

OLLSCOIL NA hÉIREANN, GAILLIMH
THE NATIONAL UNIVERSITY OF IRELAND, GALWAY

SEMESTER TWO EXAMINATIONS 2000/01

MASTER OF ACCOUNTING

AUDITING

AY508

Mr Kieran Wallace
Professor J. F. Collins
Mr F. Conaty
Ms. E. Curtis

Time allowed: Three and a half hours

**Candidates are required to attempt Questions ONE, TWO and THREE from Section A
and ANY TWO questions from Section B**

Students are permitted to bring the following publications into the examination:

- **Auditing and Reporting 1999/2000**
- **Accounting Standards 1999/2000**

Section A – Compulsory

Candidates are required to answer ALL THREE questions in this section

Question 1 - Compulsory

Extended responses to these questions are not required. They may be answered in note form and ideally should not exceed 100 words for each part.

Each question carries 4 marks.

- a) Auditing standards state: 'Financial statement assertions are the representations of the directors that are embodied in the financial statements'. These assertions are resolved into a number of headings one of which is 'presentation and disclosure'. Set out four further headings and explain their significance in the context of financial statements.
- b) Identify two alternative means of documenting systems of internal control and for each one identified, set out one relative strength and weakness.
- c) Explain the role of audit working papers in supporting the audit opinion.
- d) State four factors an auditor will consider in deciding on an appropriate sample size for a substantive audit test.
- e) State the extent of the auditor's responsibility for financial and non-financial information other than the financial statements included in a company's annual report.
- f) State the factors to be considered by external auditors when deciding whether or not to place reliance on the work of internal auditors.

Total marks: 24

Question 2 - Compulsory

In preparing for the audit of Busjet Systems Limited ('Busjet'), the audit senior, Grace Hummel had the following discussion with the managing director, Barry Wynet:

- Grace:* I understand that you have been on the acquisition trail again?
- Barry:* That's right Grace, we finally jumped overseas and broke into the East European market. We acquired two distribution companies based in Budapest and Riga and intend to turn them to our way of doing business. All is going well so far and Tom (financial controller) has hired a graduate trainee to deal with all the extra work on the foreign currency side. I leave all that confusing stuff to those guys and concentrate on building the customer base.
- Grace:* Any other changes I should know about?
- Barry:* Well you know about our complete computer system overhaul. Your consultancy guys sure cost us enough and we still managed to encounter some teething problems and you do remember Angela don't you?
- Grace:* Yes, your 'helpful' procurement manager. Is she still here?
- Barry:* No. Angela left us four months ago and we promoted Sarah into the position. It turns out that Angela was a good buddy with the sales guy in one of our main suppliers, Thompson's. To put it diplomatically we felt that we should all part company.
- Grace:* I read recently that G&S have developed a new generation Data Flow Controller. Will that hit sales of your TQV component?

[Question 2 continues over....

...Question 2 continued from previous page]

- Barry: Well spotted. It is a concern. TQV accounts for 18% of our turnover, but we feel we can match their lower price. If it comes to a price war we have deep enough pockets and our component is compatible with a broader range of machines than theirs.
- Grace: Finally, our management letter last year highlighted a concern we had over shortcomings in your control of fixed assets. You have a heavy investment in IT equipment. Have things improved in this area?
- Barry: I suppose I could say that they have in certain respects but to be honest the answer is no. You understand what with the new systems going in and the acquisitions I'm afraid it just did not make it up the priority ladder. Hopefully your concerns will be addressed next year.

Following a full assessment of Busjet's circumstance and financial position you have decided to increase the preliminary level of audit materiality from your audit senior's initial figure of £150,000 to £200,000.

Required

- a) In relation to the issues raised in the conversation above:
- discuss the overall impact on audit risk and the specific components of audit risk affected, and
 - describe the impact of each issue on your overall audit plan.
- 13 marks**
- b) What is the relationship between materiality and audit risk?
- 3 marks**
- c) How will the increased level of materiality affect the nature and extent of auditing procedures?
- 3 marks**
- Total marks: 19**

Question 3 - Compulsory

You are the audit senior on the audit of Miltech Ltd. According to the draft financial statements, Miltech Ltd had turnover of £5 million, net profit of £980,000 and net assets of £2,500,000 for the year ended 31 March 2001. You have completed the audit fieldwork and are satisfied that you have adequate reliable audit evidence for all items in the accounts except for the matters outlined below:

- During the audit, you discovered a number of invoices from a company called Gilbane Ltd. who are supplying consulting services to Miltech Ltd. The creditors ledger clerk mentioned that Gilbane Ltd is owned by the managing director's brother. You noted that all of the invoices from Gilbane Ltd. booked for the year totalled £313,000 and were approved for payment by the managing director. When you discussed the matter with the managing director at the closing meeting, he said that the invoices were in respect of advice on internal control and strategic planning systems. When you suggested that the amount of the invoices and nature of the relationship should be disclosed in the accounts, the managing director got very irate and said that this was a preposterous suggestion as there is nothing improper about the relationship with Gilbane Ltd. Indeed he claims that they have received excellent advice from the company.

[Question 3 continues over....

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- The managing director was so annoyed about your suggestion that you disclose details of the invoices from Gilbane Ltd. that when you telephoned to ask if you could come out and review post balance sheet events, he said that you had had your two weeks to do the audit as agreed and he didn't need you coming back to poke your nose into the current year's accounts as he had not yet decided to reappoint your firm as auditors.

Required

- a) Explain, with reference to relevant accounting and auditing standards, the impact of each of the issues outlined above on your audit report, assuming no changes were made to the draft financial statements. You are not required to draft the relevant sections of the audit report.

9 marks

- b) What audit procedures should be performed in relation to the invoices from Gilbane Ltd?

4 marks

- c) Describe the audit procedures you would adopt to identify post balance sheet events.

6 marks

Total marks: 19

P.T.O.

Section B

Candidates are required to attempt ANY TWO questions

Question 4

You have recently been promoted to audit manager in your firm and one of your first audit assignments in your new role is High Sea Supplies Limited ('High Sea'). High Sea has six chandler outlets in ports around the country. You are in the process of completing the planning for the forthcoming audit and have the following information on stocks and fixed assets to hand:

Outlet	Turnover	NBV of fixed assets	Carrying value of stocks	Average stock aging
	£000	£000	£000	Months
Smallport	440	140	150	2.5
Cityport	2,580	430	360	4.4
Southport	630	150	130	3.8
Eastport	1,900	450	410	3.1
Northport	800	190	210	5.2
Helmport	740	120	70	2.7
	7,090	1,480	1,330	3.8

From discussions with management you have ascertained the following additional information:

- During the year the company introduced a new integrated stock and point of sale terminal system. Northport was used to pilot the system. However, serious problems were encountered in the first three weeks of commissioning. The problem centred on stock codes being misread in which cases the staff had to revert to issuing manual receipts and invoices. The difficulties were overcome and did not present when the system was rolled out to the other outlets.
- Smallport suffered a fire towards the end of the year and all damaged stock was written out of the stock records. The company plans to hold a clearance sale of this stock early in the new year.
- Cityport acts as a supply depot for the other outlets.
- The general manager at Eastport was changed at the start of the current year to great effect. The new manager was appointed by head office and reports directly to the group general manager.

The planned group materiality level is £300,000. Stock and fixed assets are the only material assets. It is your intention to visit three outlets to observe the stocktake and verify the existence of fixed assets.

Required

- Identify the retail sites that you will visit and give the reasons for your selection.
5 marks
- Describe in detail your planned procedures for the visits generally and those that might be individually important for any of the locations selected.
8 marks
- What audit procedures might you plan to perform to ensure that stocks and fixed assets are fairly stated for the outlets not subject to attendance?
6 marks

Total: 19 marks

P.T.O.

Question 5

You are the audit senior for Nantech Ltd., a new audit client of your firm, which manufactures bicycles. You have spent the last week at the client's premises obtaining background information and planning for the audit. You have ascertained the following information regarding the company's computer system and the payroll function.

- The company has a computer department which has two employees, an analyst and a computer operator. The company uses a popular manufacturing accounting software package. The software has a very good reputation in the industry and no modifications have been made to the package since it was installed three years ago. All of the subsidiary ledgers (debtors, creditors, stock and payroll) are fully integrated with the general ledger.
- The company has 150 employees who are paid weekly. These employees are paid an hourly rate. They receive double pay for overtime, and special shift allowances where they work anti social hours. The hours worked by each employee are recorded in a computerised time and attendance system when the employee clocks in and out. This system uses data on rates of pay and shift allowances contained in personnel master files to calculate each employee's gross weekly pay. The gross pay for each employee is then transferred electronically to the payroll module of the accounting system which calculates the PAYE, PRSI and net pay for each employee. This system then automatically updates the general ledger and produces net pay cheques for each employee.

You have discussed these systems with your audit manager, who has suggested that it would probably be most efficient to test the controls around the computer system rather than attempting to test the source code of the software. He also suggested that it might be efficient to use some CAATs in testing the payroll system.

Required

- a) Describe, using examples, the types of controls relating to the computer system which should be in place in Nantech Ltd. and explain how you might test these controls.
11 marks
- b) Explain what is meant by Computer Assisted Audit Techniques (CAATs) and describe how you might use CAATs to assist with the audit of Payroll.
8 marks

Total marks: 19

Question 6

- a) Consider the following statement:

'Auditing practice is constantly evolving. In few areas is this more apparent than in the case of analytical review. For a term that was rarely seen in auditing literature until the 1970s it now commands a 'Statement of Auditing Standard' all to itself.'

Discuss possible reasons why analytical review has become widespread practice among auditors and describe the manner in which the technique is utilised in the audit process.

10 marks

- b) Describe the auditors' responsibilities in relation to the detection of fraud as set out in **SAS 110 Fraud and Error** and discuss whether you think that these responsibilities meet shareholders', creditors' and the public's expectations of auditors in relation to fraud.

9 marks

Total marks: 19