

**UNIVERSITY OF BOLTON**  
**INSTITUTE OF MANAGEEMNT**

**ACCOUNTANCY**

**SEMESTER 2 EXAMINATIONS 2018/19**

**AUDITING AND ASSURANCE**

**MODULE NO: ACC5004**

Date: Monday 20 May 2019

Time: 2.00 – 5.00

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**INSTRUCTIONS TO CANDIDATES:**

There are 4 questions in this examination; Answer ALL questions.

This is a closed book examination.

You must hand in this exam paper with your answer booklet.

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## **Question 1**

### **Introduction**

Blake Co assembles specialist motor vehicles such as lorries, buses and trucks. The company owns four assembly plants to which parts are delivered and assembled into the motor vehicles. The factory workers normally work a standard eight hour day, although this is supplemented by overtime on a regular basis as Blake has a full order book. There is one shift per day; mass production and around the clock working are not possible due to the specialist nature of the motor vehicles being assembled.

### **Wages system – shift workers**

Shift-workers arrive for work at about 7.00 am and clock-in using an electronic identification card. The card is scanned by the time recording system and each production shift-worker's identification number is read from their card by the scanner. The worker is then logged in as being at work. Shift-workers are paid from the time of logging in. The logging in process is not monitored as it is assumed that shift-workers would not work without first logging in on the time recording system. At least 400 vehicles have to be manufactured each day by each work group. If necessary, overtime is worked to complete the day's quota of vehicles. The shift foreman is not required to monitor the extent of any overtime working although the foreman does ensure workers are not taking unnecessary or prolonged breaks which would automatically increase the amount of overtime worked.

### **Payment of wages**

Details of hours worked each week are sent electronically to the payroll department, where hours worked are allocated by the computerised wages system to each employee's wages records. Staff in the payroll department compare hours worked from the time recording system to the computerised wages system and enter a code word to confirm the accuracy of transfer. The code word also acts as authorisation to calculate net wages. The code word is the name of a domestic cat belonging to the department head and is therefore generally known around the department.

The list of net pay for each employee is sent over Blake Co's internal network to the accounts department. In the accounts department, an accounts clerk ensures that employee bank details are on file. The clerk then authorises and makes payment to those employees using Blake Co's online banking system. Every few weeks the financial accountant reviews the total amount of wages made to ensure that the management accounts are accurate.

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**Question 1 continued.**

**Termination of employees**

When employees leave Blake Co, the personnel department sends an e-mail to the payroll department detailing the employee's termination date and any unclaimed holiday pay. The receipt of the e-mail by the payroll department is not monitored by the personnel department.

**Required:**

- (a) List FOUR control objectives of a payroll system. **(4 marks)**
- (b) In respect of the wages recording and payment system of Blake Co:
- (i) Explain FIVE deficiencies in that system
  - (ii) Recommend a control to overcome each deficiency
  - (iii) Describe a test of control the auditor would perform to assess if each of these controls is operating effectively.

Note: Prepare your answer using three columns headed Control deficiency, Control recommendation and Test of control respectively. **(15 marks)**

- (c) Describe the substantive procedures the auditor should perform to confirm Blake Co's payroll figure. **(6 marks)**

Blake Co is considering outsourcing its payroll department to an external payroll service provider in order to reduce costs

- (d) Explain the impact outsourcing the payroll function will have on the external audit of Blake Co. **(5 marks)**

**(Total: 30 marks)**

**End of Question 1**

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## Question 2

Your firm has recently been appointed as auditor for Wover Co, a small car manufacturer. The audit partner has recently attended a planning meeting with William Harris the Finance Director and has left the following notes to assist with your planning of the audit.

The draft results are showing revenue of £198m (2018: £200m), gross profit of £71m (2018: £71m) and profit before tax of £40m (2018: £46m). Performance in the first half of the year was stronger than the same period in 2018, however, due to a series of safety issues with some cars (see below), sales in the second half were not as strong resulting in an overall reduction in revenue compared with the prior year. All cars are sold with a 5 year warranty which enables customers who experience problems with their car, that are not due to normal usage and wear and tear, to take the car to an approved mechanic for repair or replacement free of charge.

During the year, 50 customers experienced severe safety issues with their car and as a result are suing Wover Co. The matter has not yet been brought to court. Given the circumstances of the safety issues, Wover's lawyers believe an out of court settlement will be less costly and less risky than allowing the matter to be settled by the court.

The company replaced a significant part of its production line during the year to improve the quality of production following the safety issues. As a result of the disposal of the old equipment there is a significant loss on disposal recognised in the statement of profit or loss. The company also revalued its factory premises 3 months before the year end to a value of £5m. This valuation figure is used in the financial statements.

In order to finance the replacement of the production line, Wover took out a 5 year loan for £3m which is repayable in quarterly instalments.

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**Question 2 continued**

Extracts from the statement of financial position are shown below.

	2019	2018
	£m	£m
Inventory	11	8
Trade receivables	22	17
Cash	0.9	1.4
Trade payables	13	10
Other current liabilities	9	9

**Required:**

- (a) Calculate FIVE ratios for both years which could assist when planning the audit. **(5 marks)**
- (b) Using the information provided and the ratios calculated, describe FIVE audit risks and explain the auditor's response to each risk when planning the audit of Wover Co. **(10 marks)**
- (c) Explain FIVE items that should be included on every working paper. **(5 marks)**
- (Total: 20 marks)**

**End of question 2**

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### Question 3

Lantern Co manufactures glassware. Its year-end was 31 July 20X6 and the draft revenue is £37 million and draft profit before tax is £9.2 million. You are the audit supervisor and the year-end audit is due to commence shortly. The following matters have been brought to your attention.

Lantern Co pays a bonus to its sales staff if a specified sales target is achieved. The finance director is concerned that the sales staff have recorded fictitious sales in the final month of the financial year in order to increase their bonus.

All sales are made on credit and the sales staff are responsible for performing credit checks on all new customers however, during your tests of controls you discovered that this rarely happened. The value of receivables which are over 6 months old is £780,000. Standard credit terms offered to customers are 30 days.

#### Required:

- (a) Explain the auditor's responsibilities in relation to fraud and error. **(5 marks)**
- (b) Describe substantive procedures you should perform to obtain sufficient, appropriate audit evidence in relation to:
- (i) Revenue **(5 marks)**
  - (ii) Receivables **(6 marks)**
  - (iii) Sales related bonus **(4 marks)**

The audit is nearly complete, and the auditor's report is due to be issued next week. Your testing of revenue identified that a material value of fictitious sales had been recorded and management have adjusted the financial statements accordingly. Your testing of receivables concluded that the debts over 6 months old are likely to result in irrecoverable debts and should be written down. Management has agreed to make an allowance of £390,000.

- (c) Describe the implications for the auditor's report as a result of the above information. **(5 marks)**

**(Total: 25 marks)**

**End of question 3**  
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#### Question 4

You are the audit senior of Seagull & Co and are currently planning the audit of your existing client, Eagle Heating Co (EHC), for the year ending 31 December. EHC manufactures and sells heating and plumbing equipment to a number of home improvement stores across the country.

EHC has experienced increased competition and as a result, in order to maintain its current levels of sales, it has decreased the selling price of its products significantly since September. The finance director has informed your audit manager that he expects increased inventory levels at the year end. He also notified your manager that one of EHC's key customers has been experiencing financial difficulties. Therefore, EHC has agreed that the customer can take a six-month payment break, after which payments will continue as normal. The finance director does not believe that any allowance is required against this receivable.

In October the financial controller of EHC was dismissed. He had been employed by the company for over 20 years, and he has threatened to sue the company for unfair dismissal. The role of financial controller has not yet been filled and so his tasks have been shared between the existing finance department team. In addition, the purchase ledger supervisor left in August and a replacement has been appointed in the last week. However, for this period no supplier statement reconciliations or purchase ledger control account reconciliations were performed.

#### Financial statement extracts for year ended 31 December

	2019	2018
	£m	£m
Revenue	246	283
Cost of sales	172	184
	<hr/>	<hr/>
Gross profit	74	99
Operating expenses	40	50
	<hr/>	<hr/>
Operating profit	34	49
	<hr/>	<hr/>
Inventory	51	28
Trade receivables	35	25
Cash	0.1	3.4
Trade payables	19	16
Other current liabilities	5	5

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**Question 4 continued**

**Required:**

- (i) Calculate FOUR ratios, for BOTH years, which would assist in planning the audit. **(4 marks)**
- (ii) Using the information provided and the ratios calculated, identify and describe FIVE audit risks and explain the auditor's response to each risk in planning the audit of EHC. **(10 marks)**
- (iii) Describe the substantive procedures that should be performed to obtain sufficient and appropriate evidence in relation to the receivable balance outstanding from EHC's key customer. **(6 marks)**
- (iv) Explain the audit senior's responsibilities in relation to supervising the work of the audit team during the audit of EHC. **(5 marks)**

**(Total: 25 marks)**

**END OF QUESTIONS**