. **[6 Marks]**
2. Draft the section of the audit plan of KTL Limited dealing with the audit of construction work in progress. **[10 Marks]**
3. Based on the information provided in respect of the company's activities, set out four laws or regulations that you would examine as part of your assessment of the company's compliance with law and regulation. **[4 Marks]**

**Total 20 Marks**

### Question 5.

You are a Partner in Byrne & Co. Incorporated Public Accountants. Your firm acts as Reporting Accountant to the Law Society for Murphy, Dunne and Heapy & Co., Solicitors, Main Street, Cork. Your staff have completed the field work in relation to the reporting accountant assignment for the year ended 30th June 2009. The following is a summary of matters appearing in the Partner highlights memorandum.

1. On the 10th July 2008, a cheque for €23,000 was drawn on the client current account and was issued to client B. The cheque represented a balance due to the client in respect of the sale of a property. Unfortunately the cheque was overstated by €3,000 due to a transcription error made when writing the cheque. This error did not come to light until a review of the client ledger balances revealed a debit balance on the client ledger card of €3,000 in July 2008. The client was contacted about the matter in September 2008 and after prolonged correspondence with the client the client repaid the amount in July 2009.
2. On the 20th April 2009 a client gave a cheque of €176,000 to Mr. Heapy a partner in the firm of Solicitors. The cheque represented fees of €3,000 due by the client to the solicitor firm and €173,000 to put the firm in funds to complete a property purchase on behalf of the client. On the 21st April 2009 Mr. White lodged the cheque to the office bank account. On receiving confirmation on the 26th April 2009 that the client cheque had been cleared by the drawer's bank Mr. Heapy transferred the client funds (€173,000) to the client deposit account. The receipt of the cheque was then recorded in the accounting records of the solicitor firm.
3. At the 30th June 2009, the total funds held in the client accounts maintained by the firm amounted to €1,230,789. Included in this figure was funds of €12,500 owned by Mr. Heapy, a partner in the firm. The accounting records show a liability to clients for funds held of €1,235,000 (excluding the liability to the partner Mr. Heapy of €12,500). Your staff has concluded that the funds held in the client account to discharge the liability to clients are materially correct.

4. The firm maintained a client ledger card for each client. On the credit side of the client ledger card a record of all client funds received from the client was maintained and on the debit side a record of all payments of client funds was maintained. A review of the client ledger cards has shown that debit balances appeared on numerous ledger cards during the year to 30th June 2009 but that all debit balances were corrected at the 30th June 2009.
  
5. When the firm pays outlay on property transactions on behalf of clients it will first transfer funds from the client account to the office account. On receipt of written confirmation from the bank that the inter account transfer is complete a cheque is drawn on the office account to discharge the outlay. The confirmation of the transfer is usually received by the firm two working days after the date of the transfer.

**Required:**

1. Outline the role of a Reporting Accountant to the Law Society as set out in the Solicitors Accounts Regulations, 2001 **[6 Marks]**
  
2. Prepare working papers demonstrating how you as Reporting Accountant would deal with each of the above matters in your report to the Law Society **[10 Marks]**
  
3. Write a brief note setting out the accounting records that are required to be maintained by a Solicitor firm in order to comply with the requirements of the Solicitor Accounts Regulations 2001 to 2006. **[4 Marks]**

**Total Marks 20**

**Question 6.**

1. Explain the purpose of the issuance to the Board of Directors of an audit findings letter (management letter) at the conclusion of an audit. **[4 Marks]**
  
2. Set out the typical matters you would expect an auditor to address in an audit findings letter. **[4 Marks]**
  
3. In respect of the following audit findings, draft the appropriate paragraphs (including recommendations) for inclusion in the audit findings letter that would address these matters:
  - a. Company does not maintain a fixed asset register.
  
  - b. The company has inadequate controls to ensure that the customer only pays for goods received.
  
  - c. The company has inadequate credit checks on new customers seeking to purchase goods on credit.
  
  - d. There is inadequate disclosure of directors' loans in the draft annual financial statements.

**[12 Marks]**

**Total Marks 20**