

UNIVERSITY OF BOLTON

GREATER MANCHESTER BUSINESS SCHOOL

BA (HONS) ACCOUNTANCY

SEMESTER TWO EXAMINATIONS 2022/2023

ADVANCED AUDITING PRACTICE

MODULE NO: ACC6006

Date: Thursday 11 May 2023

Time: 10.00 – 1.00

INSTRUCTIONS TO CANDIDATES:

There are FIVE questions on this paper.

Section A consists of TWO questions. Answer ALL questions.

Section B consists of THREE questions. Answer ONLY TWO questions

This is a closed book examination.

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

Use of calculators is allowed.

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SECTION A – ANSWER ALL QUESTIONS FROM THIS SECTION

Question 1

Part(a)

You work for Brudy Co, a small firm of chartered certified accountants with an annual turnover of £2.5 million derived from local clients. Carl Plc is a well-known local wholesaler which sells clothes to a large number of shops in the area. Owing to the long standing friendship between the Managing Director of Carl Plc and your senior partner, Jamie Brudy have been asked to accept the appointment of the audit of the accounts for the year ending 30 September 2023.

Mr Jamie Brudy has asked you to perform any necessary work before taking up the offer. He has told you that:

- a) He sees this as a great opportunity, as Carl are preparing to take over one of their major rivals, whose operation extends throughout the country;
- b) Fees for the audit are expected to be around £180,000, but Mr Brudy says '*if the take-over goes ahead the fee could be £250,000 or more*'.
- c) A number of members of staff were recently seconded to Carl to perform a variety of accounting functions. One senior member acted as the firm's financial controller for six months last year;
- d) There have been rumours recently that Carl has struggled to pay its bills on time, and several suppliers have apparently stopped dealing with them

You have heard that the current auditors are unhappy at being superseded. You have also been told that no one is clear how their planned takeover is to be financed though there may be interested parties abroad.

Required:

- a) **Critically evaluate five ethical threats that this proposed appointment would present and for each threat, identify the appropriate safeguard. You should prepare your answer using two columns headed Ethical threat and possible safeguard respectively.**

(10 Marks)

- b) **Evaluate the importance of the auditor's independence and assess why it may be an issue in this case.**

(5 Marks)

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Question 1 continued

Part (b)

You are a manager in Bridge & Bond, a firm of chartered certified accountants. One of your audit clients is Charles & Co, a firm which manufactures dance costumes. The engagement partner has received a letter from the Managing Director of Charles & Co in which he complains that a long-standing fraud has recently been found.

The letter says that the fraud resulted from collusion between two brothers, Peter and John, who both worked in the sales department of Charles & Co. Peter would raise two invoices for goods supplied. One at full price was sent to the customer, but Peter entered a second at a much lower price into the accounting records. When the customer paid, John received the money, used some to settle the company's debt and the brothers kept the rest.

The Managing Director makes the following points in his letter:

- i) He is very surprised that this fraud has not previously been discovered by the auditors, although it seems to have been going on for several years. He comments '*I should have thought that finding fraud was a fundamental part of the audit*'.
- ii) He says that he cannot understand why the audit did not include tests on the price at which goods were being sold.
- iii) He writes '*I also understand that you are auditors of several of our customers; indeed, when we asked you to be our auditors 5 years ago it was in part because of your knowledge of our industry. Why did you not check that what they paid was not what we received?*'
- iv) He concludes '*unless you agree to compensate us for the loss, we have incurred you will no longer be our auditors*'.
- v) The engagement partner has asked you to draft him a briefing note for a meeting he is to hold with the Managing Director next week.

Required:

- a) **Appraise the extent of the auditor's responsibilities towards fraud, referring to ISA 240. (8 marks)**
- b) **Referring to the above case and auditors' responsibilities, draft a brief response to each of the points (i) to (iii). (3 Marks)**
- c) **Evaluate the risks to the audit that point (iv) raise. (4 Marks)**

Total 30 Marks

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Question 2

Part (a)

- a) You are the audit senior responsible for the audit of Foodie Co, a company that runs a chain of fast-food restaurants. During the final audit it has come to your attention that one month before the year-end, a customer filed a claim for £200,000 against the company for personal injury caused by food poisoning. This amount is material to the stated profit of the company, but management believes that it has a good defence against the claim.

Following your audit, you have concluded that there is a possibility, but not a probability, that the claim will be successful. However, management have decided not to make a provision or include a disclosure note in the financial statements in respect of this matter.

(5 Marks)

- b) It is 1 June 2023. Red and Co, Chartered Certified Accountants, are the external auditors of Nur, a listed company. On completing the audit for the year ended 31 March 2023 the following list of matters was prepared for the partner's attention.

- i) On 25 April 2023 Nur agreed to a pay rise of 5% for all of its employees backdated to 1 January 2023. No provision for this has been made in the financial statements.

(5 Marks)

- ii) One of the company's oil tankers has just run aground off the coast of California. There is a risk of a serious oil spill which could cost a significant amount to clear up as is required by local legislation. This could have a significant effect on the future of the company. Further information will not be available until after the auditors' report has been signed.

(5 Marks)

- iii) The draft Chair's Statement, to be included in the Annual Report, states that profit before tax has increased by 25%. It is true that operating profit has increased by 25% but, after deducting reorganisation costs and losses on disposals of property, plant and equipment profit before tax has increased by only 4% compared with the previous year.

(5 Marks)

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Question 2 continued

Required:

Assume that each of the above matters are potentially material and are to be considered independently of each other.

Evaluate what further actions are required to be taken with respect of each of the matters listed including the potential impact on the auditor's report.

(Total 20 Marks)

Part (b)

Dawson & Co is an audit firm that provides auditing and assurance services to clients in various industries. The firm has been in business for 10 years and has built a reputation for providing high-quality services to its clients. However, the firm has recently experienced some quality management issues, which have raised concerns among its clients and stakeholders.

Required:

Critically evaluate the importance of quality management in auditing and assurance, and provide recommendations for Dawson & Co to address its quality control issues and ensure compliance with auditing and assurance standards.

(10 Marks)

Total 30 Marks

**END OF SECTION A
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Section B: Answer ONLY TWO questions from this section

Question 3

The following information is relevant to part (a):

Global Logistics Co is a publicly listed company that specializes in freight and cargo services. The company has been in business for 15 years and has recently experienced significant growth, resulting in its IPO. The board of directors comprises six members, with the CEO also serving as the chairman. The board is dominated by executive directors, with only one non-executive director. The company's remuneration policies are heavily based on short-term financial performance, with the CFO having sole discretion in setting executive directors' bonuses. There is no formal process for selecting board members, and there is no diversity on the board. The company has not established an audit committee, and the internal audit function reports directly to the CFO. Additionally, the company has not provided any training to its new marketing director.

Required:

- a) Critically evaluate the FIVE corporate governance deficiencies present at Global Logistics Co and provide recommendations to address each deficiency to ensure compliance with corporate governance principles. You may wish to use a two-column format in your answer. (10 Marks)**

The following information is relevant to part (b):

You are a senior auditor working for a reputable audit firm. You have been assigned to audit a manufacturing company, Mo & Ko Ltd, that has been experiencing financial difficulties over the past year. The company has been struggling to meet its loan repayment obligations and has experienced a decline in sales due to increased competition in the industry. Your audit team has identified the following matters.

- The company's cash flows from operating activities have been negative for the past year, indicating that it may not be able to generate enough cash to meet its obligations.
- The company has seen a decline in sales and market share due to increased competition and economic downturn, which could impact its ability to generate future profits.
- The company has had difficulty in securing additional funding to support its operations, which could impact its ability to meet its debt obligations.

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Question 3 continued

- The company has significant inventory levels that are not moving, which could indicate a decline in demand for its products.

Required:

Critically evaluate the potential indicators that suggest Mo & Ko Ltd is not be a going concern and discuss the responsibilities of auditors when assessing a company's ability to continue as a going concern and the implications of issuing an audit report with a material uncertainty related to going concern.

(10 Marks)

Total 20 Marks

Question 4

ABC Manufacturing is a publicly listed company that operates in the automotive industry. The company has engaged the services of an audit firm, XYZ Audit Co, to perform its annual financial audit. The audit team at XYZ Audit Co is responsible for evaluating the company's financial statements, internal controls, and compliance with regulatory requirements.

During the planning phase of the audit, the audit team at XYZ Audit Co identified several areas of high risk, including revenue recognition, inventory valuation, and related party transactions. These areas of risk require the audit team to maintain a high level of professional scepticism throughout the audit process.

Required:

Critically evaluate the importance of professional scepticism in the audit process, and describe how auditors at XYZ Audit Co can exercise increased levels of professional scepticism throughout the audit of ABC Manufacturing. You should use examples to illustrate your answer.

(Total 20 Marks)

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Question 5

JHK Holdings Ltd is a multinational corporation with subsidiaries in various countries. The company has appointed DAB Audit Co as the group auditor for the year ended 31 December 2023. The group auditor is responsible for the audit of the consolidated financial statements of JHK Holdings Ltd.

The group auditor needs to evaluate the work of component auditors who have audited the financial statements of the subsidiaries. The group auditor needs to determine the extent of reliance to be placed on the work of the component auditors. The group auditor identifies that the component auditors have different levels of expertise and quality of work. Some component auditors have well-established audit practices and procedures, while others may have limited resources and experience. Additionally, the group auditor identifies that some of the subsidiaries operate in high-risk jurisdictions, and the local regulations and laws may impact the quality of financial reporting. The group auditor is also aware that some component auditors have provided a qualified opinion on the financial statements of their respective subsidiaries.

The group auditor needs to determine the extent of reliance to be placed on the work of the component auditors. The group auditor needs to evaluate the quality and sufficiency of the work performed by the component auditors and determine if additional audit procedures are required.

Required:

Critically evaluate the extent of reliance to be placed on component auditors in group audit engagements, and provide examples of factors that the group auditor should consider in evaluating the quality of work performed by the component auditors.

(20 Marks)

END OF QUESTIONS