Fundamentals Level - Skills Module

# Audit and Assurance

September/December 2017 – Sample Questions



Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

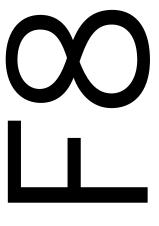
Section A – ALL 15 questions are compulsory and MUST be attempted

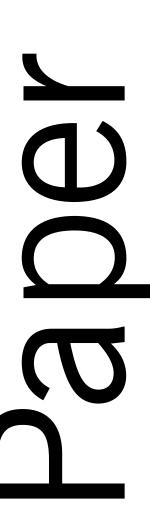
Section B – ALL THREE questions are compulsory and MUST be attempted

Do NOT open this question paper until instructed by the supervisor.

Do NOT record any of your answers on the question paper.

This question paper must not be removed from the examination hall.









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#### Section B – ALL THREE questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

16 You are an audit supervisor of Halley & Co and you are reviewing the documentation describing Comet Publishing Co's purchases and payables system in preparation for the interim and final audit for the year ending 30 September 20X7. The company is a retailer of books and has ten stores and a central warehouse, which holds the majority of the company's inventory.

Your firm has audited Comet Publishing Co for a number of years and as such, audit documentation is available from the previous year's file, including internal control flowcharts and detailed purchases and payables system notes. As far as you are aware, Comet Publishing Co's system of internal control has not changed in the last year. The audit manager is keen for the team to utilise existing systems documentation in order to ensure audit efficiency. An extract from the existing systems notes is provided below.

# Extract of purchases and payables system

Store managers are responsible for ordering books for their shop. It is not currently possible for store managers to request books from any of the other nine stores. Customers who wish to order books, which are not in stock at the branch visited, are told to contact the other stores directly or visit the company website. As the inventory levels fall in a store, the store manager raises a purchase requisition form, which is sent to the central warehouse. If there is insufficient inventory held, a supplier requisition form is completed and sent to the purchase order clerk, Oliver Dancer, for processing. He sends any orders above \$1,000 for authorisation from the purchasing director.

Receipts of goods from suppliers are processed by the warehouse team, who agree the delivery to the purchase order, checking quantity and quality of goods and complete a sequentially numbered goods received note (GRN). The GRNs are sent to the accounts department every two weeks for processing.

On receipt of the purchase invoice from the supplier, an accounts clerk matches it to the GRN. The invoice is then sent to the purchase ordering clerk, Oliver, who processes it for payment. The finance director is given the total amount of the payments list, which she authorises and then processes the bank payments. Due to staff shortages in the accounts department, supplier statement reconciliations are no longer performed.

# Other information – conflict of interest

Halley & Co has recently accepted the audit engagement of a new client, Edmond Co, who is the main competitor of Comet Publishing Co. The finance director of Comet Publishing Co has enquired how Halley & Co will keep information obtained during the audit confidential.

#### Required:

- (a) Explain the safeguards which Halley & Co should implement to ensure that the identified conflict of interest is properly managed. (5 marks)
- (b) Explain the steps the auditor should take to confirm the accuracy of the purchases and payables flowcharts and systems notes currently held on file. (5 marks)
- (c) In respect of the purchases and payables system for Comet Publishing Co:
  - (i) Identify and explain FIVE deficiencies;
  - (ii) Recommend a control to address each of these deficiencies; and
  - (iii) Describe a TEST OF CONTROL the auditor should perform to assess if each of these controls, if implemented, is operating effectively to reduce the identified deficiency.

Note: Prepare your answer using three columns headed Control deficiency, Control recommendation, and Test of control respectively. The total marks will be split equally between each part. (15 marks)

(d) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate evidence in relation to Comet Publishing Co's purchases and other expenses. (5 marks)

(30 marks)

17 You are an audit supervisor of Cupid & Co, planning the final audit of a new client, Prancer Construction Co, for the year ending 30 September 20X7. The company specialises in property construction and providing ongoing annual maintenance services for properties previously constructed. Forecast profit before tax is \$13.8m and total assets are expected to be \$22.3m, both of which are higher than for the year ended 30 September 20X6.

You are required to produce the audit strategy document. The audit manager has met with Prancer Construction Co's finance director and has provided you with the following notes, a copy of the August management accounts and the prior year financial statements.

#### Meeting notes

The prior year financial statements recognise work in progress of \$1.8m, which was comprised of property construction in progress as well as ongoing maintenance services for finished properties. The August 20X7 management accounts recognise \$2.1m inventory of completed properties compared to a balance of \$1.4m in September 20X6. A full year-end inventory count will be undertaken on 30 September at all of the 11 building sites where construction is in progress. There is not sufficient audit team resource to attend all inventory counts.

In line with industry practice, Prancer Construction Co offers its customers a five-year building warranty, which covers any construction defects. Customers are not required to pay any additional fees to obtain the warranty. The finance director anticipates this provision will be lower than last year as the company has improved its building practices and therefore the quality of the finished properties.

Customers who wish to purchase a property are required to place an order and pay a 5% non-refundable deposit prior to the completion of the building. When the building is complete, customers pay a further 92.5%, with the final 2.5% due to be paid six months later. The finance director has informed you that although an allowance for receivables has historically been maintained, it is anticipated that this can be significantly reduced.

### Information from management accounts

Prancer Construction Co's prior year financial statements and August 20X7 management accounts contain a material overdraft balance. The finance director has confirmed that there are minimum profit and net assets covenants attached to the overdraft.

A review of the management accounts shows the payables period was 56 days for August 20X7, compared to 87 days for September 20X6. The finance director anticipates that the September 20X7 payables days will be even lower than those in August 20X7.

#### Required:

- (a) Describe the process Cupid & Co should have undertaken to assess whether the PRECONDITIONS for an audit were present when accepting the audit of Prancer Construction Co. (3 marks)
- (b) Identify THREE main areas, other than audit risks, which should be included within the audit strategy document for Prancer Construction Co, and for each area provide an example relevant to the audit.

(3 marks)

(c) Using all the information provided describe SEVEN audit risks, and explain the auditor's response to each risk, in planning the audit of Prancer Construction Co.

Note: Prepare your answer using two columns headed Audit risk and Auditor's response respectively.

(14 marks)

(20 marks)

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18 Dashing Co manufactures women's clothing and its year end was 31 July 20X7. You are an audit supervisor of Jaunty & Co and the year-end audit for Dashing Co is due to commence shortly.

The draft financial statements recognise profit before tax of 2.6m and total assets of 18m. You have been given responsibility for auditing receivables, which is a material balance, and as part of the audit approach, a positive receivables circularisation is to be undertaken.

At the planning meeting, the finance director of Dashing Co informed the audit engagement partner that the company was closing one of its smaller production sites and as a result, a number of employees would be made redundant. A redundancy provision of \$110,000 is included in the draft financial statements.

## Required:

- (a) Describe the steps the auditor should perform in undertaking a positive receivables circularisation for Dashing Co. (4 marks)
- (b) Describe substantive procedures, other than a receivables circularisation, the auditor should perform to verify EACH of the following assertions in relation to Dashing Co's receivables:
  - (i) Accuracy, valuation and allocation;
  - (ii) Completeness; and
  - (iii) Rights and obligations.

Note: The total marks will be split equally between each part.

(6 marks)

(c) Describe substantive procedures the auditor should perform to confirm the redundancy provision at the year end. (5 marks)

A few months have now passed and the audit team is performing the audit fieldwork including the audit procedures which you recommended over the redundancy provision. The team has calculated that the necessary provision should amount to \$305,000. The finance director is not willing to adjust the draft financial statements.

# Required:

(d) Discuss the issue and describe the impact on the auditor's report, if any, should this issue remain unresolved.

(5 marks)

(20 marks)

**End of Question Paper**