



Institute of Incorporated Public Accountants

Audit Practice

25th. August 2015

2pm – 5pm

There are six questions and ~~nine-ten~~ pages in this examination paper.

Instructions to Candidates:

- **Answer five questions in total**
- **All three questions in Section A and only two questions from Section B should be attempted.**
- **All questions carry equal marks.**
- **Include all workings with your answer.**

Candidates are reminded of the importance of the overall presentation of their answers. Where appropriate, reference to the audit standards, ethics and company law should be clearly made.

Time allowed 3 hours

Section A (All three questions in this section to be attempted)

Question 1

Part A

You are the external auditor to Cement Lite plc, a company listed on the Dublin and London stock exchanges. The company has a large internal audit department and you are considering whether or not to rely on specific auditing work undertaken by the internal audit department in the conduct of your audit of the financial statements for 31 December 2014.

Required:

Explain how you would establish that it is possible to rely on the work of the internal audit department and how you would evaluate its work in order to confirm that it is reliable for your purposes as external auditor to the company. **(4 marks)**

Part B

Explain the context in which an auditor would add an emphasis of matter paragraph in his auditor's report to the members of a company. **(4 marks)**

Part C

In the context of a statutory audit of a private limited company, outline why an engagement letter is considered to be an important document and set out what you would include in such an engagement letter in order to comply with International Standard_s on Auditing 210. **(4 marks)**

Part D

Explain what is meant by the terms "substantive test" and "test of control" and illustrate your answer with two examples of each type of test **(4 marks)**

Part E

International Standard on Auditing (UK and Ireland) 250 deals with the Auditor's consideration of laws and regulations in an audit of financial statements. Set out the audit procedures that this standard requires where non-compliance is discovered during the course of an audit assignment. **(4 marks)**

Total Marks 20

Question 2

Your client Nutrients for Life Limited operates a chain of food supplement shops in Ireland's major cities. The company was established in 2007 and quickly expanded through the acquisition of city centre retail units and the opening of shops in these premises. The objective of the founders of the company was to grow a company with an annual turnover in excess of €50 million. They believed that if they could develop a business with a large market share, it would become an acquisition target for a large American retailer seeking an entry into the Irish market.

The company made accumulated losses in the years 2007 to 2014. It experienced severe cash flow problems in 2012 and at that time the total bank borrowings were restructured. All bank loans were amalgamated into one loan of €40,000,000 repayable over 20 years commencing in 2013. The interest rate payable on the loan is the European Central Bank rate plus the banks margin of 3.5%. The Bank has a fixed and floating charge over the assets of the company.

In April 2014 the company failed to make the scheduled loan repayments and faced the threat of the appointment of a receiver by the Bank. On reviewing the bank loan agreement you have noted that the bank loans become repayable on demand if the terms of the loan agreement are breached during the loan term. The Managing Director of the company has informed you that the threat of appointment of a receiver is now lifted and that the company has re-established a very good working relationship with the Bank. You are informed that the company has entered into discussions with the bank to arrange additional finance. If these negotiations are successful the company will then be in a position to pay all arrears of taxes and bring trade creditors within approved credit terms.

The company has not received any takeover approaches from potential acquirers and the ~~downturn in the US economy makes~~[downturn in the US economy makes](#) it unlikely that such an approach will be received in the near future. The summary financial statements for the year ended 31 December 2014 and notes are provided in appendix 1.

Appendix 1.

Balance sheet of Nutrients for Life Limited as at 31 December 2014

Fixed assets	€	€
- Buildings		32,564,000
- Fixtures and fittings		<u>1,020,513</u>
		33,584,513

Current assets

Stocks	11,596,514	
Cash on hand	<u>96,546</u>	
	11,693,060	

Creditors falling due after one year

Trade creditors	4,050,000	
Bank loans	200,000	
VAT	2,001,924	
PAYE/PRSI	<u>2,000,503</u>	
	8,252,427	

Net Current assets 3,440,633

Creditors falling due after one year

Bank loans	40,054,376	
Shareholder loans	267,000	<u>40,321,376</u>
Total net (liabilities)		<u>€(3,296,230)</u>

Share capital		2,000,000
Revenue deficit		<u>(5,296,230)</u>
Net shareholders deficit		<u>€(3,296,230)</u>

A summary of the profit & loss account for the year ended 31 December 2014 is as follows:

	€
Sales	44,100,560
Cost of sales	<u>33,200,546</u>
Gross profit	10,900,014
Less expenses:	
Wages and Salaries	7,888,140
Bank interest and charges	1,050,000
Other overheads	<u>2,050,100</u>
Total expenses	<u>10,988,240</u>
Operating loss for year	<u>(88,226)</u>

Notes:

1. Included in other overheads is a depreciation charge of €1,540,000.
2. The buildings are included in the accounts at cost less accumulated depreciation. Some recent sales of other shop premises would indicate that the valuation of retail businesses is declining due to the difficulties experienced in the economy in late 2014 and early 2015. The company has never undertaken an impairment review of assets.
3. The financial statements as currently drafted do not disclose the fact that there is a degree of uncertainty in respect of the ability of the company to continue to trade in the future. Your discussions with the Managing Director indicate that the Board of Directors will consider disclosures in the financial statements in relation to the uncertainty pertaining to going concern.

Total Marks 20

[Requirements to this question are outlined on next page](#)

Question 2 – Continued

Required:

(a) When preparing financial statements for Nutrients for Life Limited a decision must be made as to whether the going concern basis is appropriate. Set out who should make this decision and the reasons for your answer. (2 marks)

(b) Based on the information provided in the question and attached appendix prepare an extract from the audit plan dealing with going concern and impairment of fixed assets. The extract should include the audit risk identified and the planned audit response to the stated risk. Marks will be awarded for the use of relevant information provided in the question and appendix. (8 marks)

(c) Detail the specific audit tests you would perform as part of your year-end audit work in the going concern area. (6 marks)

(d) Discuss the possible impact (if any) that the going concern issue may have on the final audit report issued on the financial statements of Nutrients for Life Limited for the year ended 31 December 2014 based on the assumption that adequate disclosure is made in notes to the financial statements of the uncertainty relating to the ability of the company to continue to trade in the future. (4 marks)

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Total Marks 20

Question 3

You are auditor of Safebuild Limited, a company involved in the construction of commercial units. The company is currently involved in two warehouse construction contracts. Details of the status of these contracts as at 30 June 2015 are as follows:

	Gorey Contract	Brittas Contract
	€	€
Fixed price of contract at sales value	6,000,000	1,700,000
Initial budgeted costs of entire contract (at cost)	5,200,000	1,500,000
Actual costs incurred to 30/06/15	5,050,000	1,050,000
Expected additional costs to complete contract	50,000	850,000
Value of work certified to date by Customer's Architect	6,100,000	750,000
Cost of work certified to date	5,000,000	900,000

The above contracts are included on the balance sheet as construction work in progress at a cost of €5,050,000 for Gorey contract and a cost of €1,050,000 for Brittas contract.

In September 2014, the company was prosecuted for serious breaches of the Safety Health and Welfare at Work Act and was found guilty of breaches of the Act. Fines of €400,000 plus costs of €155,000 were imposed. Due to cash flow difficulties, the company has not paid the fines or costs. The company has now engaged the services of an outside consultant to provide assistance in bringing about changes in its work practices. The company is confident that the planned changes will make the company compliant with the "Safety Health and Welfare at Work Act".

Required:

(a) Based on the information provided in relation to the Gorey Contract and Brittas Contract, draft the "Points for the attention of the Audit Partner" setting out the results for each contract that should be accounted for in the financial statements for the year ended 30 June 2015. Your draft note should set out both the appropriate presentation in the profit and loss account and the balance sheet, references to financial reporting standards and a summary of the key audit verification work done.

(12 marks)

(b) Set out the audit issues (if any) that arise from the company's failure to comply with Health and Safety legislation and state clearly the appropriate audit response to such issues

(5 marks)

(c) Based on the information provided, identify one other significant audit risk that arises in the audit of the financial statements of Safebuild Limited for the year ended 30 June 2015 and outline an appropriate audit response to the risk identified.

(3 marks)

Total Marks 20

Section B (Any 2 questions to be attempted in this section)

Question 4

Dexel Limited is a computer manufacturer based in Lucan, Co Dublin. It is the major employer in the area employing about 1,500 staff. The turnover of staff is quite high as it is a very labour intensive business. You are the audit senior with Baxter Brown Auditors and are currently reviewing the working papers for the audit of Dexel limited. You have the following documentation regarding payroll:

Joiners: When a new employee is hired, individual managers send a "new recruit" form to Human Resources (HR). This form includes the individuals name, address, PPS number, phone number, email, bank details, position and pay. HR log the details into an excel spread sheet. Weekly, HR then send the excel spread sheet to Martin, the payroll supervisor and he enters them onto the software payroll package. Martin is the only employee in Dexel who can do this.

Leavers: when an employee leaves, there is an exit interview held by their immediate manager, after which the Manager sends an "employee gone" form to HR. This form includes the reasons the employee is leaving, the date they will leave and any holiday entitlements they are owed. HR update their spread sheet to take account of this change and send the spread sheet to Martin who is the only person who can delete the employee from the system to ensure they do not get paid after they have left.

Employees paid

Fixed salary employees: Employees on fixed term contracts or permanent are paid the same amount each month.

Hourly paid employees:

These employees are paid an hourly rate. Their immediate Manager records on an excel spread sheet the number of hours they worked, any overtime worked and any leave taken. John (the payroll junior) enters this into the software package and Martin then runs a "gross to net" report and looks for anything odd. If he is happy he prints payslips and sends the file by email to the bank to ensure employees are paid directly into their bank accounts.

Required:

- a) Identify FIVE weaknesses of the payroll system in Dexel Limited and for each weaknesses identified outline the risk connected with that weakness. **(10 marks)**
- b) List the controls you feel Dexel Limited should introduce to mitigate each risk identified in part a. **(10 marks)**

Total Marks 20

Question 5

You are an audit manager for Black and White Accountants and Auditors. Usually Black and White deal with small businesses but a strategic decision has been made to expand the client base by competing for the audit and support services of larger businesses.

John Brown, a partner and Black and White met the directors of Paint by Numbers Limited at a business Conference in Galway. John really believes in Paint by Numbers, a manufacturer of organic chemical free paint that has a life of 25 years when applied and rubs clean with a cloth. He believes so strongly in the company that as well as painting his own house throughout with their paint he spent €25,000 on shares in the company in March 2012. Recently John received a call from Mark Patton, the CEO of Paint by Numbers as they are looking for a new auditor as their old auditor passed away and they see this as a time to be audited by a new firm.

Sally Simon, the audit manager will most likely perform the audit as she is due back soon after six months stress leave due to the bankruptcy of her brother's firm and the stress that placed on the entire family. The partners of Black and White would like to win this new audit business as the fee income alone would increase their overall firm income by 23% for the year. This type of business is exactly what they hoped to attract. Black and White have also introduced a new bonus structure which gives every employee a 5% bonus for every client they bring in with a fee income of €10,000 per annum or above.

Required:

- a) The engagement partner has asked you to identify any ethical, regulatory or legislative reasons why they should not accept this audit and any issues you have identified to overcome potential risks. **(10 marks)**

- b) The directors of Paint by Numbers have requested that the audit report state a guarantee by the auditors that the financial statements are accurate as there is potential they will be bought over by a US company and they feel this will help in the due diligence. They are prepared to pay more for the audit to get this guarantee included. You have been asked to outline a response to the directors to this request. **(10 marks)**

Total Marks 20

Question 6

White Horse Ltd is a new audit client for your firm. The engagement partner and audit manager attended a meeting with the financial controller and managing director of White Horse Limited. The audit is due to start in two weeks. The audit manager has noted the following:

- More competitors have come into the field in recent years and in order to attract and retain customers, the credit terms have been relaxed from 30 days to 60 days.
- White Horse Ltd is considering introducing a discount of 5% for payment in 25 days.
- After reviewing Trade Receivables half of the outstanding balances are over 100 days.

Required:

a) Draft a memorandum to your audit team outlining how the team will approach the audit of trade receivables balances greater than 100 days. Include both general and specific guidance. **(14 marks)**

b) If the client does introduce the 5% discount for early payment explain how the audit team could evaluate how much the discount allowed would be during the performance of substantive analytical procedures.

(6 marks)

Total Marks 20

End of paper

