



Professional 2 – Module 7

Auditing

Monday, 24 August 2015

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 (This question must be attempted)

- a) Distinguish between Significant Business Risk and Significant Audit Risk.
(4 marks)
- b) The audit engagement partner has been contacted by the Finance Director of Smithy Ltd, a major audit client of the firm. The finance Director has requested that the partner attend the company's monthly board meetings. Identify the issues that the partner should consider arising from this request.
(4 marks)
- c) Explain the difference between fraud and error in the context on an audit.
(4 marks)
- d) Explain the purposes of audit working papers.
(4 marks)
- e) Outline and explain with examples, two benefits of using audit software during an audit.
(4 marks)

Total 20 marks

Question 2

Part A

White Tile Ltd sells bathrooms suites to the public. It has a head office and warehouse in Dublin and branches in Galway and Cork. Your firm has performed the annual statutory audit of White Tile for a number of years. All accounting records are kept on a computer system at the head office and the only major audit issue in the past has been problems with stock levels - actual v book – and with stock obsolescence. The company has a small internal audit department.

Required:

- a) Outline 5 factors the audit manager of White Tile should consider in relation to the planning of this year's audit
(4 marks)
- b) What type of audit approach is most suited to White Tile?
(4 marks)

Part B

The audit firm of Howlin and Burke, has been asked to bid for the annual audit of the financial statements of Sparkle, a publicly traded jewelry manufacturer. The firm has provided other financial supporting services for Sparkle over the past three years. Almost everyone on the audit team has investments in stocks and mutual funds. Sparkle and Howlin and Burke firm have had disputes in the past about the quality and extent of the other services provided. One of the members of the proposed audit staff was an employee of Sparkle until 18 months ago. Only one person on the proposed audit team has experience in the audit of a jewelry manufacturer.

Required:

- a) What procedures would Howlin and Burke conduct to determine the independence of the firm and of the audit team? **(4 marks)**
- b) Do the Howlin and Burke audit team have the proper competencies to undertake the audit of Sparkle? What specific industry competencies are needed? **(4 marks)**
- c) What circumstances might disqualify Howlin and Burke from serving as an auditor for Sparkle? **(4 marks)**

Total 20 marks

Question 3

Your firm is the newly appointed external auditor to a large company that sells, maintains and leases school equipment and furniture to its customers. This year, you have been asked to co-operate with internal audit to keep the audit costs down. The company wants the external auditors to rely on some of the work already performed by internal audit.

The internal auditors provide the following services to the company:

- a) A cyclical audit of the operation of internal controls in the company's major functions (operations, finance, customer support and information services);
- b) A review of the structure of internal controls in each major function every five years;
- c) An annual review of the effectiveness of measures put in place by management to minimise the major risks facing the company
- d) ~~a~~ visit to customers to confirm the existence and condition of a sample of 10% of the leased equipment.

During the current year, the company has gone through a major internal restructuring in its information services function and the internal auditors have been closely involved in the preparation of plans for the restructuring, and in the related post-implementation review of the upgraded systems modules.

Required:

- a) Explain the extent to which your firm will seek to rely on the work of the internal auditors in each of the areas noted above. **(5 marks)**
- b) Describe the information your firm will seek from the internal auditors in order for you to determine the extent of your reliance. **(5 marks)**
- c) Describe the circumstances in which it would not be possible to rely on the work of the internal auditors. **(5 marks)**
- d) Explain why it will be necessary for your firm to perform its own work in certain audit areas in addition to relying on the work performed by internal audit. **(5 marks)**

Total 20 marks

Question 4

Your firm is the auditor of Gardens-for-us Nurseries, a company operating four large garden centres which sell plants, shrubs and trees, garden furniture and gardening equipment to the general public. You are involved in the audit of the company's non-current assets. The main categories of non-current assets are as follows:

- a) Land and buildings (all of which are owned outright by the company, none of which are leased);
- b) Computers (on which an integrated inventory control and sales system is operated);
- c) A number of large and small motor vehicles, mostly used for the delivery of inventory to customers and forklift trucks in the garden centres;
- d) Equipment for packaging and pricing products.

The company holds records of these assets on a computerised non-current asset register. The depreciation rates used are as follows:

- a) buildings 5% each year on straight line cost
- b) computers and motor vehicles 20% per year reducing balance
- c) equipment 15% each year on straight line cost

You are concerned that these depreciation rates may be inappropriate.

Required:

- a) Explain the main risks associated with financial statement assertions relating to non-current assets. **(3 marks)**
- b) List the sources of evidence available to you in verifying the ownership and cost of:
 - i) the land and buildings
 - ii) the computers and motor vehicles. **(9 marks)**
- c) List the procedures you would perform to check the appropriateness of the depreciation rates on each of the three categories of non-current asset. **(5 marks)**
- d) Describe the action you would take if you disagreed with any of the depreciation rates used and explain the potential effect of the disagreement on your audit report. **(3 marks)**

Total 20 marks

Question 5

You are the audit senior at Berry & Brown accountants and auditors. Your boss Joe Berry has asked you to take over the management of the audit of Juicy Flavours Ltd., a health drink supplier and a client of the firm for the last three years. The audit is for the year ended 31 December 2014. Mark Smith, an audit junior is responsible for the audit of accounts payable and he has asked for your guidance on the audit of trade creditors which he is about to begin. He has drawn up the following working paper:

<u>Juicy Flavours Ltd. - Accounts payable reconciliation</u>		€
Balance per accounts payable listing		574,000
Balance per suppliers' statements - 29 December 2014		<u>1,854,000</u>
<i>Reconciling items:</i>		
Payments made not on statement		(€520,000)
Invoices on statement not on ledger		
29/12/14	Creditor Mr White Invoice No. 1563	€270,000
30/12/14	Creditor Mr Green Invoice No. 1762	€180,000
30/12/14	Creditor Mr Black Invoice No. 1921	<u>€125,000</u> <u>€575,000</u>

The accounting records (including accounts payable records) are maintained by Mrs Jones who is a trusted employee who has worked for Juicy Flavours Ltd for 25 years and is approaching retirement. No work has yet been done by Mark to audit the accounts payable figures.

Requirement

- a) Outline the performance indicators the auditor would look at for the accounts payable cycle. **(4 marks)**
- b) Outline the specific substantive tests that the auditor will perform (i) on the overall listing of the creditors control account and (ii) to investigate the unexplained difference noted in the draft reconciliation. **(10 marks)**
- c) Draft a paragraph for the letter to management suggesting the management controls you would expect to see over accounts payable in Juicy Gem Ltd. **(6 marks)**

Total 20 marks

Question 6

You are the Audit Manager on the audit of the financial statements for the year ended 31 December 2014 of Little Gifts Limited and you are planning the audit process. You have assigned Bríd Phelan a junior to attend the stock count on 31 December 2014 in the company's only warehouse in Swords.

Bríd only joined your firm four months ago and this will be her first stock take so it is vital you prepare a detailed briefing memorandum for her outlining the work you expect her to undertake during her attendance at the stock count. You should address the following in your memorandum:

Required:

- a) Why should Bríd attend the stock count? **(5 marks)**
- b) What should Bríd do during her attendance? You should address any work Bríd needs to complete before, during and after the count. **(10 marks)**
- c) What documentation should Bríd prepare for inclusion on the audit file?

(5 marks)

Total 20 marks

Question 7

1. Explain what is meant by each of the following categories of risk:

- a. Audit risk.
- b. Inherent risk.
- c. Detection risk.
- d. Control risk.

(8 marks)

2. In respect of the above risks, identify which categories of risks are the risks of the entity being audited and provide an explanation for your answer.

(4 marks)

3. Explain how the extent of audit testing may influence or be influenced by each of the above categories of risk.

(4 marks)

4. In the audit of a small owner managed business the auditor would normally expect a high degree of control risk. Explain why the auditor would have this expectation and an appropriate audit response to this situation.

(4 marks)

Total 20 marks

End of paper