



# Auditing Module 7 November 2009

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

Instructions to Candidates:

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

Time Allowed: 3 Hours

**Question 1 (This question must be attempted)**

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

1. Explain what is meant by the terms “control risk” and “detection risk” in the context of an audit of the financial statements of a company.  
**[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. Explain what is meant by the term “materiality” in the context of an audit of the financial statements of a company  
**[4 Marks]**
  
4. A walk through test is a common procedure undertaken by an auditor. Outline the purpose of such a test and the approach you would adopt in undertaking such a test.  
**[4 Marks]**
  
5. Describe a set of audit procedures that an auditor would undertake to confirm that all transactions for a transaction cycle relating to the accounting period being audited are included in the accounting records and that no transactions from another period are included in the accounting records for the period.  
**[4 Marks]**

**Total Marks 20**

**Question 2.**

International Standards on Auditing (UK and Ireland) 210 establishes standards and guidance in relation to agreeing the terms of an audit engagement with a client. An engagement letter is an important part of the process.

**Required:**

Drawing on the content of International Standards on Auditing (UK and Ireland) 210, answer each of the following questions.

1. To whom would you address an audit engagement letter?  
**[3 Marks]**
2. What procedures would you follow in respect of the issuing, drafting, agreeing and signing of an engagement letter?  
**[3 Marks]**
3. Why is it important for an engagement letter to be issued?  
**[3 Marks]**
4. In what circumstances should an engagement letter be revised?  
**[3 Marks]**
5. What are the principal contents of an engagement letter?  
**[8 Marks]**

**Total Marks 20**

**Question 3.**

You are an audit senior assigned to the annual audit of Black Limited. During the course of an audit of the financial statements of Black Limited for the year ended 31 December 2008, you examine the following documents:

1. Accounting records for the period immediately after 31 December 2008.
2. Supplier invoices in respect of machinery purchased on the 31 July 2008.
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 10<sup>th</sup> January 2009.
6. The company's fixed asset register.
7. A computer report that shows the age of the stock on hand as at 31 December 2008.
8. Invoices from the company's solicitor for legal fees incurred.
9. Company's annual return to the Revenue Authorities of wages paid in 2008 (Form P35).
10. Record of employee holiday entitlements due as at 31 December 2008.

**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 Marks 20**

#### Question 4

Analytical procedures are an efficient and widely used audit procedure in the audit of financial statements. International Standard on Auditing (UK and Ireland) 520 establishes standards and provides guidance on the application of analytical procedures during an audit.

#### Required:

- (a) Explain what is meant by the term analytical procedures? **[5 Marks]**
- (b) When, during the course of an audit assignment, would it be appropriate to use analytical procedures? **[3 Marks]**
- (c) Provide five examples of how you would use analytical procedures in a typical audit assignment. **[5 Marks]**
- (d) During the conduct of analytical procedures, how should an auditor respond where he identifies (A) significant or unexpected fluctuations or (B) relationships between account items or balances that are inconsistent with other relevant information or that deviate from predictable patterns? **[7 Marks]**

**Total Marks 20**

#### Question 5.

1. Identify five internal controls you would expect to find in the sales / debtors / receipts accounting cycle of a manufacturing company selling goods on credit to customers. **[10 Marks]**

2. Design tests of control to evaluate the effectiveness of each control identified. **[10 Marks]**

**Total Marks 20**

### **Question 6**

You are Audit Manager on the audit of the financial statements of Yellow Limited and are currently planning the audit assignment for the year ended 31 December 2009. You have assigned Joe Bloggs (Audit Senior) to attend the annual stock count of the company on the 31 December 2009.

#### **Required:**

As Joe is a new employee, you are required to prepare a detailed briefing memorandum for him setting out the work you expect him to undertake during his attendance at the annual stock count. You are required to address the following matters in the briefing paper:

1. The reason why the auditor attends the annual stock count. **[5 Marks]**
  
2. The audit work Joe is required to undertake during his attendance at the count. The memorandum should address the work required before, during and after the stock count. **[10 Marks]**
  
3. The documentation Joe is expected to prepare for inclusion on the audit file. **[5 Marks]**

**Total Marks 20**

### Question 7

You are auditor to South Western Manufacturing Limited and you are about to commence the audit of the financial statements for the year ended 30 June 2009. South Western Manufacturing Limited was established in the 1940s to manufacture widgets for the export market. The company owns a factory building in Kerry from where it operates its manufacturing facility. You recently met with the Finance Director and established the following information:

1. In the year to 30 June 2009 the company has invested in excess of €500,000 in new manufacturing equipment. The company used their own labour in fitting and installing the new plant and the company estimates that the cost of labour used to install the plant was €120,000. This cost is included in the company's profit and loss account as part of manufacturing wages.
2. In addition to acquiring new plant, the company spent in excess of €106,000 on a major overhaul of plant and equipment originally purchased in 2000. This plant is being depreciated over 20 years and the directors are confident that the current year overhaul will ensure that the plant will have a useful life of twenty years from now. The Finance director is not sure of the accounting treatment that would be appropriate in relation to this expenditure.
3. The Board of Directors has recently approved further capital expenditure of €3,000,000 on a new manufacturing plant in Poland. This facility will meet the growing demand for the company's product in Eastern Europe. No contracts have yet been awarded for the construction of the new facility.

#### Required:

1. Based only on the information provided, discuss how the issues outlined will impact the focus of your audit work in respect of the audit of the financial statements for the year to 30 June 2009.

**[6 Marks]**

2. Set out how you would advise the finance director in relation to the accounting treatment of the expenditure of €106,000 on the overhaul of the plant and equipment.

**[6 Marks]**

3. Design a programme of audit tests that would be appropriate for the audit of the fixed assets owned by the company for the year ended 30 June 2009.

**[8 Marks]**

**Total Marks 20**