



Institute of Incorporated Public Accountants

Professional 2 – Module 7

Auditing

Monday 26th August 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. Outline 2 financial statement assertions and the corresponding audit objectives for the audit of cash balances.
4 marks

2. State the audit risk model and provide brief definitions for each of the components of the model
4 marks

3. List four worksteps the auditor should perform when attending a stock count of a client firm.
4 marks

4. Highlight two distinctions between internal and external audit.
4 marks

5. ISA 705 sets out the different types of modified opinion an auditor can give. Explain briefly the circumstances in which an adverse opinion might be given by the auditor.
4 marks

Total 20 marks

Question 2

You are an audit senior at Brown & Co a medium sized firm of accountants and auditors with offices in Dublin, Cork and Limerick and a total of 120 professional staff. The firm has been asked to tender to provide external audit and other services to Bright Light Limited, a private company providing light fittings and equipment to retailers.

Bright Light Limited are expanding rapidly since they were the first to the market with a new solar powered light that is revolutionising the way people light their houses especially after it was featured on a prominent RTE house renovation programme. The fee income for your firm would be substantial. The services that Bright Light limited would like you to provide include the year end audit and assistance to prepare the financial statements.

Bright Lights Limited would also like their tax affairs reviewed and they would like to pay 25% of the tax Brown & Co save them as a fee for this service. The managing director of Bright Light Limited is a sister of one of the audit partners in the Limerick office and each year they take a Christmas holiday together skiing in the Alps.

Required:

1. Analyse the ethical considerations that Brown & Co need to consider when deciding whether to tender for the services required by Bright Light Limited. **6 marks**
2. Identify the potential threats both real and perceived to the independence of the audit team and the steps that could be taken to address the threats. **6 marks**
3. If the tender is successful, state 4 matters that you would include in the letter of engagement to Bright Lights Ltd. **4 marks**
4. Outline the information you would seek and any other matters you would include in the letter of discovery to the retiring auditors. **4 marks**

Total 20 marks

Question 3

Gromit Limited is a construction company based in Swords which builds houses and apartments. Its annual turnover is €350 million, the wages and salaries bill is €80 million and the profit before tax for 2012 is €45 million. The company has a workforce of 1,000 construction workers who are employed on a piecework basis and are paid in cash every week at the worksites. In addition, a further 200 technician workers (electricians, plumbers) are engaged through a sub-contracting arrangement with Watergate Ltd.

You are undertaking the audit for the year ended 31 December 2012 and have come across the following specific matters:

Sunny Hotels limited, a major customer of Gromit Limited have gone into liquidation shortly after the year end. Sunny Hotels owed Gromit limited €4.3 million on 31 December 2012.

Tom Smith (an ex works foreman of Gromit Limited) is suing for unfair dismissal. He turned up for work one morning intoxicated and was considered to pose a danger to himself and to the workers under his supervision. He was instantly dismissed. The lawyers advise it is very unlikely he will win his €5 million unfair dismissal claim.

Required:

1. Prepare a working paper that uses the audit risk model to determine the optional approaches to the audit of wages and subcontractor balances. (Use bullet points) **8 marks**
2. Draft 3 tests of controls and 3 substantive tests you would perform as part of the audit of the payroll. **6 marks**
3. State the additional audit procedures you will carry out at Gromit Limited as a result of the two specific incidents mentioned. **2 marks**
4. Outline if you think the accounts will need to be amended and provide justification for your answer. **2 marks**
5. What is the potential impact on the audit report, if any? **2 marks**

Total 20 marks

Question 4

Audit evidence is the information used by the Auditor in arriving at the conclusions on which the audit opinion is based. The gathering of audit evidence is therefore a critical part of the audit process. In relation to audit evidence:

1. Set out five procedures that International Standard on Auditing 500 identifies for gathering audit evidence
5 marks
2. In respect of each of the above procedures describe an audit test that illustrates the use of the procedure
5 marks
3. Outline three factors that you would consider in assessing the reliability of audit evidence
6 marks
4. What is a letter of representation? What contribution does the letter make to the audit evidence collected?
4 marks

Total 20 marks

Question 5

The auditor must always be mindful of the going concern concept when undertaking an audit of the financial statements.

Required:

1. Set out five possible performance indicators or non-financial factors that would alert you to potential going concern problems.
10 marks
2. Indicate five audit procedures (including any analytical procedures) that 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.
10 marks

Total 20 marks

Question 6

You are an audit senior assigned to the annual audit of Chocolate Limited, a very successful company that manufactures chocolate bars. The chocolates are supplied to a network of 50 franchise retail outlets on a sale or return basis. The chocolate bars have a shelf life of four months.

Within the last year there have been several reported cases of severe illness arising from the consumption of contaminated chocolate bars. While these bars were not made by Chocolate Limited the reputation of the entire industry has been damaged and sales have been affected in the second half of the year. You know that a major risk in this industry is poor food quality in chocolate bars. Chocolate Limited have a reputation for high production standards and the use of quality ingredients but one month before the year end you discover a customer who purchased handmade chocolate for all the guests at her wedding is suing for food poisoning claiming €10,000 per guest in compensation. There were 100 guests at the wedding.

Required:

1. Outline the effect of the incidents described above would have on your approach to the audit of (a) sales and (b) year-end stock balances. What specific audit procedure would you perform to address the use of the sale or return trading basis. **6 marks**
2. State two controls that Chocolate Limited should have in place to reduce the risk associated with food contamination in the preparation of chocolate bars. **4 marks**
3. State two audit procedures you would carry out when testing controls to ensure control risk is low. **2 marks**
4. Describe the factors you would consider to assess the potential financial effect of the compensation claim. Indicate four pieces of evidence you will try and obtain in order to help you form a conclusion if the wedding food poison claim will be successful. **8 marks**

Total 20 marks

Question 7

Auditors use Computer Assisted Techniques (CAATS) to carry out substantive tests for larger clients. One reason for this is that this results in a cost saving and a lower audit fee can be charged. Another reason is the possibility to perform a more effective analysis of financial transaction populations and perform programmed tests on a full population rather than relying on sampling procedures.

Required:

1. For any of the following transaction cycles give four examples of CAATs that could be used to improve substantive testing:

1. Sales and trade receivables
2. Purchases and trade creditors
3. Payroll
4. Non-current assets

16 marks

2. Set out two key steps you would take to determine the suitability of the use of audit sampling techniques for large transaction cycles.

4 marks

Total 20 marks

End of paper