A. MULTIPLE CHOICE QUESTIONS (20%)

1	B	6	C
2	A	7	C
3	A	8	A
4	A	9	B
5	C	10	D

B. True OR False (15%)

1	T	9	T
2	F	10	T
3	T	11	F
4	F	12	T
5	T	13	T
6	F	14	T
7	T	15	F
8	T		

C. Exercises

Exercise 1 (30%)

(a) Describe 5 substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Jasmine Co.'s trade receivables.

- Obtain the aged receivables listing and agree to the balance on the sales ledger control account and trial balance.
- Review the aged trade receivables ledger to identify any slow moving or old balances, discuss the status of these balances with the credit controller to assess whether they are likely to pay.
- Select a representative sample of trade receivables and review for any after-date cash receipts. Ensure that a sample of slow moving/old receivable balances is also selected.
- Review customer correspondence to identify any balances which are in dispute or unlikely to be paid and discuss with management.
- Review board minutes to identify whether there are any significant concerns in relation to payments by customers.

- Calculate the average receivables collection period and compare this to the prior year and investigate any significant differences.
- Inspect post year-end sales returns/credit notes and consider whether an additional allowance against receivables is required.
- Obtain a breakdown of the allowance for trade receivables, recalculate and compare to any potentially irrecoverable balances to assess if the allowance is adequate.
- Select a sample of goods dispatched notes (GDN) immediately before and after the year end and follow through to the receivables ledger to ensure they are recorded in the correct accounting period.
- Select a sample of year-end receivables balances and agree back to valid supporting documentation of sales invoices, GDNs and sales orders to ensure existence.

(b) Describe 5 substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Jasmine Co.'s bank balances.

- Obtain a bank confirmation letter from Jasmine Co's bankers for all of its accounts.
- Agree all accounts listed on the bank confirmation letter to the company's bank reconciliations or the trial balance/general ledger to ensure completeness of bank balances.
- For the current account, obtain Jasmine Co's bank reconciliation and cast to check the additions to ensure arithmetical accuracy.
- Agree the balance per the bank reconciliation to an original year-end bank statement and to the bank confirmation letter.
- Agree the reconciliation's balance per the cash book to the year-end cash book.
- Trace all the outstanding lodgements to the pre year-end cash book, post year-end bank statement and also to the paying-in book pre year end.
- Trace all unpresented cheques through to a pre year-end cash book and post year-end bank statement. For any unusual amounts or significant delays, obtain explanations from management.
- Examine any old unpresented cheques to assess whether they need to be written back.
- Review the cash book and bank statements for any unusual items or large transfers around the year end, as this could be evidence of window dressing.
- Examine the bank confirmation letter for details of any security provided by Jasmine Co, with regards to the bank overdraft or any legal right of set-off as this may require disclosure.
- For the savings bank accounts, review any reconciling items on the year-end bank reconciliations and agree to supporting documentation.
- Review the financial statements to ensure that the disclosure of bank balances is complete and accurate and classified appropriately between current assets and current liabilities.

(c) Describe 5 the audit procedures the auditor should perform in assessing whether or not Jasmine Co is a going concern.

- Obtain the company's cash flow forecast and review the cash inflows and outflows. Assess the assumptions for reasonableness and discuss the findings with management to understand if the company will have sufficient cash.
- Perform a sensitivity analysis on the cash flows to understand the margin of safety the company has in terms of its net cash in/outflow.
- Evaluate management's plans for future actions, including their contingency plans in relation to ongoing financing and plans for generating revenue, and consider the feasibility of these plans.
- Review the company's post year-end sales and order book to assess if the levels of trade are likely to increase and if the revenue figures in the cash flow forecast are reasonable.
- Review any agreements with the bank to determine whether any covenants have been breached, especially in relation to the overdraft.
- Review any bank correspondence to assess the likelihood of the bank renewing the overdraft facility.
- Review post year-end correspondence with suppliers to identify if any have threatened legal action or any others have refused to supply goods.
- With the client's permission, enquire of the lawyers of Jasmine Co as to the existence of any litigation and if so, the likely outcome of any litigation.
- Perform audit tests in relation to subsequent events to identify any items which might indicate or mitigate the risk of going concern not being appropriate.
- Review the post year-end board minutes to identify any other issues which might indicate further financial difficulties for the company.
- Review post year-end management accounts to assess if in line with cash flow forecast.
- Consider whether any additional disclosures as required by IAS 1 *Presentation of Financial Statements* in relation to material uncertainties over going concern should be made in the financial statements.
- Consider whether the going concern basis is appropriate for the preparation of the financial statements.
- Obtain a written representation confirming the directors' view that Jasmine Co is a going concern.

(d) Discuss the issue and describe the impact on the auditor's report of Jasmine Co of adequate AND inadequate going concern disclosure.

<u>auditor's report:</u>

As the outcome regarding the negotiations for the overdraft facility renewal will not be known at the time of signing the auditor's report, there is a material uncertainty which may cast significant doubt on the company's ability to continue as a going concern.

The impact on the auditor's report depends on whether this uncertainty is deemed to be adequately disclosed in the financial statements.

Disclosure adequate

If the disclosures are adequate, then the auditor's report will need to include a material uncertainty related to going concern section.

The section will state that the audit opinion is not modified, indicate that there is a material uncertainty and will cross reference to the disclosure note made by management. It would be included after the opinion and basis for opinion paragraph.

Disclosure inadequate

If the disclosures made by management are not adequate, the audit opinion will need to be modified as there is a material misstatement relating to inadequate disclosure. The failure to adequately disclose is likely to be material but not pervasive due to the ongoing nature of the negotiations and so a qualified opinion will be issued.

The opinion paragraph will state that 'except for' the failure to adequately disclose the uncertainty, the financial statements give a true and fair view. The report will contain a basis for opinion paragraph, subsequent to the opinion paragraph, explaining that a material uncertainty exists and that the financial statements do not adequately disclose this matter.

Exercise2 (15%)

Read the following scenario and answer the below:

You are an audit manager in Tigger &Co, a large audit firm which specializes in the audit of car manufacturers. The firm currently audits Winne Co. Winnie Co.'s main competitor, Piglet Co, has approached Tigger &Co to act as auditor. The audit engagement partner for Winnie Co has been in place for seven years. Winnie Co has approached Tigger &Co to provide internal audit services as well as the external audit.

3. Select whether the following statements are true or false in respect of the audit of Winnie Co. knowing that they have suggested that the external audit fee should be renegotiated with at least 20% of the fee being based on the profit after tax of the company as they feel that this will align the interests of Tigger &Co and Winne Co.

	TRUE	**FALSE**
The audit partner must be rotated	√	
The proposal of 20% of the audit fee being based on profit is acceptable if appropriate safeguards are implemented		√
Being appointed as internal auditor as well external auditor for Winnie CV will create a confidentiality threat.		√

1	C
2	B
4	A and D

<u>Exercise 3 (20%)</u>

A financial statement audit typically consists of four phases. Identify each of these four phases of an audit and discuss the major activities performed by the auditor in each phase.

Phase I: Plan and design an audit approach. In this phase, the auditor obtains an understanding of the client's entity and its environment. In addition, the auditor obtains an understanding of the client's internal control and assesses the risk of material misstatement.

Phase II: Perform tests of controls and substantive tests of transactions. In this phase, the auditor tests those internal controls he/she believes may be effective at preventing or detecting misstatements. In addition, the auditor performs substantive tests of transactions to verify the monetary amounts of transactions.

Phase III: Perform analytical procedures and tests of details of balances. In this phase, the auditor performs analytical procedures to assess the overall reasonableness of transactions and balances. In addition, tests of details of balances are performed to test for monetary misstatements in the financial statements.

Phase IV: Complete the audit and issue an audit report. In the last phase of the audit, the information obtained in the previous phases is combined to reach an overall conclusion as to whether the financial statements are fairly presented. An audit report is then issued based on this conclusion.

Good Work!!