OCD027

UNIVERSITY OF BOLTON

OFF CAMPUS DIVISION

WESTERN INTERNATIONAL COLLEGE

BA (HONS) ACCOUNTANCY

SEMESTER TWO EXAMINATIONS 2023/2024

ADVANCED AUDITING PRACTICE

MODULE NO: ACC6006

Date: Thursday 16 May 2024 **Time: 1:00pm – 4:00pm**

INSTRUCTIONS TO CANDIDATES:

There are FOUR questions on this paper.

Answer ALL questions.

All questions carry equal marks.

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Question 1
Part A
You are the audit manager in charge of the field work of the Wilson Co; it is the first year you have been involved with this client, although your audit firm has carried out the audit for the last eight years. Wilson is a general manufacturing company which is listed on the stock exchange of the country it is based in. The company manufactures and distributes household products including kitchen equipment, chairs, tables, and bedroom furniture. The audit work for the year to 30 June has been in progress for the last three weeks, and there is one week to go before it is completed. The audit team of five staff comprises two juniors, two seniors and yourself.

Peter, one of the audit juniors, has been working exclusively on checking the existence and valuation of the inventory in the kitchen equipment division of Wilson. The work is not particularly difficult, but it is quite time-consuming and means checking many items of inventory in a large warehouse. A lot of the inventory is old and dirty and Peter normally brings old clothes each day to wear around the warehouse. The warehouse manager recently approached Peter and offered a free re-fitting of Peter's kitchen as a 'thank you' for carrying out the inventory work. The warehouse manager stated this was a normal activity each year, in recognition of Peter's difficult working conditions. During the audit Peter has identified that the inventory is over-valued, particularly in respect of many old kitchen units being maintained at full cost price, even though those units have had no sales in the last 18 months. The extent of the over-valuation appears to be material to the financial statements.

Qasim, an audit senior, has been working on the disclosure elements of directors' remuneration for the financial statements and the directors' remuneration regulations disclosure for that jurisdiction. Qasim has discovered that disclosure in the financial statements and remuneration regulations is different from the information provided by and checked by the audit committee. When queried, the newly appointed chair of the audit committee stated that share options were not considered part of disclosable remuneration as the value was uncertain, being based on future share price, which could not be determined. This element of remuneration was therefore omitted from the financial statements and remuneration regulations disclosure. The chair informed Qasim that due to the confidential nature of directors' remuneration, no further disclosure of this situation was to be made. The chair also noted that recent review of shareholdings indicated that Qasim had a 2.5% share of the company and again this would not be disclosed due to the confidential nature of the information.

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Question 1 continued

Finally, it was noted that the chair of the remuneration committee was also a director of Wilson Co.

Ray, the second audit junior, has been auditing the bank reconciliations on Wilson Co's 26 different bank accounts. The work is considered suitable for a junior member as it mainly entails checking that cheques issued prior to the year-end were presented to the bank for payment after the end of the year. Ray has completed work on the reconciliations, and stated correctly that all cheques were presented to Wilson Co's bank for payment after the end of the year. However, Ray failed to state that a number of cheques, material in amount, were only presented two months after the year end. In other words, the financial statements were 'window dressed' to show a lower creditors' amount than was actually the case at the year end.

When queried about this omission during final review of the audit files, Ray correctly stated that he was never informed that timing of presentation of cheques was part of the audit procedures.

Required:

From the information above, critically evaluate five ethical threats and propose appropriate ethical safeguards explaining why that safeguard is appropriate.
(15 Marks)

Part B
Slime Holidays Co is an independent travel agency. It does not operate holidays itself. It takes commission on holidays sold to customers through its chain of high street shops. Staff are partly paid on a commission basis.

Well-established tour operators run the holidays that Slime Holidays Co sells. The networked reservations system through which holidays are booked and the computerised accounting system are both well-established systems used by many independent travel agencies.

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Question 1 continued

Payments by customers, including deposits, are accepted in cash and by debit and credit card. Slime Holidays Co is legally required to pay an amount of money (based on its total sales for the year) into a central fund maintained to compensate customers if the agency should cease operations.

Required:

a) **Evaluate the responsibilities of external auditors in respect of the risk of fraud and error in an audit of financial statements.**

(6 Marks)

b) **Evaluate the nature of the risks to which Slime Holidays is subject arising from fraud and error.**

(4 Marks)

Total 25 Marks

Question 2
Part A
You are the audit manager of Betty & Co and you are briefing your team on the approach to adopt in undertaking the review and finalisation stage of the audit. In particular, your audit senior is unsure about the steps to take in relation to uncorrected misstatements.

During the audit of Jasmine Co, the following uncorrected misstatement has been noted.

The property balance was revalued during the year by an independent expert valuer and an error was made in relation to the assumptions provided to the valuer.

Required:
(a)Evaluate the term "misstatement" and describe the auditor's responsibility in relation to misstatements.

(4 marks)

(b)Critically analyse the factors Betty & Co should consider when placing reliance on the work of the independent valuer.

(6 Marks)

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Question 2 continued

Part B
The following additional issues have arisen during the course of the audit of Jasmine Co. Profit before tax is $10m.

(i) Depreciation has been calculated on the total of land and buildings. In previous years, it has only been charged on buildings. Total depreciation is $2.5m and the element charged to land only is $0.7m.

(5 marks)

(ii) Jasmine Co's computerised wages program is backed up daily, however for a period of two months the wages records and the back-ups have been corrupted, and therefore cannot be accessed. Wages and salaries for these two months are $1.1m.

(5 marks)

(iii) Jasmine Co's main competitor has filed a lawsuit for $5m against them alleging a breach of copyright; this case is ongoing and will not be resolved prior to the auditor's report being signed. The matter is correctly disclosed as a contingent liability.

(5 Marks)

Required:

(c)Discuss each of these issues and describe the effects on the auditor's report if the above issues remain unresolved.

Total 25 Marks

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Question 3

Medica Co is an established pharmaceutical company that has, for many years, generated 90% of its revenue through the sale of two specific cold and flu remedies. Medica has lately seen a real growth in the level of competition and demand for its products has significantly declined. To make matters worse, the company has not invested sufficiently in new product development and so has been trying to remedy this by recruiting suitably trained scientific staff, but this has proved more difficult than anticipated.

Medica also needed to invest $2m in plant and machinery. It wanted to borrow this sum but was unable to agree suitable terms with the bank; therefore, it used its overdraft facility, which carried a higher interest rate. Consequently, some of Medica's suppliers have been paid much later than usual and hence some of them have withdrawn credit terms meaning the company must pay cash on delivery. As a result of the above, Medica's overdraft balance has grown substantially.

The directors have produced a cash flow forecast and this shows a significantly worsening position over the coming 12 months.

The directors have informed you that the bank overdraft facility is due for renewal next month, but they are confident that it will be renewed. They also strongly believe that the new products which are being developed will be ready to market soon and hence trading levels will improve and therefore that the company is a going concern. Therefore, they do not intend to make any disclosures in the accounts regarding going concern.

Required:

a) Identify any potential indicators that the company is not a going concern and describe why these could affect the ability of the company to continue trading on a going concern basis.

(14 marks)

b) Evaluate the audit procedures that the auditor of Medica should perform in assessing whether the company is a going concern.

(6 marks)

The auditors have been informed that Medica's bankers will not make a decision on the overdraft facility until after the auditor's report is completed. The directors have now agreed to include going concern disclosures.

Required:

c) Describe the impact on the auditor's report of Medica if the auditor believes the company is a going concern but a material uncertainty exists.

(5 marks)

Total 25 marks

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Question 4

Part A

Serene Co has been trading for over 20 years and obtained a listing on a stock exchange five years ago. It provides specialist training in accounting and finance.

The listing rules of the stock exchange require compliance with corporate governance principles, and the directors are fairly confident that they are following best practice in relation to this. However, they have recently received an email from a significant shareholder, who is concerned that Serene Co does not comply with corporate governance principles.

Serene Co's board is comprised of six directors; there are four executives who originally set up the company and two non-executive directors who joined Serene Co just prior to the listing. Each director has a specific area of responsibility and only the finance director reviews the financial statements and budgets.

The chief executive officer, Daniel Brown, set up the audit committee and he sits on this sub-committee along with the finance director and the non-executive directors. As the board is relatively small, and to save costs, Daniel Brown has recently taken on the role of chairman of the board.

It is the finance director and the chairman who make decisions on the appointment and remuneration of the external auditors. Again, to save costs, no internal audit function has been set up to monitor internal controls.

The executive directors' remuneration is proposed by the finance director and approved by the chairman. They are paid an annual salary as well as a generous annual revenue related bonus.

Since the company listed, the directors have remained unchanged and none have been subject to re-election by shareholders.

Required:

Critically analyse <u>SIX</u> corporate governance weaknesses faced by Serene Co and provide recommendations to address each weakness, to ensure compliance with corporate governance principles.

(12 marks)

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Question 4 continued

Part B

Critically evaluate the challenges and methodologies involved in conducting group audits versus transnational audits, highlighting key considerations for auditors in ensuring compliance with international auditing standards. Provide examples and discuss potential strategies to address these challenges effectively.

(13 Marks)

Total 25 Marks

END OF QUESTIONS
END OF EXAM PAPER