



Professional 2 – Module 7

Auditing

August 2012

Instructions to Candidates:

1. **There are 7 questions on this examination paper.**
2. **Answer Question 1 and any 4 other questions.**
3. **All questions carry equal marks.**
4. **Include all workings with your answers.**

Time Allowed: 3 Hours

Question 1

Answer each of the following:

- a) The auditor can obtain information necessary to gain an understanding of the entity from internal and external sources. In respect of contextual financial information, identify two internal sources and two external sources where the auditor can obtain information for the purposes of his audit.

4 marks

- b) Define any two of the components of the audit risk model as set out in International Standards on Auditing (UK and Ireland) 200 Objective and General Principles Governing an Audit of Financial Statements and establish the linkage between the components.

4 marks

- c) An auditor must be viewed as completely objective. Describe four matters that may threaten or appear to threaten the independence of the auditor.

4 marks

- d) What is the purpose of a letter of engagement? Include 4 issues that should be included in the letter in your answer.

4 marks

- e) Briefly outline the provisions in ISA 260 setting out the auditor's responsibility to report breaches of the law or regulations to the responsible authorities.

4 marks

Total 20 marks

Question 2

Your school friend Mary Burke has recently established a company Happy Babies Limited to manufacture healthy ready made baby meals. The company employs three people and Mary expects to have a turnover of €500,000 in the first twelve months trading. The total assets of the company are likely to be in the region of €70,000. She has approached you for advice in relation to her obligations to prepare financial statements for the company. She has requested that you provide her with specific guidance on the matters set out below:

Required:

1. Briefly outline Mary's obligations as a company director in relation to keeping accounting records and preparing financial statements. **(4 Marks)**
2. Outline any requirement to have the financial statements of the company audited and any exemption from the audit requirement that exists in the Republic of Ireland. **(4 Marks)**
3. Describe the type and content of report that an Accountant / Auditor issues in an audit assignment and in a financial statement compilation assignment and explain the fundamental difference between these two reports in terms of assurance provided to the shareholders in the company. **(8 Marks)**
4. Set out two advantages that accrue to a company from having their financial statements audited by an independent auditor. **(4 Marks)**

Total 20 marks

Question 3

- a) ISA 315 states that the auditor should use professional judgement to assess the risk of material misstatement. Describe five risk factors relating to inventory. **10 marks**
- b) What principal controls should an organisation have in place to establish the existence of inventory? **4 marks**
- c) What substantive tests would the auditor perform to confirm the valuation of inventory? **6 marks**

Total 20 marks

Question 4

Your firm is the auditor of Brill Fencing, a company operating three large centres which sell decking, wooden offices and wooden furniture (such as garden benches, seats and playhouses) to the general public. You are involved in the audit of the company's non current assets. The main categories of non current assets are as follows:

- i) Land and buildings (all of which are owned outright by the company, none of which are leased)
- ii) Computers (on which an inventory control and sales system is operated)
- iii) A number of large and small vans, mostly used for the delivery of inventory to customers
- iv) Equipment for packaging and pricing products.

The company holds records of these assets on a computerised non current asset register.

The depreciation rates used are as follows:

- i) buildings 10% each year on cost
- ii) computers and motor vehicles 20% each year on the reducing balance basis
- iii) equipment 12% each year on cost

You are concerned that these depreciation rates may be inappropriate.

Requirement:

a) Explain the main risks associated with financial statement assertions relating to non current assets. **4 marks**

b) List the sources of evidence available to verify the ownership and cost of:

- i) the land and buildings
- ii) the computers and motor vehicles. **10 marks**

c) List the procedures you would perform to check the appropriateness of the depreciation rates on each of the three categories of non current assets.

6 marks

Total 20 marks

Question 5

You are the audit senior at Smith & Jones accountants and auditors. Your boss Tom Smith has asked you to take over the management of the audit of Pear Ltd., a health drink supplier and a client of the firm for the last three years. The audit is for the year ended 31 December 2011. Bob Brown, an audit junior is responsible for the audit of accounts payable and he has asked for your guidance on the audit of trade creditors which he is about to begin. He has drawn up the following working paper:

<u>Pear Ltd. - Accounts payable reconciliation</u>			€
Balance per accounts payable listing			874,000
Balance per suppliers' statements - 29 December 2011			<u>1,354,000</u>
Difference			<u>480,000</u>
<i>Reconciling items:</i>			
Payments made not on statement			(€320,000)
Invoices on statement not on ledger			
29/12/11	Creditor Mr Jones Invoice No. 1563	€270,000	
30/12/11	Creditor Mr Smith Invoice No. 1762	€180,000	
30/12/11	Creditor Mr Burke Invoice No. 1921	<u>€125,000</u>	<u>€575,000</u>
Difference unexplained			<u>€225,000</u>

The accounting records (including accounts payable records) are maintained by Mrs Byrne who is a trusted employee who has worked for Pear Ltd for 25 years and is approaching retirement. No work has yet been done by Bob to audit the accounts payable figures.

Requirement

- Outline the performance indicators the auditor would look at for the accounts payable cycle. **4 marks**
- Outline the specific substantive tests that the auditor will perform (i) on the overall listing of the creditors control account and (ii) to investigate the unexplained difference noted in the draft reconciliation. **10 marks**

- c) Draft a paragraph for the letter to management suggesting the management controls you would expect to see over accounts payable in Pear Ltd. **8 marks**

Total 20 marks

Question 6

“Audit evidence” is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Therefore, the gathering of audit evidence is a fundamental step in the audit process.

Requirement

In respect of International Standards on Auditing (UK and Ireland) 500 Audit Evidence, you are required to:

1. Set out five procedures that International Standards on Auditing (UK and Ireland) 500 identify for gathering audit evidence and illustrate the application of these procedures by way of examples. **10 marks**
2. Using assumed data, prepare a work paper for an audit test that documents the use of one of the audit evidence gathering procedures outlined in 1 above in the sales cycle of an audit client who has a group of retail shops. The work papers should adhere to best practice in relation to the documentation of audit evidence. **5 marks**
3. Indicate three factors that would be relevant in judging the reliability of audit evidence. **5 marks**

Total 20 marks

Question 7

(a) What are the principal matters that are addressed in an unmodified auditor's report? **6 marks**

(b) In the audit of a limited company, who is the audit report addressed to **2 marks**

(c) What is a "limitation of scope" of the auditor's work? Provide an example of the possible implications of a limitation of scope on the content of the audit report. **6 marks**

(d) Explain, supported by an example, what is meant by the term "emphasis of matter". **6 marks**

Total 20 marks

End of paper