

Audit Solutions September 2013

Solution 1

1)

Existence – recorded cash balance exist at year end

Completeness – all cash transactions have been recorded

Rights and obligations – legal title to cash balances by entity

Valuation – cash balances recorded at correct value

Presentation and disclosure – disclosures adequate and in accordance with accounting standards and legislation

Any 2 relevant points, 2 marks each.

2)

Audit risk model

Audit risk = inherent risk + control risk + detection risk **1 mark**

Audit risk – risk auditor will give wrong opinion **1 mark**

Inherent risk – risk that misstatements will occur and will not be detected
1 mark

Control risk – risk that the client's internal control system will not detect errors **1 mark**

Detection risk – risk that auditor procedures will fail to detect errors **1 mark**

Any 2 relevant points, 2 marks each.

3)

Observe staff

Perform test counts

Ensure obsolete or damaged stock is moved

Confirm stock held on behalf of third parties is separately identified and accounted for

Conclude whether stock count has been properly carried out

Consider any amendment needed to audit procedures

Give overall impression of levels and values of inventories

Any 4 relevant points, 1 mark each.

4)

Internal audit

- Add value and improve operation of firm
- Report to Board of Directors
- Work relates to operation of firm
- Usually done by employees of firm
- Long term planning
- Staff interviews

External audit

- Auditors express opinion on financial statements
- Report to shareholders of firm
- Work related to financial statements
- Independent of company
- Planning carried out to achieve objective regarding truth and fairness of financial statements

Any 4 relevant points, 1 mark each.

5)

An adverse opinion is given when the auditor has sufficient appropriate audit evidence and then concludes that the misstatements are material and pervasive to the financial statements e.g. going concern issue.

4 marks

Solution 2

1.

- have firm skill to take on audit
- will fee income represent more than 15% of overall fee income
- will taking on this client cause conflict of interest with any other client
- have firm the time to take on audit
- will independence be affected by preparing accounts and then auditing them (use different staff for the two roles)

Any 3 points 2 marks each

2.

Close personal relationships could be seen as self-interest threat, do not let partner in Limerick on job and perhaps only use Dublin staff for audit.

3 marks

Contingent fees – not acceptable and should be turned down and fixed fee agreed perhaps based on hourly rate. **3 marks**

3.

Scope of audit

Due to inherent limitations of audit and indeed internal control, there is a risk that some material misstatements may not be detected by audit.

Agreement of management to provide draft financial statements.

Fees and billing arrangements (set fee)

Staff involved (independence, audit partner connected to firm not on audit)

Any four relevant points, 1 mark each, total 4 marks

4.

Enquire whether there are reasons or circumstances behind the change which the new auditors ought to know.

Ask old auditors for all books and papers that belong to client.

Ask for any useful information that retiring auditors can provide you relating to client.

Any two relevant points, 2 marks each, total 4 marks

Solution 3

1.

**EXAMPLE AUDIT WORKPAPER
CLIENT: Gromit Limited**

Prepared by & Date:

**ACCOUNTING PERIOD: 31 December 2012.
& Date:**

Reviewed by

Wages and subcontractor balances

TEST

In respect of wages and subcontractors determine that the amounts paid to the individuals are correct.

OBJECTIVE OF TEST

To establish that the figure for wages and subcontractor payments is correct and reflects the work performed by these individuals.

RESULTS OF TEST

- Confirm number of employees
- Confirm hours worked reviewing clocking in and clocking out method.
- Confirm how hours worked are authorised.
- Review system for individuals responsible for signing off on hours worked informing payroll department.
- Review system for appointing new employees.
- Review system for appointing new subcontractors.
- Review systems for paying out cash.

CONCLUSIONS.

- The company has paid the correct wages.

Any four relevant points, 2 marks each, total 8 marks.

2.

Test of control for payroll

- Check internal control system for wages, can system detect dummy workers

- A sample of 30 employees would be selected and for one week in the year a test of control would be undertaken to determine if the control to ensure that employees were only paid for hours worked operated effectively.
- A sample of 30 wage payments during the year would be selected and a test of control would be undertaken to determine if the payment was correctly authorised in accordance with the bank mandate approved by the board of directors.
- A sample of 30 wage payments would be selected and a test of control would be undertaken to ensure that the control in place to ensure employees are paid at the correct rate of pay operated effectively.

Any three relevant points, 1 mark each.

Substantive tests for payroll

- Investigate fluctuations in payroll
- Look at summary of payments made and ensure correct authorisation
- Perform analytical procedures

Any three relevant points, 1 mark each.

3.

Customer in liquidation

- See what amount if any Gromit can recover
- Review receivables and communicate with customer to confirm amount owed
- Review any correspondence between firm and client
- See what documentation has been received from liquidator

Any 2 points 1/2 mark each

Unfair dismissal claim

Audit Procedures

- Review client correspondence with ex-employee
- Discuss with client
- Review lawyer correspondence on case

- Review minutes of Board meetings
 - Get written representations from directors of firm
- Any 2 points 1/2 mark each**

4.

Customer in liquidation

Impact on accounts

- IAS 10 adjusting event, alter accounts reduce receivables balance and profit.

1 mark

Unfair dismissal claim

Impact on accounts

IAS 37 – no provision as not probable. No contingent liability as possibility of disclosure remote.

1 mark

5.

Customer in liquidation

Audit report

No impact once adjustments made to accounts.

1 mark

Unfair dismissal claim

Audit report

No affect.

1 mark

Solution 4

(1)

International Standards on Auditing 500 identifies the following five procedures for gathering audit evidence:

1. Inspection
2. Observation
3. Enquiry
4. Confirmation
5. Recalculation and re-performance

Examiner Note: Analytical procedures would also have been acceptable as one of the methods of obtaining audit evidence as set out in ISA 500.

Any 5 relevant points 1 mark each

(2)

An example of the application of each procedure in a typical audit is as follows:

- Inspection- An inspection of fixed assets shows the existence of assets at the balance sheet date.
- Observation and enquiry-Attendance at the stock take at year-end to prove the accuracy of the stock count and the basis for the year-end stock figure.
- Confirmation- The issue of a bank letter to confirm the bank balances directly with the company's bankers at the year-end.
- Recalculation and re-performance- recalculation of the holiday pay accrual to establish if the holiday pay accrual in the financial statements is correct.

Any 5 relevant points 1 mark each

(3)

The three factors that I would consider in deciding on the reliability of audit evidence are:

1. Audit evidence obtained from an independent source is more reliable than audit evidence obtained from a source within the company.
2. Audit evidence obtained from an internal source within the company is more reliable when the related controls imposed by the company are effective.
3. Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.

Any 3 relevant points 2 marks each

(4)

The four steps that I would include in an audit program for the audit of the year-end bank balances would be:

1. Obtain bank reconciliation in respect of each bank balance and agree the bank balance for the trial balance to the bank balance per the bank reconciliation
2. Obtain confirmation directly from the bank to my firm of the bank balances at year-end. I would then agree these balances to the bank reconciliation.
3. I would vouch the reconciling items on the bank reconciliation to the supporting documentation e.g., outstanding lodgments would be traced to the bank statements to ensure they were lodged within a short time of the year-end.
4. I would carry out a search for unrecorded bank accounts

Any 4 relevant points 1 mark each.

Solution 5

1.

The following indicators of going concern problems would alert the auditor to a going concern issue arising:-

1. Late payment of value added tax and PAYE/PRSI
2. Loss making trading operations
3. Breaches of bank covenants
4. The granting of judgements against the company by the Courts
5. Dependence by the company on sources of short term finance
6. Taking of extended credit from suppliers
7. Loss of major contracts/customers
8. The happening of a catastrophic event which would have a major negative effect on the company's operations
9. Over-trading situations as a result of significant increase in turnover without a matching increase in investment in working capital

Any 5 relevant points 2 marks each

2.

The following six audit procedures would provide the auditor with evidence in relation to the reasonability of the application of the going concern assumption in the preparation of the financial statements:-

1. Review of management accounts in the post balance sheet period to indicate current trading situation
2. Review of financial projections for the 18 month period after the balance sheet date
3. Review of current banking situation including the use of current bank facilities

4. Examine the ability of the company to raise additional bank finance should the need arise
5. Examine profitability of core services/products
6. Carry out analytical procedures to include the following:-
 - Calculation of number of days credit given in comparison to prior year
 - Calculate number of days stock held in current year versus prior year
 - Calculate number of days credit taken from suppliers in this year versus prior year

Any 5 relevant points 2 marks each

Solution 6

1.

a) Sales

- Impact on other sales (reduction in coming months)
- Returns, will they result from this?
- Should company recall stock if food poisoning is confirmed?

b) Year-end stock

- Will it increase with returns?
- Will chocolate have to be destroyed?

Audit procedures

- Determine was contaminated chocolate from same batch, retrace sources.
- Consult with legal team for client to determine likely outcome of case
- What percentage of sales came from wedding?
- Chocolate has life of four months, how many sales were made at time of wedding?
- Was this isolated incident or have more been reported?

Any 6 relevant points, 1 mark each, total 6 marks.

2 and 3.

Use pre-approved suppliers – identify the supplier list

3 marks, 1.5 for each point

Check food purchases on arrival – document testing

3 marks, 1.5 for each point

4.

Factors to consider

Reputation
Public relations impact
Moral considerations

Evidence

Review written correspondence from customer
Try and see where all guests ill
Contact hotel venue for verification
Get written representations from management
Communicate with legal advisors

2 marks per relevant point need four points, total 8 marks

Solution 7

1.

Sales and trade receivables

- re tot ledger
- stratify sales
- identify round sum amounts
- select sales
- review credit notes in excess of limited
- analysis of VAT

Any 4 relevant points, 1 mark each, total 4 marks

2.

Inventories

- report negative balances
- report unusual movements
- aging
- identify obsolete inventory
- identify missing invoice numbers

Any 4 relevant points, 1 mark each, total 4 marks

3.

Purchases and trade payables

- re tot ledger
- stratify
- select credit notes
- identify large round sum amounts

Any 4 relevant points, 1 mark each, total 4 marks

4.

Wages and salaries

- re tot ledger

- report gross wages in excess of amount
- check staff numbering
- review holidays

Any 4 relevant points, 1 mark each, total 4 marks

5.

Non-current assets

- re tot
- identify fully depreciated assets
- identify round sum amounts
- identify aged and obsolete
- identify credit balances

Any 4 relevant points, 1 mark each, total 4 marks

Any 4 selected, total of 16 marks

2.

- 1) Has data been saved in a systematic manner and is it suitable for CAATs?
- 2) Does cost of using CAATs justify results?
- 3) Have the audit team the necessary skill to use CAATs?

Any 2 relevant points, 2 marks each.