

Audit Solutions May 2013

Solution 1

1.

- In conducting an audit of financial statements, the overall objectives of the auditor are:
- To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; **2 marks**
- and
- To report on the financial statements, and communicate as required by the ISAs (UK and Ireland), in accordance with the auditor's findings. **2 marks**

4 marks

2.

Unqualified, qualified, adverse or disclaimer. **2 marks**

An adverse opinion is issued when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of her report is not adequate to disclose the misleading or incomplete nature of the financial statements.

2 marks

3.

- The purpose of an auditor preparing an audit strategy/plan is to ensure that the audit engagement is performed in an effective manner.
- Good audit planning work will ensure that the auditor understands the entity to be audited and its environment and that appropriate audit risk assessment is undertaken.
- The audit planning work will focus on designing audit tests to respond to the level of audit risk identified.
- By undertaking the testing, the auditor hopes to reduce the overall audit risk to an acceptable level. **4 marks**

4.

The term "inherent risk" means the susceptibility of an account balance or class of transactions to material misstatements either individually or when aggregated with misstatements in other balances or classes irrespective of related internal controls.

The term "control risk" is the risk that a misstatement that could occur in an account balance or class of transactions and that could be material,

either individually or when aggregated with other misstatements in other balances or classes would not be prevented or detected and corrected on a timely basis, by the accounting and internal control system.

The level of inherent risk and control risk will have an influence on the level of audit testing to be undertaken. Audit risk consists of inherent risk, control risk and detection risk. Detection risk is the only component of audit risk that the auditor can influence. If the level of inherent risk and control risk is high, the auditor will aim to reduce detection risk and will do this by increasing the level of audit testing he undertakes.

4 marks

5.

The four methods that are available to the auditor of gathering audit evidence are:

1. Inspection of tangible assets.
Example- fixed assets inspection undertaken to determine the existence of fixed assets.
2. Recalculation.
Example- recalculating the accruals to determine the accuracy of the accrual
3. Confirmation.
Example- obtaining bank confirmation letter to verify the bank balances at year end
4. Inspection of records or documents.
Example- vouching of entries in the nominal ledger to supplier invoices to determine accuracy of entry.

4 marks

Solution 2

1.

It would not be appropriate to undertake tests of control as part of the audit strategy in respect of the audit of trade debtors of White Limited. It is clear from the information provided that there is an absence of segregation of duties / division of responsibilities in the company. The fact that one individual carries out the function of maintaining the records and taking physical custody of assets (receipts of cheques) means that where controls are in place, they could be circumvented by the employee concerned.

Therefore the auditor will not plan to place reliance on internal controls.

3 marks

2.

Due to the small number of staff in the company, the absence of complete segregation of duties will be a negative in relation to internal control. Notwithstanding this, the following procedural changes may assist in improving internal control within the company:-

- John Mc Cann should be made responsible for the dispatch of stock and Mary Duffy should be made responsible for the preparation of sales invoices to customers
- The post should be opened by Mary Duffy in the presence of John Mc Cann and a list of all cheques received should be immediately prepared and signed by both Mary Duffy and John Mc Cann as evidence of completeness.
- Customers should be instructed not to deliver cheques to John Mc Cann in the factory warehouse but be instructed to post all cheques to the company.
- The company should consider engaging an outside accountant to prepare monthly management accounts which will facilitate monitoring of the company's performance on an ongoing basis. Formal credit control procedures should be established.

5 marks

3.

a)

AUDIT WORKING PAPER

ABC Auditors
CLIENT: Toys are Us Limited
date:

Prepared by & date:
Reviewed by &

ACCOUNTING PERIOD: 31 December 2012.

Accounts Receivable

TEST

To analyse the performance indicators relevant to accounts receivable.

Year end accounts receivable = 454,635

Sales = 1,254,000

Period of credit taken = 132 days

Period of credit allowed asserted by management = 60 days

Period of credit allowed per company policy = 30 days

Audit conclusion from analysis	Effect on nature of substantive testing	Extent of test
Performance indicator for	Discuss the finding with	

period of credit taken shows that the actual period is more than twice the stated period by the management.	management	
There could be a significant error in the accounting records in: Sales (under reported) Accounts receivable (over stated) or Receipts (under stated)	Increase the testing of the reconciliation of the accounts receivable records with both sales and receipts; calculation errors; cut off.	100%
The higher period of credit taken increases the risk of bad or doubtful debts	Increase level of substantive tests of: value of accounts receivable and adequacy of provisions for doubtful debts and write off of bad debts	All accounts over 60 days due

4 marks

b)

An appropriate substantive audit procedure to obtain audit evidence in respect of valuation of trade receivables would involve the undertaking of a bad debts review by the auditor.

This would involve an examination of the amounts due from trade receivables at the year-end and checking to see that the amounts due were paid after the year-end.

3 marks

4.

To establish that the physical cut off of goods is correctly reflected in the accounting records, we would obtain details of the last goods dispatched to customers before the stock take and details of the last goods received from suppliers before the stock take.

During the course of our final audit, we would agree these physical details to sales and purchase invoices and then trace these invoices to the accounting records to ensure they were accounted for in the correct accounting period.

In addition to checking the last dispatch and the last receipt of stock, we would check four other dispatches and receipts of stock either side of the year-end for accuracy of cut-off.

5 marks

Total marks 20

Solution 3

**ABC Auditors Ltd,
Abbey Moat House,
Naas,
Co. Kildare**

**Managing Director,
Bird feeders Ltd,
2 Main Street
Blackrock
Co Dublin**

1 May 2013

RE: Responsibilities of the auditor in respect to Fraud

Dear Managing Director,

It has come to our attention there may be some misunderstandings relating to the role of the auditor in relation to the detection of fraud. I hope the following letter is clear and informative for you in relation to this matter.

The respective duties of directors and auditors in relation to the prevention and detection of fraud

The primary responsibility for the detection and prevention of fraud rests with the director and management of the company. The duty of the auditor is to plan, perform and evaluate his audit work so as to have a reasonable expectation of detecting material misstatements in the financial statements, whether they are caused by fraud or other irregularities or errors.

The approach the auditor should take in discharging his responsibility in relation to fraud

Initially, the Auditor will perform a fraud risk assessment. This assessment will include identification of "fraud risk factors" present in the entity. The auditor then will design audit procedures to address the risks identified. These procedures will address the following:

- Misstatements of the financial statements from misappropriation of assets.

- Misstatements of the financial statements from fraudulent financial reporting. Risk of management override of controls and the fraud risk factors identified.
- Auditor will ordinarily presume risk of fraud in revenue recognition and respond accordingly.
- Will get written representations from Management in relation to fraud.
- Will perform inquiries and obtain an understanding of oversight exercised by those charged with Governance (normally the Board of directors).
- Perform inquiry to see if anyone within the entity has any knowledge of fraud (including Board).
- Initial analytical review may show unusual or unexpected relationships indicating a fraud.
- Other information obtained during planning may indicate a fraud or risk of fraud.

Steps the auditor should take where he becomes aware of suspected or actual instance of fraud.

- Discuss the matter with the board.
- Establish the steps taken by the board to prevent the fraud occurring again.
- Consider the obligation that the auditor may have to report the matter to a third party. The bodies he may be required to report to include the Gardai, Revenue, Office of Director of Corporate Enforcement or Financial Regulator.
- Investigate if the full extent of the fraud is known and the impact of the matter on the financial statements.
- Design an appropriate audit response in order to address the risk of material misstatements of the financial statements arising from the fraud.
- Obtain a representation from the board that this is the only incidence of fraud identified by the Board.

If you have any queries in relation to any of the information included in this letter, please do not hesitate to contact me.

Yours sincerely,

ABC Auditors

Total Marks 20

Solution 4

1.

Audit Programme – Attendance at stock count.

Suggested audit procedures

Before count

- Obtain a good knowledge of the nature and location of the stock.
- Ascertain the proposed count procedures to be utilised by client.
- Obtain copies of stock take instructions.
- Determine if stock is held at any other locations or if any third party stock is held on the premises.

During the stock count:

- Observe the manner in which count is carried out. Determine if it is accurate and complete
- Perform two-way test counts (sheet to floor, floor to sheet).
- Document test counts
- Ensure any units of measurement used are correct.

After count:

- Obtain cut off information.
- Copy stock sheets and retain copies on audit file.
- Conclude on reliability of stock count.

10 marks

2.

The following cut off information would be obtained at the stock count:

- Details of the last three deliveries of goods before the year-end.
- Details of last three shipments of goods before the year-end in respect of non-cash sales.
- Details of till rolls (cash sales) for last day of financial year.
- Details of last three cheques written in financial year.
- Details of last three receipts written in financial year.
- Details of last three credit notes issued before year – end.

4 marks

3.

- The transactions documents above would be traced to the books and records of the company to check that the transactions were recorded in the correct financial year.
- In respect of goods received and shipments this would require matching the transaction with the appropriate purchase and sale

invoice and tracing these invoices to the purchases book and sales book.

6 marks
Total 20 marks

Solution 5

1.

“Going concern concept” refers to the fact that financial statements are prepared under the presumption that the entity is carrying on a business as a going concern and that it will continue in operational existence for the foreseeable future.

4 marks

2.

The responsibility of the company directors in relation to going concern is that in preparing financial statements for the company, they should examine whether it is appropriate to prepare the accounts on a going concern basis. Where it is not appropriate to prepare the accounts on a going concern basis, they should prepare the financial statements on an alternative basis. There may be situations where there are significant uncertainties about the application of the going concern basis and in such situation, the directors should provide adequate disclosures in the notes to the financial statements in relation to the matters giving rise to the uncertainty.

The responsibility of the auditor in relation to going concern is to examine the evidence in relation to the ability of the company to continue to trade into the foreseeable future (one year from the date the financial statements are approved) and make a determination on whether or not the decision made by the directors in relation to this matter was appropriate. Where the auditor disagrees with the directors’ application of the going concern basis, he will have to address this matter in his audit report. Where there is uncertainty affecting the ability of the company to continue to trade, the auditor may decide to include an “emphasis of matter” paragraph in his audit report drawing the attention of the user of the financial statements to the disclosure in the financial statements in relation to this matter.

6 marks

3.

Work Programme-Going concern

Consider the following audit procedures in order to determine the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements.

1. Examine the budgeted income statement, pro-forma statement of financial position and forecasted cash flow statements for twelve months from today's date.
2. Assess the assumptions underlying the above forecasts to determine if they are realistic.
3. Examine the company's current trading prospects for profitability and cash flow generation situation.
4. Discuss with management their future plans
5. Assess the company's ability to raise additional bank finance if required over the next twelve months
6. Review the results of post balance sheet events audit procedures undertaken to determine if any matters arising have an impact on the ability of the company to continue to trade.
7. Consider both the general economic climate and the industry/sector economic climate to identify any matters that may have an impact on the company
8. Examine the current level of debtors and stock to determine if the company is collecting its debtors and converting stock into cash or cash equivalents in a normal time period
9. Examine the ability of the company to pay its debts as they fall due paying particular attention to the payment of taxes on time

Having completed the above procedures and any additional procedures that are considered appropriate, document all findings and make an assessment of the appropriateness of management's decisions in relation to the application of the going concern basis to the preparation of the financial statements.

10 marks

Total 20 marks

Solution 6

1. Accounting records for the period immediately after 31 December 2012.

The purpose of the auditor examining the document:

The auditor would want to determine if any transactions after the year-end indicated that there was a post balance sheet event (adjusting or non adjusting) that required to be accounted for in the year under review.

Information that the auditor would specifically look for in examining

the document

In this situation the auditor would look at some of the following specific information:

- a. Evidence of payments after the year-end that may indicate the requirement for an accrual for the expense at year-end.
 - b. Evidence of invoices received after the year end that may require an accrual at year-end,
 - c. Evidence of reversal of transactions after the year end that might indicate that the directors had engaged in window dressing at the year-end.
- 2.** Supplier invoices in respect of machinery purchased on the 31 July 2012.

The purpose of the auditor examining the document:

To determine if the machine is owned by the company and valued at cost.

Information that the auditor would specifically look for in examining the document

The auditor would look to see if the invoice is addressed to the company so as to prove ownership of the asset . In addition he would confirm that the price of the asset per the invoice is in agreement with the cost figure included in the financial statements.

- 3.** Budgets and financial projections for the audit client in respect of the next financial year

The purpose of the auditor examining the document:

In order to determine the appropriateness of the directors preparing the financial statements on a going concern basis the auditor would examine the budgets and financial projections for the next accounting period.

Information that the auditor would specifically look for in examining the document

The auditor would examine if the company was likely to have sufficient resources to meet its ongoing obligations in the 12 months from the date of approval of the financial statements by the directors.

4. Minutes of meetings of directors and shareholders:

The purpose of the auditor examining the document:

To become aware of any board decisions that were made that could have a material impact for the financial statements.

Information that the auditor would specifically look for in examining the document

Among the specific information that the auditor will be alert to will be:

- Declaration of dividends.
- Capital commitments and other commitments entered into by the company.
- Changes in the Board of Directors.
- Significant acquisitions or disposals of subsidiary companies / assets.
- Significant management decisions that may impact the future of the company.

5. A lease agreement in respect of a finance lease entered into by the audit client on the 10th January 2013.

The purpose of the auditor examining the document:

The auditor will need to determine the terms and conditions of the lease so as to reach a conclusion on the correctness of the accounting treatment of the lease.

Information that the auditor would specifically look for in examining the document:

The auditor will look at the number of lease payments, the value of each payment, the fair value of the assets acquired and the implicit interest rate in the lease.

6 The company's fixed asset register.

The purpose of the auditor examining the document:

To determine that the fixed asset figure in the accounts is supported by underlying assets.

Information that the auditor would specifically look for in examining the document:

The auditor would first look to see if the total figures for fixed assets (cost and accumulated depreciation) in the accounts agreed to the figure in the registrar. Specific audit work to verify existence, ownership and valuation would then be undertaken on the assets in the registrar.

- 7.** A computer report that shows the age of the stock on hand as at 31 December 2012.

The purpose of the auditor examining the document:

To determine the requirement for the inclusion of a provision for obsolete and slow moving stock in the accounts.

Information that the auditor would specifically look for in examining the document:

The auditor would look at the age of specific categories of stocks. The auditor would then determine if there was an adequate provision included in the accounts in respect of the old and obsolete stock identified by the review.

- 8** Invoices from the company's solicitor for legal fees incurred.

The purpose of the auditor examining the document

To determine if adequate provision for an accrual for legal fees were made in the accounts.

Information that the auditor would specifically look for in examining the document

The auditor would focus on the amount of legal fees charged after the period end that related to the financial year under review.

- 9** Company's annual return to the Revenue Authorities of wages paid in 2012 (Form P35).

The purpose of the auditor examining the document

To determine the accuracy of the wages figure included in the financial statements.

Information that the auditor would specifically look for in examining the document

The auditor would want to perform a reconciliation of the wages figure shown on the annual return to the wages figure shown in the accounts.

- 10.** Record of employee holiday entitlements due as at 31 December 2012.

The purpose of the auditor examining the document

To determine the correctness of the holiday pay accrual included in the company's accounts/

Information that the auditor would specifically look for in examining the document

The auditor would look to establish the value of holidays earned but not yet taken at the balance sheet date. This would be compared to the accrual in the financial statements for holiday pay.

Total 20 marks

Solution 7

1.

Assess are payroll costs correct.

Salary levels for 2011 8,560,700

First 6 months 2012

$8,560,700/2 = 4,280,350$ Actual paid €4,500,600 **3 marks**

Next 6 months expect $4,280,350 \times 95\% = 4,066,333 \times 1.1 =$
€4,472,966, actual paid €4,680,800. **3 marks**

Both periods different, investigate the difference. **1 mark**

Ask management. **1 mark**

Get audit evidence to explain difference. **2 marks**

2.

- What controls are in place to ensure correct information emailed? – check information emailed for a month and review how company ensure they send correct information. **5 marks**
- Are payroll providers competent – look at expertise. **5 marks**