

**UNIVERSITY OF BOLTON**

**GREATER MANCHESTER BUSINESS SCHOOL**

**BA (HONS) ACCOUNTANCY**

**SEMESTER 2 RESIT EXAMINATIONS 2022/2023**

**AUDITING AND ASSURANCE**

**MODULE NO: ACC5004**

Date: Tuesday 18 July 2023

Time: 2pm – 5pm

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**INSTRUCTIONS TO CANDIDATES:**

There are 5 questions on this paper.

Answer BOTH questions from section A and TWO questions from section B.

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**Section A: Answer Both Questions**

**QUESTION 1**

**Introduction**

DEL 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 motor vehicles. The factory workers usually work a standard eight-hour day, although this is supplemented by overtime regularly as DEL has a full order book. There is one shift per day; mass production and around the clock working are impossible due to the specialist nature of the assembled motor vehicles.

**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-workers 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 must be manufactured each day by each workgroup. If necessary, overtime is performed to complete the day's quota of cars. The shift foreman is not required to monitor the extent of any overtime work. However, the foreman ensures workers are not taking unnecessary or prolonged breaks, which would automatically increase the amount of overtime.

**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 transfer accuracy. The code word also acts as authorisation to calculate net wages. The codeword is the name of a domestic cat belonging to the department head and is generally known around the department.

Each employee's net pay is recorded, and a list is sent over DEL Co's internal network to the accounts department. An accounts clerk ensures that employee bank details are on file in the accounts department. The clerk then authorises and makes payments to those employees using DEL Co's online banking system. The financial accountant reviews the total amount of wages made every few weeks to ensure that the management accounts are accurate.

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**Question 1 continued...**

**Termination of employees**

When employees leave DEL 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 DEL 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 DEL Co's payroll figure. (6 marks)

DEL is considering outsourcing its payroll department to an external payroll service provider to reduce costs.

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

(Total: 30 marks)

**End of question 1  
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## QUESTION 2

You are a manager in the audit department of S&S. A potential new client, Delta Co, an aircraft obstruction lighting company, has approached your firm to perform the external audit in addition to some other non-audit services for the year ending 30 October 20X3. Your audit firm was recommended to Delta Co by an existing client, B&L, a telecommunication company who is also a major customer of Delta Co.

You have been chosen to lead the engagement as you have experience of auditing such organisations and also manage the audit of B&L.

Whilst arranging the initial meeting with the directors of Delta Co you discover that you studied accountancy with the finance director at university.

Delta Co has not made a profit for the last two years. The directors explain it is largely due to increased costs within the industry including rising prices of fuel. They are confident they have now controlled their costs for the current year. They have also been approached to tender for a large profitable contract which would improve the company's financial performance in future. They would like you to help them for preparing this tender and present with them on the day.

The prior year financial statements are being audited by another audit firm. The finance director tells you that the current auditors have identified material misstatements but the board of directors are refusing to make these adjustments. If adjusted it turn the break-even into a loss.

The current auditors have replied to your professional clearance letter and have informed you that they are still owed fees relating to the prior year.

You calculate the potential fees from Delta Co would amount to approximately 15% of your firms total fee income.

### Required:

(a) Explain the following fundamental principles in the code of ethics:

Integrity

Professional competence and due care

Objectivity

(5 Marks)

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**Question 2 continued...**

**(b) Identify and explain two threats and recommend a possible safeguard to objectivity if S&S accept Delta Co as a new client.**

**(Prepare your answer using two columns headed ethical threat and possible safeguard respectively)**

**(10 Marks)**

**(c) Explain matters that should be considered before accepting the engagement, other than ethical threats.**

**(5 Marks)**

**Total (20 Marks)**

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**End of section B  
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**Section B Answer Two Questions Only**

**QUESTION 3**

Your firm has recently been appointed as auditor for Joseph Co, a small carpet manufacturer. The audit partner has recently attended a planning meeting with Adam Wood, the Finance Director and has left the following notes to assist with your audit planning.

The draft results show revenue of £396m (2021: £400m), gross profit of £142m (2021: £142m) and profit before tax of £80m (2021: £92m). Performance in the first half of the year was stronger than in the same period in 2021. However, due to a series of quality issues with some carpets (see below), sales in the second half were not as strong, resulting in an overall reduction in revenue compared with the prior year. All carpets are sold with a 5-year warranty, enabling customers who experience problems with the carpet that are not due to normal usage and wear and tear to take the carpet to an approved stockist for repair or replacement free of charge.

During the year, 50 customers experienced quality issues with their carpet and, as a result, are suing Joseph Co. The matter has not yet been brought to court. Given the circumstances of the quality issues, Joseph'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 production following the quality issues. As a result of the disposal of the old equipment, there is a significant loss on disposal recognised in the income statement. The company also revalued its factory premises 3 months before the year-end to a value of £10m. This valuation figure is used in the financial statements.

To finance the replacement of the production line, Joseph took out a 5-year loan for £6m, which is repayable in quarterly instalments.

Extracts from the statement of financial position are shown below.

	2021	2022
	£m	£m
Inventory	22	16
Trade Receivables	44	34
Cash	1.8	2.8
Trade Payables	26	20
Other Current Liabilities	18	18

**Question 3 continued over...**  
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**Question 3 continued...**

**Required:**

**(a) Calculate FIVE ratios for both years which could assist when planning the audit.**

**(10 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 Joseph Co.**

**(10 marks)**

**(c) Explain FIVE items that should be included on every working paper.**

**(5 marks)**

**(Total: 25 marks)**

**Question 4**

Sand & Glass Co manufactures glassware. Its year-end was 31 July 2022, and the draft revenue is £74 million and the draft profit before tax is £18.4 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.

Sand & Glass 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 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, you discovered that this rarely happened during your tests of controls. The value of receivables over 6 months old is £1,560,000. Standard credit terms offered to customers are 30 days.

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**Question 4 continued...**

**Required:**

- (a) Evaluate the auditor's responsibilities in relation to fraud and error (5 marks)
- (b) Analyse 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)
- (c) Discuss the expectation gap. (5 marks)
- (Total: 25 marks)

**Question 5**

- a) Examine the following statements and explain the extent to which you agree with them:
- (i) **Audit risk is the risk that control systems will not detect material misstatements in the financial statements subject to audit.** (5 marks)
- (ii) **The letter of engagement is of little value, as most clients will not understand what it means.** (5 marks)
- b) **Cumulative client knowledge enables the auditor to be more efficient and aids effectiveness in the audit process. Explain what you understand by cumulative client knowledge. What information about an organisation would be helpful to you permanently?** (5 marks)

Question 5 continued over...

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**Question 5 continued...**

- c) **Discuss the validity of the following statement: 'It is very easy to apply the audit risk model. All you have to do is multiply figures together to determine the amount of testing you have to do.'**

**(10 marks)**

**(Total 25 Marks)**

PAST EXAMINATION

**End of questions**