



Professional 2 – Module 7

Auditing

May 2014

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

- a) State four matters that may threaten or appear to threaten the independence of the auditor. **(4 marks)**

- b) Briefly outline the approach the auditor should adopt to determine that a company has good and valid title to the freehold building included on its Statement of Financial Position which is being audited. **(4 marks)**

- c) Describe two factors you would consider when deciding on the reliability of audit evidence. **(4 marks)**

- d) Explain the significance of the statement "auditor is a watchdog not a bloodhound" in modern times. **(4 marks)**

- e) List and explain four items that are normally included in an audit engagement letter. **(4 marks)**

Total 20 marks

Question 2

You are a new audit senior in Smith & Co Accountants and Auditors and are informed by your manager, Mr Burke, that you will be involved in the audit of Healthy and Hearty Limited, a café and food supplier based in Dundrum, County Dublin. The management team of Healthy and Hearty Limited has prepared the financial statements for the year ended 31 December 2013 on a going concern basis. Mr Burke tells you they are organized and have the first quarterly management accounts prepared for 2014 and also have cash budgets and income statements for the twelve months of 2014.

The company was established in 1982 by Tom O'Reilly with a dream of "providing healthy food to the masses", as he put it after his father died aged 52 of a heart attack. The last few years have been difficult and they have had to rely on their overdraft and more credit has been taken from suppliers and in the payment of VAT and payroll taxes to the Collector General. Tom also admitted they missed a few repayments on their loan. He feels that the main difficulties arose from customers having less discretionary income and the fact their juice bar never really took off despite a €120,000 investment. Dundrum is a good trading location and a forecast in a recent report by the Central Statistics Office said fast food consumption had risen by 25% in the last year and that mass cafes are taking over. Tom feels this has not impacted on them too much but is not pleased to hear that Avoca are looking at a vacant property in Dundrum to rent at a substantially lower rent than Healthy and Hearty pay due to the upwards only rent review they signed back in the 1980s.

To address their financial challenges all costs were examined on a line by line basis. Two staff were let go in 2013 and a new employee was hired on a part time basis. The salaries of family members have been reduced, but Tom is optimistic for the future.

Required:

Prepare an internal memo to Mr Burke that clearly sets out:

a) four indicators of going concern problems in Healthy and Hearty Limited and their potential effect on your proposed audit procedures.

(8 marks)

b) the proposed programme of work in respect of an examination of the appropriateness of management's use of the going concern assumption in the preparation of the financial statements of Healthy and Hearty Limited.

(12 marks)

Total 20 marks

Question 3

As a recently qualified senior in Burke & Co Auditors, you have been given responsibility to draft the audit plan for trade receivables in White & Co Limited, a farm machine supplier. You have been told you can rely on the management assertion that the company's internal controls over trade receivables are working very well.

Required:

a) What potential effect does the existence of an effective internal control system over the sales and receipts transaction cycle have on the efficiency of the audit?

(2 marks)

b) Outline four pieces of audit work to be undertaken in respect of the audit of trade receivables.

(10 marks)

c) Outline five principle matters to be addressed in an unmodified audit report.

(10 marks)

Total 20 marks

Question 4

You are Mary Monaghan, the new audit junior that has just commenced work in Smith Langan Accountants. You are very excited as after three weeks training and many great social evenings out getting to know your colleagues you are now being sent out on your first job to the annual stock take of Murphy Building Supplies on the Naas Road. Their year end is 31 May 2014 and you are going out that day.

Required:

- a) Outline the audit programme you should follow for the audit of inventories, before, during and after the stock take. **(12 marks)**
- b) Draft the headings for your working paper to record the test counts you make while attending the stock count. **(2 marks)**
- c) List four pieces of cut off information that you would obtain at the stock take. **(6 marks)**

Total 20 marks

Question 5

You are Dick Smith, the audit senior in charge of the audit of White Shops Limited for the year ended 31 December 2013. You are asking your colleague Mary Byrne to audit trade payables and want to make it as clear as possible for her what you expect to ensure that the audit runs smoothly. With this in mind you decide to prepare a step by step guide for her.

Required:

- a) In planning the audit of accounts payable, describe the management assertions that apply to the trade payable balances. **(3 marks)**
- b) Audit clients are often less willing to allow the auditor to seek a direct confirmation of trade creditor balances from suppliers. Outline any three acceptable alternative audit procedures Mary should take in the audit of trade payable balances. **(6 marks)**
- c) Outline five controls that should be incorporated into the trade payables system. **(5 marks)**
- d) In respect of any one of the controls identified in c) above, draft a paragraph for the letter to management describing a breakdown in the control you have detected during the audit, the effect on the performance of the internal control system and a recommendation to solve the breakdown. **(6 marks)**

Total 20 marks

Question 6

After completing three years of college and your Masters in Accounting you are in your three week induction training period at ACF Accountants. Today's session is about risk and the trainers have set you a task to assess your level of understanding regarding audit risk.

Required:

- a) Name and explain the types of risk associated with the audit **(4 marks)**
- b) Explain, using an example of a general audit risk scenario, the interrelationship between the three elements of risk and how they impact on the audit work performed. **(4 marks)**
- c) Outline and explain an example where this interrelationship would influence my audit work of sales revenue. **(6 marks)**
- d) Outline six factors that affect audit risk in an audit. **(6 marks)**

Total 20 marks

Question 7

Analytical procedures are often used in audits.

Required:

- a) Outline what analytical procedures involve and what they are used for in the course of an audit. **(6 marks)**
- b) Give 3 examples of accounting ratios or other financial information that is used in analytical procedures. **(3 marks)**
- c) Outline and explain two dangers of an auditor over relying on analytical procedures during the course of an audit. **(6 marks)**
- d) Outline five situations where analytical procedures could be efficiently used. **(5 marks)**

Total 20 marks

End of paper