



Professional 2 – Module 7

Auditing

Monday, 25th. May 2015

10am – 1pm

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 answer

- Time Allowed: 3 Hours

Question 1 (This question must be attempted)

- a) Explain the purpose of an audit engagement letter **(4 marks)**
- b) Auditors perform their work in strict compliance with a code of ethics. Identify two elements covered by the IIPA ethical code. **(4 marks)**
- c) Bob Fried, the Training Partner of your audit firm explained to the new staff that for their large clients both an interim audit and a final audit is carried out. Explain the difference between the two types of audit and the reasons for using the two types of audit. **(4 marks)**
- d) ISA 530 Audit Sampling: Explain what is meant by audit sampling and why it is needed in the case of an audit. **(4 marks)**
- e) Describe four elements of an unmodified auditor's report. **(4 marks)**

Total 20 marks

Question 2

Mergrape Limited is a wine distributor that has traded for the last ten years. The company is financed through a combination of share capital contributions and debt in the form of loans and an overdraft. The year end is 31 January 2015. Mergrape has performed very well over the last few years especially through their organic wine range. A new competitor, Grapevine Limited, is a well-established bulk buyer and seller of wine in the UK and entered the Irish market in summer 2014. Supervalu (a large supermarket chain) has moved its wine purchasing business from Mergrape Ltd to Grapevine Limited since November 2014 which represents a loss of 15% of their sales revenue. On 14 February 2015, David Smith the Mergrape wine taster and a key employee who goes to all important Trade Shows and selects the wine for Mergrape moved to Grapevine. He explained he felt bad about the move but at a 50% pay increase and a company car it was an offer he could not refuse. At the moment, the Managing Director, Tom Savvy, has temporarily taken over this role. Tom recognizes that in order to survive and prosper the company must continuously supply new product lines and with that in mind they would like to introduce non-alcoholic wine to their product offering. They have managed to open discussions with one of their suppliers in France who agreed if Mergrape puts up 50% of the investment they will produce and supply non-alcoholic wine to Mergrape on an exclusive basis. The costs are significant, €10 million in total, so Mergrape needs to find €5 million for this to happen.

The shareholders were consulted but they have declined to invest more. The good news is that the company's loans are nearly repaid with only three years remaining and €250,000 owing. The bank overdraft of €65,000 is up for renewal in two months and Tom is confident this is merely a formality and should not cause any problems.

The cash budget for the next twelve months is worse than the previous three years but Tom is confident if the new product comes on stream by 2017 this will solve the problem and he does not feel it is necessary to make any disclosures in the financial statements regarding going concern.

At the end of the year a customer who slipped on a wet floor back two years ago has put in a legal claim for €200,000 against the company as she said she has been unable to work since the incident with severe back pain. Mergrape vaguely remember a fall but have no record of it.

Required:

- a) Identify and explain four potential indicators that Mergrape is not a going concern. **(8 marks)**
- b) Describe the audit procedures that you would perform to assess if Mergrape is a going concern. **(8 marks)**
- c) If the bankers do not make a decision until after the year end on the renewal of the overdraft describe the impact on the audit report if the going concern is subject to material uncertainty. **(4 marks)**

Total 20 marks

Question 3

Toys for All, a company that sells children toys is planning to list on the Irish Stock Exchange within the next nine months. Management understand there are corporate governance requirements to fulfill and are looking at the possibility of establishing an audit committee. They are thinking of approaching Tom Burke (the audit partner in Jones and Co, the auditors) to serve on the committee. Tom does not take part in the audit of Toys for All but is a good friend of the audit partner, Dick Jones. They propose to pay Tom a fixed fee for his services.

Required:

- a) Explain to Toys for All the role of an audit committee and the benefits of setting one up. **(12 marks)**
- b) Discuss the advantages and disadvantages of appointing Tom Burke to the audit committee. **(8 marks)**

Total 20 marks

Question 4

1. Explain the purpose of an auditor preparing an audit strategy or plan.
(4 marks)

2. Describe the matters you would expect to be addressed in a typical audit plan.
(6 marks]

3. Using assumed data in relation to a fictitious trading company, draft the section of an audit plan dealing with the audit of the company's trade debtors in the situation where some reliance will be placed on the system of internal controls.
(10 marks)

Total 20 marks

Question 5

You are the Auditor in charge of the audit of the financial statements of Bellissimo Limited for the year ended 31 December 2014. Bellissimo Limited operates three restaurants in Dublin. The company's accounting department employs three staff who perform all major accounting functions. The company uses a computerised accounting system which is interfaced with a central reservations system and the catering and beverage tills in each restaurant. Due to low staffing levels there is an absence of strict segregation of duties within the accounting and financial management functions of 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. The company's freehold properties are included on the company's balance sheet at cost and depreciated over 40 years. The other fixed assets are furniture and fittings, crockery and linen, and motor vehicles.

Required:

- a) What steps can the management take to compensate for the lack of proper segregation of duties in the accounts department?**(5 marks)**

- b) Design a programme of audit tests that you will conduct as part of the final audit (balance sheet audit) of the fixed assets included in the balance sheet as at 31 December 2014.
(9 marks)

- c) Explain how your programme of work would differ if the company adopted an accounting policy of including the hotel properties on the balance sheet at a valuation.
(3 marks)

- d) Comment on the audit issues that might arise in respect of depreciation policies used by Bellissimo Limited for crockery and linen and for motor vehicles.
(3 marks)

Total 20 marks

Question 6

In respect of each of the three scenarios set out below, provide concise answers (not more than 100 words) to the questions that follow.

Scenario 1

You are auditor to ABC Limited, undertaking the audit of the financial statements for the year ended 30 June 2014. You have completed your analytical procedures and have identified that the period of credit allowed to customers has grown from an average period of 22 days in the year ended 30 June 2013 to an average period of 100 days in the year ended 30 June 2014.

Required:

Set out how you, as auditor would respond to the above findings and outline what type of substantive procedures you would consider appropriate in the circumstances. **(6 marks)**

Scenario 2

During the course of the audit of the financial statements of Bags Limited for the year ended 30 June 2014, you have obtained information that suggests that a building purchased by the company in 2007 has become impaired.

Required:

Set out the responsibilities of the directors and the auditor with respect to the possible impairment of the premises. **(6 marks)**

Scenario 3

You are the partner in charge of the audit of Toxy Limited for the year ended 30 June 2014. You have a concern that there could be liabilities that are not recorded on the company's balance sheet at the 30 June 2014.

Required:

Discuss the audit procedures you would undertake to satisfy yourself that the financial statements of the company were not materially misstated due to the under-recording or non-recording of liabilities. **(8 marks)**

Total 20 marks

Question 7

You are the audit senior on the audit of Pamela Jones Ltd which sells high quality women's clothes. The audit is due to start in two weeks and you have been given the following information:

Significant risk

The finance director has explained that sales have slowed down over the last nine months. This is due in the main to the new trend to buy online and the opening of several large UK chain stores in the local shopping centre. The finance director is concerned about the appropriateness of the year end stock valuation of €1.5 million which is material to the financial statements.

Internal Control

The finance director has let you know that one of the accounts team Mary has been ill and absent from work for the last seven months. Her duties include monthly supplier reconciliation statements and reconciling the tills daily. This work has not been done in her absence.

Required:

- a) Outline the approach you would adopt to address the significant risks identified in relation to inventory **(6 marks)**

- b) Discuss the impact of the absence of Mary and identify and discuss what financial statement areas and assertions may be impacted.

(14 marks)

Total 20 marks

End of paper