

BINDURA UNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTANCY

PROGRAMMES

BACHELOR OF ACCOUNTANCY (HONOURS) DEGREE

COURSE: ADVANCED AUDITING 1 EXAMINATION PAPER (AC403)

DURATION: 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Answer all questions
2. Cell phones are not allowed in the examination
3. Start each question on a fresh page

QUESTION 1

You work in the Quality Control department of CPA Ireland. You have been contacted by a member in practice, Bobby Salter, about what he feels is an ethical dilemma he is facing. Bobby has recently been appointed as a partner of Murphy & Co, a medium-sized firm of Certified Public Accountants and Registered Auditors. He has been a close personal friend of Adam Murphy, the firm's managing partner for many years. Bobby was previously training manager in the firm and he has now been asked to act as training partner.

This is the first time Murphy & Co have designated a particular partner as having responsibility for training. As part of their professional development, trainees are expected to keep a 'learning log' - a kind of professional diary - which Bobby reviews periodically. During a recent review, one of the trainees, Sarah Costigan, noted that she was disturbed by something that had happened on an audit of a company called Smiggy Ltd, a medium-sized family-run business and longstanding client of Murphy & Co.

Sarah was auditing purchases of non-current assets when she noticed a transaction that she thought might be suspicious. There was a charge of €175,000 (an individually material amount) for a sophisticated IT video conferencing system for an address in a rural area with no obvious link to the company.

When she asked Smiggy's financial controller about the matter she was told it referred to the installation of such a system in a second home owned by the CEO. This was to facilitate excellent communications and interaction with the CEO especially during the summer period when he liked to reside there with his family. She further explained that part of the cost was attributed to having to pay for a personal broadband connection since the house was in an isolated area where normal broadband connections were unavailable. The financial controller appeared surprised and even irritated by the queries about the matter and said that auditors had not previously been concerned about the company being charged for non-current assets and operational expenses at properties owned by the CEO.

The engagement partner on the assignment happened to be the managing partner, Adam Murphy. Sarah told him what she had found and Adam simply said that the charge could probably be ignored. He did, however, say that he would include a reference to the matter in the written representations letter required by ISA 580 - Written Representations adding with a smile that "paper never refused ink".

About two months later, Sarah looked at the completed files and the letter of representation in which there was no reference to the matter. When Sarah asked Adam about it he said "Oh dear! Must have slipped my mind. Sorry. I really must get into the habit of writing things down. Still - nothing we can do about now. All's well that ends well!"

When Bobby Salter read about Sarah's concerns and spoke to her directly, he realised that there was an ethical issue. At the very least the transaction should have been disclosed as a related party transaction under IAS 24 Related Party Disclosures but the situation was made more complicated by the fact that Adam Murphy was (for all practical purposes) still Bobby's boss in Murphy & Co.

Required:

Draft a letter to Bobby in which you:

- (a) Discuss the meaning of 'integrity' and its importance in professional relationships such as those described in the above scenario. (4 marks)
- (b) Critique Adam Murphy's ethical and professional behaviour. (9 marks)
- (c) Critically evaluate the alternatives available to Bobby Salter with regard to his ethical dilemma. (12 marks)

[Total 25 marks]

QUESTION 2

SECTION A

(a)

Sunflower Stores Co (Sunflower) operates 25 food supermarkets. The company's current year end is 31 December 2021. The audit manager and partner recently attended a planning meeting with the finance director and have provided you with the planning notes below. You are the audit senior, and this is your first year on this audit. In order to familiarise yourself with Sunflower, the audit manager has asked you to undertake some research in order to gain an understanding of Sunflower, so that you are able to assist in the planning process. He has then asked that you identify relevant audit risks from the notes below and also consider how the team should respond to these risks.

Sunflower has spent \$1.6 million in refurbishing all of its supermarkets; as part of this refurbishment programme their central warehouse has been extended and a smaller warehouse, which was only occasionally used, has been disposed of at a profit. In order to finance this refurbishment, a sum of \$1.5 million was borrowed from the bank. This is due to be repaid over five years.

The company will be performing a year-end inventory count at the central warehouse as well as at all 25 supermarkets on 31 December. Inventory is valued at selling price

less an average profit margin as the finance director believes that this is a close approximation to cost.

Prior to 2021, each of the supermarkets maintained their own financial records and submitted returns monthly to head office. During 2021 all accounting records have been centralised within head office. Therefore at the beginning of the year, each supermarket's opening balances were transferred into head office's accounting records. The increased workload at head office has led to some changes in the finance department and in November 2021 the financial controller left. His replacement will start in late December.

Required

- (a) List FIVE sources of information that would be of use in gaining an understanding of Sunflower Stores Co, and for each source describe what you would expect to obtain.

(5 marks)

- (b) Using the information provided, describe FIVE audit risks and explain the auditor's response to each risk in planning the audit of Sunflower Stores Co.

(7 marks)

SECTION B

You are the audit manager of a new client, CBD Manufacturing Ltd (CBD), which operates from a single site, and employs approximately 900 production and 100 administrative staff. You are reviewing the audit documentation produced to date as the first interim audit (conducted by your firm) draws to a close. You note that the following appear to be the most important points raised by the audit senior and her staff:

- The company manufactures products that are considered to be of extremely high quality and all members of staff are committed to the maintenance of a excellent standards in the manufacturing process. Customers recognise and appreciate the quality of CBD's products.
- Company managers and supervisors are happy to empower their employees and, whenever possible, to encourage them to use their initiative and make decisions with a minimum of formality.
- This approach encourages creativity, but has harmed the control environment which is now excessively lax. For example, most employees pay only 'lip service' to the budgetary control system and many completely ignore the variance reports that it

produces. This has a negative effect on morale in the accounts department because the accounts staff often find it very difficult to get co-operation from managers who tend to prioritise other matters.

- Suppliers, meanwhile, report that in most instances payment is received from CBD almost instantly but, in a few cases, receiving payment can require several calls and e-mails. This is apparently because CBD's accounts staff receive erroneous or incomplete reports in relation to orders placed and goods received.
- The monitoring of controls is also highly inadequate for a company of this size, and there is no internal audit department (or similar function) to supervise the control system. All of the above is substantiated by the results of the tests of controls carried out in the course of the interim audit.

REQUIREMENT:

Prepare a letter to the Board of Directors in which you recommend the steps the Board of Directors should take in order to create an effective Internal Audit department

(13 marks)

[Total 25 marks]

QUESTION 3

Chloe Hare is a senior partner in Rabbite and Hare, Certified Public Accountants & Statutory Audit Firm. She oversees the Business Services Division which generally looks after work that doesn't entirely fit into other categories such as audit, taxation, or liquidation. She is approached by one of the senior audit partners who asks if she could supply a high-ranking staff member to temporarily replace the Finance Director of Oust Ltd, an audit client involved with mining and commodity production. The audit partner explains that the current finance director has had to take an extended period of medical leave due to stress and the company has neither the time nor the resources to find a replacement who could ensure that the company is prepared for the annual audit which is due to begin in about 10 weeks' time.

In view of the urgency and apparent sincerity of the request and in light of the importance of the client to the practice, Chloe accedes to the request. She designates Mandy Hall, the most senior manager in the Business Services Division, for the task. She emphasises to Mandy the need for confidentiality and 'Chinese walls' to be maintained between her and her colleagues in the audit division for the duration of this assignment. Oust Ltd has been struggling of late as the mining and commodities sector is suffering

from a worldwide slowdown. Mandy quickly discovers that the previous Finance Director was not very well organised and she has difficulty locating the papers supporting the draft financial statements. However, she does eventually locate these and soon her attention is drawn by a small number of journals which have minimal documentary back-up. These journals were posted six months ago and increase the sales figure by more than 20%.

The journals refer to the Ketter project. It also appears that payment remains outstanding in respect of this project. Mandy decides to follow this up with the Chief Executive who explains that the Ketter project relates to a one-off shipment of a so-called 'rare earth' mineral to an entity based in Eastland, a country in the Far East. He further tells Mandy that only a few people know about this contract as apparently a number of countries have placed an embargo on supplying goods of this nature to businesses in Eastland.

This is also why the normal sales processes were not followed. He says he is extremely confident of receiving payment as the business which received the shipment is very profitable and cash rich. However, he doesn't want to "rock the boat" about the issue just now in case it could jeopardise potential future business. In the course of her work, Mandy also discovers that the Chief Executive has substantial share options which will be exercisable on 31 December 2022.

Required:

- (a) Critique the decision to provide a staff member from the Business Services Decision to temporarily assume some functions of the Finance Director in Oust Ltd under the circumstances described. (9 marks)
- (b) Recommend and justify the most appropriate course of action that should be followed by Mandy at this point. (9 marks)
- (c) Discuss the responsibility, or otherwise, of Mandy and Chloe to their colleagues in the audit division of Rabbite and Hare. (7 mark)

[Total: 25 Marks]

QUESTION 4

You are a partner in a two-partner practice in a small rural town in Ireland. There has been much talk in the town over the last few years about the migration of the population to urban centres; the closing down of several retail businesses; and the general feeling of pervasive neglect in the town centre. Some local community groups

recently got together and opened a coffee shop, a small grocery store, and a community centre in a previously disused property, provided on a long lease at a 'peppercorn' rent by the local council.

The enterprise is run by a management committee consisting of a member of the county council, the principal of the local school, two local business people and the parish priest. Although, between them, they have considerable experience of various 'for-profit' and 'not-for-profit' ventures, none has particular experience of managing retail outlets or coffee shops. The enterprise is run on a day-to-day basis by the manager who is the only full-time employee experienced in the type of businesses involved. There is one other paid part-time employee - the assistant manager - but all other staff are volunteers. The enterprise is registered as a charity with a legal requirement to reinvest any excess of income over expenditure into the operation, or into other local community initiatives, as the management committee sees fit.

It has been just over a year since the coffee shop was opened, and you are approached by a member of the management committee (a local business owner who is also one of your largest clients) to become the auditor of the not-for-profit enterprise. He tells you that the committee, of course, would not expect you to provide this service entirely pro bono (free of charge). He also mentions that he knows you wouldn't want to be seen to turn down this opportunity, given the way that "news can travel around in a small town". He is well aware that the revenue generated by the enterprise is less than 5% of the limit at which a statutory audit would be required. However, he says that the committee feels that it could be perceived as "negligent" or "attempting a cover up" if it did not request an audit, should any problems involving, for example, the misappropriation of assets emerge in the future.

Required:

- (a) Evaluate, from an auditor's perspective, the importance of controls compliance, in the case of a small, independent charity such as described above. (9 marks)
- (b) Evaluate the ethical difficulties and other risks presented to your practice as a result of the request from your client to become the auditor of this registered charity. (5 marks)
- (c) Critically analyse the management committee's assertion that it needs to be seen to have appointed an auditor in case difficult issues such as asset misappropriation should subsequently emerge. (5 marks)
- (d) Assess the extent to which a "review" assignment, as distinct from a full

(e) audit assignment, would be a more appropriate solution to the issues raised in this scenario. (6 marks)

[Total 25 narks]

END OF QUESTION PAPER