



Institute of Incorporated Public Accountants

Professional 2 – Module 7

Auditing

Monday 27th May 2013

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

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

1. ISA 200 outlines the overall objectives for the independent auditor in the audit of financial statements. Outline the audits two main objectives in conducting and audit.

4 marks

2. Outline four types of opinion an auditor could give in their reports and explain when an adverse opinion may be provided.

4 marks

3. Explain the purpose of an auditor preparing an audit strategy or plan.

4 marks

4. Explain, with examples, what is meant by the terms "inherent risk" and "control risk". Outline how the level of these components of audit risk would influence the level of audit testing an auditor would undertake.

4 marks

5. Outline four methods of gathering audit evidence that are available to the auditor and give an example of an audit procedure that illustrates the use of each method.

4 marks

Total 20 marks

Question 2

Toys are Us Limited, a company owned by Mr and Mrs White is based in Tullow Co Carlow and employs five people. The company manufactures toys and sells them directly to shops in the greater Dublin region. Due to old age, Mr and Mrs White no longer take an active part in the management of the business and rely on two long standing employees (John McCann and Mary Duffy) to manage the company. You are a member of the audit team assigned to the audit of the financial statements of Toys are Us Limited for the year ended 31 December 2012. You have established the following facts about the trade accounts receivable (debtors) of the company as at 31 December 2012.

- a. The company's annual turnover for 2012 is €1,254,000.
- b. The company has forty customers and the sale of product is evenly spread among this customer base.
- c. At 31 December 2012, the trade accounts receivables amounted to €454,635.
- d. The company gives 30 days credit to all customers. The average period of credit taken by customers in 2012 was 60 days and this represented an increase of ten days over the average credit taken in 2011. The company attributes this increase to the current recession in the retail sector for toys and to the seasonable nature of the business.
- e. John McCann is responsible for the despatch of stock to customers and the issue of sales invoices to customers. John records all despatches in a goods despatch book at the time the goods leave the factory. He prepares a sales invoice for the quantities shown in the goods despatch book and sends the invoice to the customer's head office. A copy of the sales invoice is passed to Mary Duffy in the accounts department.
- f. Mary Duffy is responsible for maintaining the accounting records and for credit control.
- g. The customers usually pay by cheque. The cheques are normally mailed to the company but a small number of customers deliver the cheques to John in the factory warehouse.
- h. Mary Duffy opens the post each morning and immediately lodges all cheques received.
- i. No monthly management accounts are prepared. Mr and Mrs White receive regular briefings by Mary and John on the progress of the company pending receipt of the audited accounts six months after the year end.

Required:

1. Based only on the information provided state if you consider it appropriate to undertake tests of control as part of your audit strategy in respect of the audit of trade accounts receivable. You should provide a clear justification for your answer. **3 marks**

2. Make appropriate recommendations in relation to the procedural changes that you consider desirable from an internal control perspective. **5 marks**

3. (a) Prepare a working paper based on the information given that analyses the performance indicators relevant to trade accounts receivable and identifies the effect of the analysis on the nature and extent of substantive audit testing. **4 marks**

(b) Outline an appropriate substantive audit test that you would undertake to obtain audit evidence in respect of the valuation of trade accounts receivable at the 31 December 2012. Indicate the level of testing you would apply based on the information provided. **3 marks**

4. Set out the audit approach you would follow to establish that the physical cut off of goods is correctly reflected in the accounting records of the company. **5 marks**

Total 20 marks

Question 3

You are the auditor to Bird Feeders Limited. In the early 2000s, 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.

Required:

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/she becomes aware of suspected or actual instance of fraud.

20 marks

Total 20 marks

Question 4

You are the auditor in charge of the audit of the financial statements of XYZ Limited for the year ended 31 December 2012. XYZ Limited operates a hardware store in Blackrock, Co Dublin. XYZ Limited plans to ascertain the quantity of stock on hand at 31 December 2012 by undertaking a full physical stock count of all stock on hand as at 31 December 2012. The company does not maintain any stock records. You will attend the stock take on behalf of your firm at 31 December 2012 in order to undertake audit procedures to satisfy yourself as to the accuracy and reliability of the stock take on that date.

Required:

1. Design a programme of audit tests that you will conduct as part of your attendance at the physical stock count on 31 December 2012. The programme should include the relevant procedures to be applied before, during and after the count.
10 marks
2. Describe the cut-off information you would obtain during your attendance at the physical stock count.
4 marks
3. State how you would use the cut off information obtained to establish the accuracy of the accounting cut off at the 31 December 2012.
6 marks

Total 20 marks

Question 5

The financial reporting standards state that financial statements should be prepared on the basis that the company is a going concern unless it is not appropriate to do so. In relation to the going concern concept:

1. Briefly explain, with examples, what is meant by the "going concern concept" **4 marks**

2. Explain, in detail, the responsibilities of company directors and the auditors in relation to the application of the going concern concept. **6 marks**

3. Outline the audit procedures (in the format of an audit work programme) for the audit of the application of the going concern concept to a set of company financial statements. **10 marks**

Total 20 marks

Question 6

You are an audit senior assigned to the annual audit of Chocolate Limited. During the course of the audit of the financial statements for the year ended 31 December 2012, you examine the following documents:

1. Accounting records for the period immediately after 31 December 2012.
2. Supplier invoices in respect of machinery purchased on the 31 July 2012.
3. Budgets and financial projections for the audit client in respect of the next financial year.
4. Minutes of meetings of directors and shareholders.
5. A lease agreement in respect of a finance lease entered into by the audit client on the 10th January 2013.
6. The company's fixed asset register.
7. A computer report that shows the age of the stock on hand as at 31 December 2012.
8. Invoices from the company's solicitor for legal fees incurred.
9. Company's annual return to the Revenue Authorities of wages paid in 2012 (Form P35).
10. Record of employee holiday entitlements due as at 31 December 2012.

Required:

In respect of each document state:

1. The purpose of the auditor examining the document
10 marks
2. The information that the auditor would specifically look for in examining the document.
10 marks
Total 20 marks

Question 7

You are the audit senior on the audit of Travel Solutions Ltd, a medium sized travel company that has operating in Ireland and France. You are responsible for auditing the payroll for the year ended 31 December 2012.

Payroll costs for the six months ended 30th June 2012 were €4,500,600 and for the six months ended 31 December 2012 €4,680,800. For the year ended 31 December 2011 the payroll costs were €8,560,700. Salary reviews take place on 30th June each year and a 10% increase was awarded in 2012. No increase was given in 2011. Employee numbers have been constant for some years but dropped by 5% on 1 July 2012 as one division of Travel Solutions Ltd was closed down. Travel Solutions outsource their payroll to PayLess Ltd, a payroll provider. At the end of each month Travel Solutions Ltd emails the payroll information to PayLess Ltd and PayLess Ltd send a report back to Travel Solutions Ltd telling them what to pay their employees.

Required:

1. On the basis of the information provided, describe the substantive analytical procedures you would perform to assess the accuracy of the payroll costs for the period 30 June 2012 and 31 December 2012. **10 marks**
2. Outline two concerns you would have regarding the payroll outsourcing and the audit work you would perform for these concerns. **10 marks**

Total 20 marks

End of paper