

UNIVERSITY OF GREATER MANCHESTER

OFF CAMPUS DIVISION

WESTERN INTERNATIONAL COLLEGE

BA (HONS) ACCOUNTANCY

SEMESTER TWO EXAMINATION 2024/2025

AUDITING AND ASSURANCE

MODULE NO: ACC5004

Date: Tuesday, 13 May 2025

Time: 1:00 pm – 4:00 pm

INSTRUCTIONS TO CANDIDATES:

There are **FOUR (4)** questions on this paper.

Answer **ALL** questions on this paper.

This is a closed book examination.

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

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QUESTION 1

You are an audit manager at Strathmore & Co., an accounting firm with eight offices and 18 partners.

You are planning the audit of Apex Gadgets Ltd, which has been an audit client for five years and specialises in designing high-end wearable technology. During the audit planning stage, you have gathered the following information:

The audit team assigned to Apex Gadgets Ltd can purchase wearable accessories at a 12% discount. The company's finance director mentioned that this perk is intended to foster goodwill with the audit team and maintain a positive working relationship. The audit engagement partner has reviewed the discount's impact and deemed it trivial and unlikely to influence the auditors' objectivity.

Earlier this year, Apex Gadgets Ltd's chief accountant took an unexpected medical leave, leaving a critical vacancy. With no internal replacement available, a senior auditor from Strathmore & Co. was seconded to the company for four months. This secondment significantly increased the firm's fee income from Apex Gadgets Ltd, which, combined with audit and consultancy fees, now makes up 27% of Strathmore & Co.'s total annual fees.

Upon reviewing correspondence files, you discover that the audit engagement partner and Apex Gadgets Ltd's finance director have been close friends for several years and even took a family holiday together last winter. Due to this personal connection, the engagement partner has not yet addressed the issue of last year's audit fee, of which 22% remains unpaid

Required:

- (a) Identify and explain THREE ethical threats to auditor independence arising from the provision of audit services at Apex Gadgets Ltd.
(9 marks)
- (b) Recommend suitable safeguards that the firm should implement to address each of the three ethical threats identified in relation to the audit of Apex Gadgets Ltd.
(9 marks)
- (c) Identify and explain the ethical principles from the relevant code of ethics that could be compromised if appropriate safeguards are not applied.
(7 marks)

[TOTAL 25 MARKS]

Please turn the page

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QUESTION 2

It is 1 May 20X5. You are an audit supervisor with Pollen Ltd and are responsible for planning the audit of a new client, Cascade Supply Ltd, for the year ending 31 October 20X5. Your audit manager recently met with the finance director of Cascade Supply Ltd and has provided you with the following planning meeting notes and financial statement extracts.

Business Overview:

Cascade Supply Ltd is a manufacturer and wholesaler of plumbing supplies. The company operates from two warehouses located in the east and west regions of the country.

Financial Statement Extracts:

Forecast	20X5 (\$m)	Final 20X4 (\$m)
Revenue	35.4	29.8
Cost of Sales	(27.6)	(22.4)
Gross Profit	7.8	7.4
Inventories	9.2	6.4
Account Receivables	7.8	4.9
Trade Payables	3.1	2.1

Additional information:

In October 20X4, Cascade Supply Ltd acquired a technology license for \$3.0m. This license grants the exclusive right to manufacture a new line of eco-friendly water filtration systems for a three-year period. The capitalised cost includes the license fee, legal fees, and other administrative costs incurred during contract negotiations. To finance the purchase, the company obtained an interest-bearing bank loan of \$2.8m, payable in four equal annual instalments. The first instalment is due on 1 November 20X5.

In April 20X5, a flood affected the west warehouse, damaging a portion of the inventory. A post-flood inventory count revealed that inventory costing \$1.3m must be fully written off. The damaged inventory has not been replaced because sufficient stock remains in the east warehouse to meet customer demand. The directors have lodged an insurance claim for the full \$1.3m loss. Although confirmation from the insurer has not been received, the directors are confident that the claim will be fully settled and have recorded the amount as other receivables within current assets.

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The credit control manager has been on leave since January 20X5 due to ill health and has been replaced by an inexperienced temporary manager. Consequently, Cascade Supply Ltd has not been effectively monitoring the ageing of its receivables, with follow-ups only initiated when invoices have been outstanding for 90 days, despite standard credit terms of 30 days.

Required:

- (a) Calculate FOUR ratios, for BOTH years, to assist you in planning the audit of Cascade Supply Ltd.
(7 marks)
- (b) Using the ratios calculated, identify and explain for any audit risks may arise.
(8 marks)
- (c) Identify FOUR audit risks that may arise from additional information and explain the auditor's response to each risk, in planning the audit of Cascade Supply Ltd.
(10 marks)

[TOTAL 25 MARKS]

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QUESTION 3

It is 1 May 20X5. You are an audit supervisor with Spectrum & Co, and you are working on the final audit of EcoCycle Ltd for the year ended 30 June 20X5. EcoCycle Ltd is a waste management company that provides waste collection and recycling services to a range of governmental and private sector clients. The draft profit before tax for EcoCycle Ltd is \$6.0 million (20X4: \$5.2 million) and total assets are \$45.0 million (20X4: \$38.5 million). You have received the following information regarding the draft financial statements:

Vehicle Additions and Disposals:

On 15 March 20X5, EcoCycle Ltd replaced 15 of its garbage trucks. The old trucks had a carrying amount of \$1.2 million as recorded in the fixed asset register. They were disposed of as part of a trade-in arrangement for new trucks costing \$3.8 million, with an additional cash payment of \$2.5 million made by EcoCycle Ltd.

Trade Receivables:

The company's credit manager left in February 20X5 and was replaced by an inexperienced temporary manager. As a result, the average collection period increased from 55 days as at 31 December 20X4 to 72 days as at 30 June 20X5. Year-end trade receivables totalled \$10.3 million (20X4: \$8.4 million), and an allowance for doubtful accounts of \$220,000 (20X4: \$180,000) has been provided.

Potential Breach of Environmental Regulations:

In April 20X5, a former employee lodged a complaint with the environmental protection agency, alleging that EcoCycle Ltd breached hazardous waste disposal regulations on several occasions. The agency has initiated an investigation; however, the directors do not intend to record any provision for potential penalties, as they consider the potential penalty of \$75,000 per violation to be immaterial.

Subsequent Event – Legal Action:

It is now 26 July 20X5, and the auditor's report for EcoCycle Ltd is being finalised. On 12 July 20X5, the environmental protection agency announced that it was initiating legal action against EcoCycle Ltd in connection with 12 alleged breaches of the hazardous waste disposal regulations. EcoCycle Ltd's legal advisors have advised that it is probable the company will be found liable for these breaches. Despite this, the directors have stated that no provision will be made in respect of this matter since the legal action was initiated after the year end, although they have agreed to disclose the issue in the notes to the financial statements.

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Required:

(a) Illustrate the substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence regarding EcoCycle Ltd's vehicle additions and disposals.

(6 marks)

(b) Illustrate the substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence regarding the valuation of EcoCycle Ltd's trade receivables.

(6 marks)

(c) Illustrate the substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence regarding the potential breach of environmental regulations by EcoCycle Ltd.

(6 marks)

(d) Identify the issue and evaluate the impact on the auditor's report, if any, should this issue remain unresolved related to legal action in the subsequent event.

(7 marks)

[TOTAL 25 MARKS]

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QUESTION 4

It is 1 August 20X5. You are an audit supervisor at Summit & Co, reviewing extracts from the internal controls documentation in preparation for the interim audit of Alpine Co. The company's year-end is 30 September 20X5. Alpine Co provides professional training services for individuals pursuing certifications in structural engineering. Its customers are corporate employers that sponsor their employees for weekly training sessions. Alpine Co operates 50 training centres nationwide.

Non-Current Assets

Alpine Co's training centres are either company-owned or leased under long-term agreements. The company also maintains a corporate headquarters and a central warehouse for storing training materials. Each training centre operates as an independent department, with an assigned annual asset expenditure budget. Some departments have already significantly exceeded their budgets.

When new equipment is purchased, the finance department categorizes the expenditure as either an asset or an expense, based on guidelines issued by the finance director. The finance director performs sample checks to ensure compliance with the classification policy.

Alpine Co's internal audit (IA) department is responsible for verifying the existence of non-current assets by reconciling the non-current asset register with the physical assets located at each training centre. However, due to staff shortages, the IA department has only been able to visit five of the largest centres and four additional randomly selected centres this year.

Payroll

Alpine Co's human resources (HR) department handles new employee registrations. HR completes pre-printed joiners' forms, ensuring all required data is documented and verified before forwarding copies to the payroll department for employee setup.

All members of the payroll team have access to modify standing payroll data, as they share the same password, which is updated quarterly by the payroll director.

Employees receive their salaries via bank transfers on a monthly basis. A senior payroll manager reviews the bank payment list, reconciling it with payroll records. Any discrepancies identified are adjusted directly in the payroll records by the senior payroll manager.

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Sales and Bank Reconciliation

New customers undergo a credit card verification before being added to the individual customer master file. The sales director assigns each new customer a credit limit, which remains unchanged unless a customer formally requests a review.

Each new customer is allocated a client services manager, responsible for managing customer relations and increasing sales. Standard payment terms are 30 days. Monthly reports of invoices outstanding beyond 90 days are sent to the relevant client services manager, who follows up with the customer.

The cashier performs monthly reconciliations of bank statements against the bank ledger account. The financial controller reviews these reconciliations, investigates discrepancies, and documents the review with a signature.

Required:

- a) Identify and explain THREE DIRECT CONTROLS on which the auditor may seek reliance.
(6 marks)
- b) Justify a TEST OF CONTROL the auditor should perform to assess if each of these direct controls is operating effectively.
(6 marks)
- c) Identify and explain FOUR DEFICIENCIES in Alpine Co's internal control system and provide a control recommendation to address each of these deficiencies.
(13 marks)

[TOTAL 25 MARKS]

END OF QUESTIONS