

Solutions to Advanced Audit September 2013

Solution 1

Part A

Degree of uncertainty increases the more into the future you go.

Size and complexity of organisation.

Nature and conditions of business.

Judgement about future is based on information available at the time of judgement but subsequent events could impact on outcome.

1 mark per point, total 4 marks.

Part B

Function of Audit Committee

- Increase assurance from internal controls and corporate governance
- Strengthen ability of external auditor to request changes in control system
- Review going concern issues

Any 2 relevant points, 1 mark each.

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Effectiveness

- Act as forum to resolve problems between directors and external auditors
- Review draft financial statements before presentation to the auditors and the executive board

Any 2 relevant points, 1 mark each.

Part C

Audit strategy

- outlines general strategy of audit
- Sets direction of audit
- describes scope of audit
- describes conduct of audit
- provides guidance for development plan

Audit plan

- more detailed document
- includes instructions to audit team that sets out audit procedures that auditors intend to adopt
- serves as means to control and record proper execution of audit work

Any 4 relevant points, 1 mark each

Part D

Random selection – all items in population have same chance of being selected.

Systematic selection – select items using a constant interval, first interval has random start.

Haphazard selection – alternative to random once auditor is satisfied that sample is representative of whole population.

Block selection – can be used to check whether certain items have particular characteristics.

Any 2 named and explained, 2 marks each

Part E

Computer assisted techniques are auditing techniques that were developed to assist the auditor in auditing in a computer environment.

They consist of two principal techniques;

1. The use of test data to test the operation of the client's programs.
2. The use of audit software (specially developed computer programs for use for audit purposes) to examine the contents and do work on the contents of the client's computer files.

Computer assisted audit techniques could be used in the audit of Save you money Limited in the following circumstances:

1. To test check the operation of the software used to record sales at the till.
2. To test check the arithmetical accuracy of reports produced by the computer system.

Any 4 relevant points, 1 mark each

Solution 2

1.

Risk affecting completeness

- The computer system does not record sales accurately and/or information is lost or transferred incorrectly from the ticket office computer to the accounts department computer.
- Cash sales are not recorded in the cash book; cash is stolen by the accounts clerks.
- Tickets are issued but no payment is received - that is the sale is not recorded.
- Cash is removed by the ticket office personnel, by the security guards or by the account clerks.
- The account clerks miscount the amount of cash received from a ticket office.

Any 4 relevant points 2 marks each, totalling 8 marks.

2.

Use of tests of controls and substantive procedures

Tests of controls

Tests of control are designed to ensure that documented controls are operating effectively. If controls over the completeness of income were expected to operate correctly, then the auditor would test those controls.

While controls could be in operation, e.g. the account clerks agreeing physical cash to computer summaries, there is no indication that the control is documented; that is the computer summary is not signed to show the comparison has taken place. The auditor could use the test of inquiry – asking the clerks whether the control has been used, and observation – actually watching the clerks carry out the controls. As noted above though, lack of documentation of the control does mean relying on tests of control for the assertion completeness of income has limited value.

Substantive procedures

Substantive procedures include analytical procedures and other procedures.

Analytical procedures include the analysis of significant ratios and trends and subsequent investigation of any trends or relationships that appear to be abnormal. These procedures can be used effectively in Fort Stillorgan as an approximation of income that can be obtained from sources other than the cash receipt records.

Other procedures, or tests of detail, are normally used to verify statement of financial position assertions and include obtaining audit evidence relevant to specific assertions. However, they could be used in Fort

Stillorgan to trace individual transactions through the sales/cash systems to ensure all ticket sales have been recorded (completeness assertion). The use of other procedures will be time consuming.

Any 3 relevant points, 2 marks each, totalling 6 marks.

3.

Disadvantages

Costs of credit cards

Ensure tickets printed have specific date or expiry date

Ensure tickets cannot be duplicated

Make sure system secure for paying online or danger credit card information could be compromised.

Advantages

Ensures less cash is handled

Will enable you to form two queues at check in, those with tickets and those without

Any 3 relevant points, 2 marks each

Solution 3

Audit Clearance Note - Company Mouse Ltd.

The approach adopted by the directors in relation to the valuation of long-term construction projects is not in compliance with Generally Accepted Accounting Practices (GAAP). Once it becomes clear that the company will make a loss on an individual contract the loss should be recognised at that time in the financial statements. GAAP requires that each contract the company is engaged in, be examined independent of other contracts in progress and that the accounting for these contracts be based on this separate examination. The outcome of one contract should not determine

the accounting treatment of another contract. Therefore I believe that the firm will have to qualify the financial statements, as the expected loss not provided for in the financial statements is material. I am proposing an adverse opinion based on the following wording:

"As more fully explained in note 1 no provision has been made for losses of €300,000 expected to arise on a long-term contracts currently in progress, as the directors consider that such losses should be off-set against amounts recoverable on other long-term contracts. In our opinion, provision should be made for foreseeable losses on individual contracts as required by IAS 11. If losses had been so recognised the effect would have been to reduce the profit before and after tax for the year and the contract work in progress at 31 December 2012 by €300,000 and €300,000 respectively.

In view of the effect of the failure to provide for the losses referred to above, in our opinion financial statements do not give a true and fair view in accordance with generally accepted accounting practice in Ireland of the state of the company's affairs as at 31 December 2012 and of its profit for the year then ended. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Companies Act 1963 to 2006." **5 marks**

Audit Clearance Note -Company Dog Ltd.

As this transaction breaches Section 31 of the Companies Act and the financial statements do not provide details of the transaction as required by the Companies Act 1990 the auditor is obliged to provide this information in his audit report. I would suggest you modify the audit report and provide the following information in relation to the transaction:

- a. Name of director who owes the loan to the company.
- b. Opening balance and closing balance on the loan account including capital and interest.
- c. The highest balance on the loan account during the accounting year.
- d. Details of any interest unpaid in respect of the loan.
- e. Details of any provision made in the financial statements for none repayment of the loan.

5 marks

Audit Clearance Note -Company Cat Ltd.

As our firm (auditor) has not attended the stock count at the year-end the firm (auditor) has not obtained sufficient and appropriate audit evidence required to express an opinion on the financial statements. Therefore a limitation of scope exists. In my opinion the effect of the limitation of scope is so material and pervasive that the auditor is unable to express an opinion on the financial statements and hence a disclaimer of opinion must be given in the audit report. The suggested wording for the audit opinion is: "We plan our audit so as to obtain all the information and explanation which we consider necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement whether caused by fraud or other irregularities or error. However, with respect to stocks having a carrying amount of €x, the evidence available to us was limited because we did not observe the counting of the physical stock as of 31 December 2012, since that date was prior to our appointment as auditors of the company. Owing to the nature of the company records, we were unable to obtain sufficient appropriate audit evidence regarding the stock quantities by using other audit procedures."

"In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements".

Qualified opinion arising from limitation in audit scope.

Except for the financial effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the physical stock quantities, in our opinion the financial statements:

Give a true and fair view in accordance with general accepted accounting practice in Ireland on the state of the company's affairs as at 31 December 2012 and of the profits for the year then ended and, have been properly prepared in accordance with the Companies Act 1963-2006.

In respect solely of the limitation of our work relating to stock:

- We have not obtained all the information and explanations that we consider necessary for the purpose of our audit and
- We were unable to determine whether proper accounting records have been maintained.

5 marks

Audit Clearance Note. Company Hamster

In this situation, we the firm (auditor) clearly disagree with the accounting treatment adopted in respect of the debtor of €35,780. We

must decide if our disagreement is so material and persuasive that the financial statements as a whole are misleading. In my opinion, this is not so and consequently an "except for" disagreement about the accounting treatment of debtors would be an appropriate audit qualification. The suggested wording for the qualification would be as follows:

Qualified opinion arising from disagreement about accounting treatment.

Included in the debtors shown on the balance sheet is an amount of €35,780 due from a trade debtor which in our opinion is unlikely to be paid. Company Hamster Limited has no security for this debt. In our opinion, full provision of €35,780 should have been made for this debt. Accordingly, debtors should be reduced by €35,780, tax by €4,473 and profits for the year and retained earnings should be reduced by €31,307. Except for the financial effects of not making the provision referred to in accordance with the preceding paragraph, in our opinion, the financial statements:

- Give a true and fair view in accordance with general accepted accounting practice in Ireland of the state of the company's affairs as at 31 December 2012 and its profits for the year then ended and
- Have been properly prepared in accordance with the Companies Act 1963-2006.

5 marks

Total 20 marks

Solution 4

1

Key industry and business information

- Margins for similar stores
- How many competitors
- Trends in industry
- **Any 2 relevant points, 1 mark each**

Main financial indicators

- Calculation of margins
- Calculation of sale stock
- Usage of rates of exchange

- What percentage of sales from what shops?
- Amount held in stock

Any 2 relevant points, 1 mark each

Operational and financial controls

1. Incorrect accounting treatment in respect of foreign currency in relation to acquisition of Stg£ denominated stock.
2. Demand for youth clothing would tend to be very fashion driven. There exists a danger that stock items could be prone to obsolescence. The overall high stock levels in all shops but in particular in the Wexford shop and Belfast shops is a cause for concern (see appendix 1).

Any 2 relevant points, 1 mark each

2

STOCKS – PROPOSED AUDIT PROGRAMME

Attend stock count at each shop location.

1. Before count
 - a. Obtain a good knowledge of the nature and location of the stock.
 - b. Ascertain the proposed count procedures to be utilised by client.
 - c. Obtain copies of stock take instructions.
 - d. Determine if stock is held at any other locations or if any third party stock is held on the premises.
2. During the stock count:
 - a. Observe the manner in which count is carried out. Is it accurate and complete?
 - b. Take test counts (sheet to floor, floor to sheet).
 - c. Document test counts
 - d. Ensure any units of measurement used are correct.
3. After count:
 - a. Get cut off information.
 - b. Copy stock sheets and retain copies on audit file.
4. Write up the stock report and conclude on stock count.

Final Audit.

1. Perform analytical review on stocks.

- a. Current year stock levels by line item to prior year.
 - b. Number of months of sales at cost on hand.
 - c. Stock turnover in period. Stock as a % of total assets.
 - d. Application of 80/20 rule to determine where value of stock lies.
2. Tie out copies of sheets to final valued sheets.
 3. Check tots, extensions, carry forward figures and summary sheets.
 4. Tie out stock sheet values to supplier invoice on FIFO basis.
 5. Determine if NRV is an issue.
 6. Consider the danger of stock losses due to fraud? Does reasonable evidence exist that losses due to fraud and pilferage are not material.
 7. Examine slow moving stocks and calculate any provisions needed.
Work could include:
 - a. Compare 2012 sheets to 2011 sheets to identify slow moving items.
 - b. Identify spring and summer 2012 stock not sold at year-end.
 - c. Request staff to identify slow moving stock.
 - d. Observation test at stock take.
 - e. Age of stock evidence presented by FIFO test.
 8. As there are indications that excess stock may arise particular attention should be paid to slow moving / obsolete stock in the Wexford and Belfast shop.

Any 6 points, 1 mark each

3

- The inclusion of stock purchased in Stg£ should be recorded in €s at the transaction rate and as stock is a non-monetary asset no retranslation at year-end is required.
- It would be important that the audit work checked that the recording of the stock was in accordance with this requirement.

3 marks

4

- Our work to establish the company's compliance with law and regulation is likely to be extended as the company will have to comply with laws in the North of Ireland as well as the laws in the Republic of Ireland.
- This will require that the auditor establish what North of Ireland laws will most impact the company and check that the company has complied with these laws.

▪

3 marks

Appendix 1.

Sales	Sales less margin	Stock	Days stock on hand
€/Stg£	€/Stg£	€/Stg£	
€1,120,345	€840,259	€120,546	52
€1,105,456	€829,092	€102,564	45
€780,654	€585,491	€80,543	50
€702,546	€529,910	€154,463	106
€564,235	€423,176	€54,645	47
£589,654	£442,241	£156,453	129

Total Marks 20

Solution 5

1

- In the period up to the date of the audit report the auditor has a responsibility to perform audit procedures so as to identify all subsequent events that may require adjustment or disclosure.
- In the event that the auditor finds that there are matters that are not accounted for correctly the auditor will have to consider the implication for his audit report.
- If the matters are material the auditor may have to issue an except for qualification or in an extreme situation an adverse opinion.

Any 3 relevant points, 2 marks each

2

Suggested audit procedures

1. Review books and records of the company in the post balance sheet period.
2. Visit the client's premises and obtain a briefing from management on the affairs of the company.
3. Review company's order book in the post balance sheet period.
4. Obtain written representations from management that all potential matters arising were disclosed to the auditor.

Any 4 relevant points, 2 marks each

3

- The auditor becomes aware of the liquidation of Soft Co Limited after signing of the audit report but before the issue of the financial statements to the members of the company.
- In this time period "ISA – Subsequent Events" states that the auditor has no responsibility to perform audit procedures to identify

subsequent events but if the auditor becomes aware of a fact that may materially affect the financial statements the auditor should consider whether the financial statements need amendment, discuss the issue with management and take appropriate action.

- Therefore the auditor of Tiny Homes Limited will need to consider the implications for the financial statements of the liquidation of Soft Co Limited, discuss this matter with the Board and take appropriate action on foot of this work.

Any 2 relevant points, 2 marks each

4

- If the matter had taken place on the 10th August 2013 the financial statements would at that point be issued to the members. In that situation "ISA – Subsequent Events" states that the auditor has no obligation to make any inquiry regarding such financial statements.
- It is then stated that if the auditor becomes aware of a relevant fact that would have caused a different audit report if known at the date of issue of the report, then he should discuss the issue with management and take the action appropriate. It is suggested that legal advice may be needed if management refuse to take any action in relation to the matter. The ISA also points to the rights of the auditor in Ireland to address the AGM and suggest that this could be considered. As the guidance provided by the ISA is slightly ambiguous the matter will ultimately be a matter of judgment for the auditor having taken advice.

(2 marks)

Total Marks 20

Solution 6

1)

- audit partner rotation
- not too familiar with clients, can't have been years as audit manager and the audit partner on job
- role of earning and generating fee income to support paying staff
- networking
- ensure independence is paramount – clear separation between audit and other services
- relating to audit partners
- applying a professional attitude to publicity and the promotion of the audit services offered by the firm

Any 3 relevant points, 2 marks each and 1 mark presentation

2)

Opportunities

- Liquidation and insolvency services
- Personal bankruptcy / financial and debt management
- Online business services
- Make use of social media

Any 2 relevant points, 1 mark each

Industry threats

- Less money available
- Increased amount of firms able to avail of audit exemption
- More competition as internet makes more firms available
- **Any 2 relevant points, 1 mark each**

My contributions

- Personal touch, increased networking
- Develop social media plan and introduce twitter, facebook and linkedin
- Become experts for new debt forgiveness and insolvency arrangements in Ireland
- **Any 2 relevant points, 1 mark each**

3)

- Liaise with colleges to discuss key attributes needed in audit juniors
- Arrange meeting with accounting bodies to discuss key attributes needed in audit juniors
- Set up a mentoring service

- Try and introduce work experience for junior auditors and training the summer they leave college before they start in roles
- Introduce work experience opportunities throughout college to ensure you chose best candidates who want to be in job
- Ensure computer skills training in CAATS and social media tools
- Ensure personal development opportunities
- Ensure networking opportunities

Any 7 relevant points, 1 mark each