



# Auditing Module 7 June 2009

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

Instructions to Candidates:

Answer Question 1, and any other 4 questions.  
All questions carry equal marks.  
Include all workings with your answers.

Time Allowed: 3 Hours

### Question 1

Provide brief answers to each of the following short form questions:

1. Explain what is meant by the terms “substantive tests” and “tests of controls”. Illustrate your answer with one example of each kind of test.  
**[4 Marks]**
  
2. International Standards on Auditing (UK and Ireland) 500 describes a number of different audit procedures for obtaining audit evidence. Outline how you would use three of these procedures as part of a statutory audit of a limited company.  
**[4 Marks]**
  
3. What is a “management letter”? Outline its purpose and likely content.  
**[4 Marks]**
  
4. An auditor’s objectivity must be beyond question. Describe four matters that may threaten or appear to threaten the independence of the auditor.  
**[4 Marks]**
  
5. Explain, with examples, what is meant by the term “analytical procedures” and indicate when analytical procedures are used in the audit of company accounts.  
**[4 Marks]**

**Total Marks 20**

## Question 2

Mary Walsh has recently established a new retail business. The business is not incorporated and is likely to have an annual turnover of between €200,000 and €250,000 per year. Mary has obtained advice from a mentor that she should not incorporate a limited liability company to run her new business on the basis that she will have to have an annual audit of the company's financial statements. She has asked you to prepare a memorandum for her in which you would address the following matters:

1. What is an audit? **[4 Marks]**
2. Who can audit the accounts of limited companies? **[4 Marks]**
3. What are the duties of (a) the Auditor and (b) the Directors in relation to the annual accounts of a company? **[6 Marks]**
4. Explain the statutory requirements for an audit of a limited company, the circumstances in which there are exemptions from the audit requirement, and the requirements where the exemption is availed of. **[6 Marks]**

## Question 3

You are the Audit Senior assigned to the audit of the financial statements of Sparrow Limited for the year ended 31 December 2008. Sparrow Limited operates two pharmacy outlets in Carlow and Kilkenny. At 31 December 2008, the company owed the sum of €795,254 to its trade creditors. Ninety per cent of the balance owing was to three principal suppliers to the company. The company's accounting department employs one person and all major accounting functions are carried out by this person. Due to low staffing levels within the company, there is an absence of strict segregation of duties within the company. The audit plan has set out an audit strategy that does not place any reliance on the company's accounting and internal control systems.

You are required to:

1. Design a programme of audit tests that you will conduct as part of the final audit (balance sheet audit) of the trade creditors balance included in the balance sheet as at 31 December 2008. **[15 Marks]**
2. Suggest five controls that you believe should be incorporated into a trade creditors system to ensure that all transactions are recorded and are recorded accurately. **[5 Marks]**

**Total Marks 20**

#### **Question 4**

You are the auditor to Blackbird Limited. In the early 1990s, an employee of the company stole a large amount of money from the company. The Managing Director of the company is very concerned that all possible steps should be taken to prevent such an event happening again in the future. At a recent meeting you attended with the Managing Director he indicated that in his opinion the principal role of the annual audit is to detect fraud. His misunderstanding of the role of the auditor is causing you concern and you have decided to write a letter to him setting out the responsibilities of the auditor in respect of the detection of fraud.

#### **Requirement:**

Draft the letter and include the following specific points:

1. the respective duties of directors and auditors in relation to the prevention and detection of fraud.
2. The approach the auditor should take in discharging his responsibility in relation to fraud.
3. Steps the auditor should take where he becomes aware of suspected or actual instance of fraud.

**[20 Marks]**

**Question 5**

You are auditor to Robin Limited. Robin Limited manufactures widgets. You obtain the following schedule in support of the fixed assets figure in the financial statements for the year ended 31 December 2008.

	<b>Factory Buildings (Freehold)</b>	<b>Plant</b>
<b>COST</b>	€	€
As at 1 January 2008	1,200,987	765,789
Additions	<u>0</u>	<u>333,900</u>
As at 31 December 2008	<u>€1,200,987</u>	<u>€1,099,689</u>
<b>ACCUMULATED DEPRECIATION</b>	€	€
As at 1 January 2008	112,000	412,987
Charge for period	<u>25,000</u>	<u>201,987</u>
As at 31 December 2008	<u>€137,000</u>	<u>€614,974</u>

**Details of Additions:**

<u>Supplier</u>	<u>Description</u>	<u>Cost</u>
Black Ltd	Widget machine	€200,000
Good Ltd	Automatic insertion machine	€133,900

**Depreciation rates:**

Freehold Buildings:	2.5% straight line
Plant	20% reducing balance

For audit efficiency reasons, it was decided that a purely substantive approach should be followed in the audit of fixed assets.

**Required:**

1. Set out an audit programme of tests that you would undertake in respect of the audit of fixed assets and depreciation. **[12 Marks]**
2. What are the audit implications of the use of reducing balance depreciation for Plant? **[3 Marks]**
3. Prepare a working paper to demonstrate how you would document both the audit procedures undertaken and audit evidence collected in relation to the ownership of the factory building. **[5 Marks]**

**Total Marks 20**

(Candidates should assume any necessary information required to complete the working paper).

### Question 6

1. Explain what is meant by the term “going concern assumption” in the preparation of financial statements. **[6 Marks]**
2. Outline the responsibility of the Board of Directors in relation to the application of the going concern assumption in the preparation of the financial statements. **[6 Marks]**
3. Outline the auditors responsibility in relation to the application of the going concern assumption in the preparation of the financial statements **[8 Marks]**

**Total Marks 20**

### Question 7

In planning an audit of a company’s financial statements, it is important that the auditor undertake an audit risk assessment. Such an assessment allows the auditor to identify the areas where material misstatement of the financial statements is most likely to occur. Audit risk has been categorised into:

1. Control risk
2. Inherent risk
3. Detection risk

You are required to:

1. Define audit risk, control risk, inherent risk and detection risk . **[4 Marks]**
2. Explain, using an example, the inter-relationship that exists between the three elements of risk identified above. **[4 Marks]**
3. Indicate how this interrelationship would influence your audit work of sales revenue of a high volume low value retailer. **[6 Marks]**
4. Explain the factors that affect inherent risk in an audit. **[6 Marks]**

**Total Marks 20**