

**A. MULTIPLE CHOICE QUESTIONS (30%)**

Read the below scenario and answer questions 1-5

You are the audit manager responsible for planning the audit of Rottnest Co. during the planning of the audit you have identified an increased risk of material misstatement due to fraud. The audit strategy and the audit plan reflect this increased risk.

- 1. Which of the following statements regarding fraud is correct?**
  - a. The auditor may not detect all material fraud in the financial statements but this won't necessarily mean the auditor has been negligent due to the nature of fraud and the likelihood of concealment.
  - b. The auditor must detect all material fraud in the financial statements.
  - c. The auditor must detect every fraud in the financial statements
  - d. The auditor is not responsible for detecting fraud as this is management's responsibility
  
- 2. If material misstatement as a result of fraud is detected during the audit, and is not corrected by management, how will this be communicated to the shareholders?**
  - a. The auditor must send a letter to the shareholders informing them of the fraud
  - b. The auditor must speak at the annual general meeting and specifically inform them
  - c. The auditor will report it to the police and the police will notify the shareholders
  - d. Through the audit report as the opinion will be modified
  
- 3. Which of the following procedures must the auditor perform to respond to the risk of fraud?**
  - (i) The auditor must obtain written representation from management confirming they have disclosed all known and suspected frauds to the auditor.
  - (ii) The auditor must incorporate an unpredictable element into the design of their audit procedures .
  - (iii) The auditor must test year end journal entries and estimates which may be used to manipulate the financial statements.
  - a. (i) and (ii) only
  - b. (i) and (iii) only
  - c. (ii) and (iii) only
  - d. (i), (ii) and (iii)
  
- 4. Which of the following statements is true in respect of the audit plan?**
  - a. The audit plan sets out the scope direction and framework for the audit.
  - b. The audit plan contains the detailed audit procedures designed to obtain sufficient appropriate evidence including the objective of each procedure and the sample size to be tested.
  - c. The plan includes preliminary engagement activities such as materiality and risk assessment
  - d. The audit plan is developed before the audit strategy

**5. Which matters will not be included in the audit strategy?**

- a. Risk assessment and materiality
- b. Communications with the client
- c. Specific audit procedures to respond to the risks assessed
- d. The need for professional skepticism

**Read the below scenario and answer questions 6- 10**

**During the audit, the auditor will use sampling. There are a variety of sampling methods available. Some sampling methods are statistical and some non-statistical. The auditor must use an appropriate method for the item being tested.**

**6. You have identified a higher than expected deviation rate when performing tests of controls over purchases. Which of the following would be an appropriate response?**

- (i) Pick alternative items to test in place of those just tested and ignore the deviations.
  - (ii) Extend the sample size.
  - (iii) Perform more substantive procedures over purchases as tests of controls have not provided sufficient appropriate evidence .
- a. (i) and (ii) only
  - b. (iii) only
  - c. (ii) and (iii) only
  - d. (i),(ii) and (iii)

**7. Which of the following statements is true?**

- a. Random sampling is a method where the auditor picks the sample with no particular pattern
- b. Deviations must be extrapolated to determine the effect on the population
- c. Block sampling is where the auditor tests all items in a population
- d. Monetary unit sampling is a statistical method of sampling

**8. Which of the following constitutes sampling?**

- a. Where less than 100% of the items in a population are tested and have an equal chance of selection
- b. Where less than 100% of the items in a population are tested and have a chance of selection
- c. Where items within a population with certain characteristics are chosen for testing
- d. Where every nth item in a population are chosen for testing

**9. Which of the following statements is true?**

- a. Statistical sampling methods are more reliable than non-statistical methods
- b. The auditor must always use stratification to ensure a representative sample is tested
- c. More than one sampling method may be used to test one population
- d. A deviation occurs when a result differs from expectation during a substantive procedure

**10. The auditor has identified a misstatement in a sample. Which of the following is the most appropriate initial course of action?**

- a. Consider whether the misstatement is an anomaly or representative of further possible misstatement
- b. Inform the client of the misstatement
- c. Calculate the materiality of the misstatement in relation to the financial statements
- d. Compare the misstatement to the tolerable misstatement level

**Read the below scenario and answer questions 11- 15**

**You are planning the audit of Wyndham Co. The company sells diamonds and other precious stones. You have decided to use the work of an auditor's expert to provide sufficient appropriate evidence over the valuation of inventory.**

**11. Before appointing an auditor's expert, what factors must the auditor consider?**

- (i) Competence
  - (ii) Capability
  - (iii) Objectivity
  - (iv) Reliability of the source data
- a. (i), (ii) and (iii)
  - b. (ii), (iii) and (iv)
  - c. (i) (iii) and (iv) only
  - d. (i), (ii), (iii) and (iv)

**12. How can the auditor assess the competence of an auditor's expert?**

- (i) Obtain copies of professional certificates and make enquiries of the expert's experience.
  - (ii) Ask for confirmation from the expert of their independence .
  - (iii) Inspect the register of members of the relevant professional body for the name of the expert.
- a. (i) and (ii) only
  - b. (ii) and (iii) only
  - c. (i) and (iii) only
  - d. (i), (ii) and (iii)

**13. What must be agreed with the auditor's expert in writing before the work is performed?**

- (i) Responsibilities of each party
  - (ii) Inherent limitations of the audit
  - (iii) Deadline for the work
  - (iv) Scope and objectives
- a. All of them
  - b. (i), (iii) and (iv) only
  - c. (iii) and (ii) only
  - d. (i), (ii) and (iv) only

**14. Which of the following statements is true in respect of the expert's work?**

- a. The auditor can rely on expert's work and does not need to review it
- b. The auditor may choose not to review the expert's work if it is an area in which the auditor lacks knowledge or experience
- c. The auditor must review the assumptions and source data used by the expert to ensure they were reasonable and reliable
- d. The auditor will engage a second expert to review the work of the first to ensure sufficient appropriate evidence has been obtained

**15. Which of the following statements best describes a management's expert?**

- a. A management's expert is an employee of the company
- b. A management's expert is someone appointed by the company to provide evidence for the auditor
- c. A management's expert is someone recommended by the auditor which management appoints to provide evidence for the audit
- d. A management's expert is someone appointed by the company to provide evidence for management which may be relied upon by the auditor

**Read the below scenario and answer questions 16- 15**

**You are testing the controls over the payroll system of Sunbury Co. You have confirmed that the following controls have operated throughout the year:**

- Sample check of payroll calculations by a payroll manager.
- Review of the payroll listing once prepared before details are entered into the banking system.
- Segregation of duties between calculation of monthly payroll and responsibility for changes to standing data.
- Each department manager receives a list of employees in their department for them to sign to confirm those employees should be paid.

**16. Which of the following is the main reason for the control of segregation of duties between calculation of payroll and responsibility for changes to standing data?**

- a. Changes to standing data must be performed by a manager whereas payroll calculations can be performed by a payroll clerk
- b. If one person was responsible for both they would be more likely to make errors due to a high workload
- c. If one person was responsible for both they could increase their salary and make fraudulent payments to themselves
- d. Each individual role within an organization must be carried out by different people

- 17. Which of the following procedures would provide the most reliable evidence that the first control, payroll calculations are checked by a payroll manager, is working effectively?**
- Enquiry with the payroll clerk performing the payroll calculation
  - Enquiry with the payroll manager performing the check
  - Recalculation of the payroll amounts by the auditor
  - Inspection of the payroll report for evidence that a sample of payroll amounts are checked
- 18. Which of the following is not a test of control?**
- Inspection of employee contracts to confirm the salary the employee should be paid
  - Inspection of payroll reports for evidence of authorisation by the manager
  - Inspection of the list of employees for each department for evidence of the department manager's review
  - Observation of the payroll function to confirm segregation of duties is in place
- 19. Which of the following is a control objective relevant to the control that each department manager reviews the list of employees to be paid?**
- To ensure payroll is accurately calculated
  - To ensure only valid employees are paid
  - To ensure employees are paid for the correct hours
  - To ensure employees are paid at the correct salary
- 20. Which of the following could be used by Bunbury Co to monitor the effectiveness of the company's controls?**
- Internal audit assignments
  - Performing bank reconciliations
  - Authorisation of payments
  - Segregation of duties

**B. Cases**

**Case # 1 (25%)**

You are the audit senior of Seagull & Co and are currently planning the audit of your existing client, Eagle Heating Co (EHC), for the year ending 31 August 20X5. EHC manufactures and sells heating and plumbing equipment to a number of home improvement stores across the country.

EHC has experienced increased competition and as a result, in order to maintain its current levels of sales, it has decreased the selling price of its products significantly. The finance director has informed your audit manager that he expects increased inventory levels at the year end. He also notified your manager that one of EHC's key customers has been experiencing financial difficulties. Therefore, EHC has agreed that the customer can take a six-month payment break, after which payments will continue as normal. The finance director does not believe that any allowance is required against this receivable.

In June 20X5 the financial controller of EHC was dismissed. He had been employed by the company for over 20 years, and he has threatened to sue the company for unfair dismissal. The

role of financial controller has not yet been filled and so his tasks have been shared between the existing finance department team. In addition, the purchase ledger supervisor left in April and a replacement has been appointed in the last week. However, for this period no supplier statement reconciliations or purchase ledger control account reconciliations were performed.

**Financial statement extracts for year ended 31 August**

	<b>20X5</b>	<b>20X4</b>
	<b>\$m</b>	<b>\$m</b>
Revenue	246	283
Cost of sales	<u>172</u>	<u>184</u>
Gross profit	74	99
Operating expenses	<u>40</u>	<u>50</u>
Operating profit	<u>34</u>	<u>49</u>
Inventory	51	28
Trade receivables	35	25
Cash	0.1	3.4
Trade payables	19	16
Other current liabilities	5	5

**Required:**

- a) Calculate FOUR ratios, for BOTH years, which would assist in planning the audit of EHC:
  - Quick Ratio
  - Payables Payment Period
  - Receivables Collection Period
  - Operating Profit Margin
- b) Using the information provided and the ratios calculated, identify and describe FIVE audit risks and explain the auditor’s response to each risk in planning the audit of EHC.
- c) Describe the substantive procedures that should be performed to obtain sufficient and appropriate evidence in relation to the receivable balance outstanding from EHC’s key customer.
- d) Explain the audit senior’s responsibilities in relation to supervising the work of the audit team during the audit of EHC.

**Case # 2 (25%)**

**DEAN MANUFACTURING**

You are the senior in charge of the audit of Dean Manufacturing. To assist you in your audit planning, one of the audit team has provided the following description of the purchasing system. No other controls exist apart from those described.

The company has no buying department so employees place orders in their own area of responsibility. A three part order form is used; copy 1 is retained by the originator, copy 2 is sent to the goods inward department and copy 3 is sent to the supplier.

Goods are received, but not checked, by the goods inwards clerk. Once received, the supplier's delivery note and the purchase order for those goods are sent to the purchase ledger clerk.

When the supplier's invoice is received the purchase ledger clerk checks the calculations on it, initials it and staples the delivery note and purchase order to it. She enters the invoice on to the purchase ledger.

The invoice is then sent to the manager responsible for the employee who ordered the goods. The manager codes the invoice and returns it to the purchase ledger clerk. Coded purchase invoices are entered onto an analysis sheet and posted to the nominal ledger monthly by journal entry.

The cashier pays suppliers monthly on instructions from the purchase ledger clerk. The purchase ledger control account is reconciled monthly by the purchase ledger clerk who also reconciles suppliers' statements.

**Required:**

**For each internal control deficiency in the purchasing system:**

- (a) Identify the deficiency and briefly explain its audit significance (if any), in terms of the type of errors that could result from it.**
- (b) Describe the effect it would have on your normal audit procedures in terms of any additional or extended procedures required.**

**Case # 3 (20%)**

You are currently reviewing the working papers of several audit assignments recently carried out by your audit firm. Each of the audit engagements is nearing completion, but certain matters have recently come to light which may affect your audit opinion on each of the engagements. In each case the year-end of the company is 30 September 20X2.

**(a) Jones (Profit before tax \$150,000)**

On October 20X2 a letter was received informing the company that a consumer, who owed the company \$30,000 as at the year-end, had been declared bankrupt on 30 September. At the time of the audit it was expected that unsecured creditors, such as Jones, would receive nothing in respect of this debt. The directors refuse to change the financial statements to provide for the loss, on the grounds that the notification was not received by the statement of the financial position dates.

Total debts shown in the statement of financial position amounted to \$700,000.

**(b) Roberts (Profit before tax) \$500,000)**

On 31 July 20x2 a customer sued the company for personal damages arising from a defect in one of its products. Shortly before the year end the company made an out of court settlement with the customer of \$10,000, although this agreement is not reflected in the financial

statements. Further, the matter subsequently became known to the press and was extensively reported. The company's legal advisers have now informed you that further claims have been received following the publicity, although they are unable to place a figure on the potential liability arising. The company has referred to the claims in a note to the financial statements stating that no provision has been made because the claims are not expected to be material.

**(c) Griffiths (Profit before tax \$250,000)**

The audit work revealed that a trade investment stated in the statement of financial position at \$500,000 has suffered a permanent fall in value of \$300,000. The company has refused to put an impairment charge through for it on the grounds that other investments (not held for resale) have risen in value and are stated at amounts considerably below their realizable values.

**(d) Evans (Profit before tax \$100,000)**

This client is a construction company, currently building a warehouse on its premises and using some of its own workforce. The labor cost has been included in the cost of the non-current asset in the statement of financial position at a value of \$10,000. During the audit it was discovered that the direct labor cost records for the early of the year have been accidentally destroyed.

**Required:**

**Discuss each of the cases outlined above, referring to materiality considerations and, where appropriate, relevant accounting principles and appropriate accounting standards. Explain the audit reporting implications in each case.**

***Good Work!!***