

A. MULTIPLE CHOICE QUESTIONS (30%)

The following scenario relates to questions 1–9

You are the audit senior working on the audit of Bash Enterprises. Bash Enterprises' main activity is the extraction and supply of building materials including sand, gravel and cement. The company's year-end is 31 July 20XS.

You are preparing the audit plan for the non-current assets section ready for the forthcoming audit.

Bash Enterprises has the following non-current assets included in the financial statements:

	length of ownership	Cost	Accumulated depreciation	Depreciation policy
Land	12 years	\$200,000	\$0	No depreciation
Buildings	12 years	\$500,000	\$120,000	2% straight line
Railway trucks	1 year	\$1,000,000	\$200,000	20% reducing balance
Fixtures & fittings	3 years	\$80,000	\$24,000	10% straight line
Other plant & machinery	6 years	\$300,000	\$120,000	10% reducing balance

Audit procedures

The following audit procedures are included in the audit plan for non-current assets:

1. Physically inspect the assets for signs of damage and ensure they are being used by Bash Enterprises
2. Trace a sample of physical assets into the non-current asset register
3. Recalculate the depreciation charge using the client's policy
4. Trace a sample of assets from the non-current asset register to the asset.

Revaluation of land and buildings

The directors of Bash Enterprises are planning to revalue the land and buildings at the year end. They plan to use an expert to perform the revaluations and have decided on a short list of two companies, Verity Valuations, which is a company run by the wife of one of the directors of Bash Enterprises, and Perfect Properties, an estate agent which also provides property valuations. Both companies are registered with the Chartered Institute of Surveyors and all property valuation experts are qualified.

Q 1. 2. 3. 4. Select which assertion is being tested by the audit procedures included in the audit plan.

	Completeness	Existence	Accuracy, valuation, allocation
1			
2			
3			
4			

Q 5. Which of the following procedures provides the most reliable evidence when verifying rights and obligations of the railway trucks?

- A. Enquire of management whether Bash Enterprises is the legal owner of the trucks
- B. Inspect the purchase invoice or registration document of the trucks
- C. Contact the supplier and ask for external confirmation that Bash purchased the trucks
- D. Physically inspect the trucks to ensure they are being used by Bash Enterprises

Q 6. Based on the information provided, which of the following categories of asset appears to be overstated?

- A. Land
- B. Buildings
- C. Fixtures and fittings
- D. Other plant and machinery

Q 7. Which of the following statements is/are true in respect of the revaluation of land and buildings?

- 1. Bash Enterprises do not need to use a firm of chartered surveyors to perform the revaluation.
- 2. The financial statements must disclose details of the revaluation and details of who performed the revaluation.
- 3. The audit firm would not be able to rely on the work of Verity Valuations.

- A. 2 only
- B. 1 and 3 only
- C. 1 and 2 only
- D. 1, 2 and 3

Q 8. 9. Which TWO of the following financial statement assertions will need to be tested when auditing the non-current assets of Bash Enterprises?

- A. Occurrence
- B. Classification
- C. Cut-off
- D. Presentation

The following scenario relates to questions 10- 18

You are the audit senior working on the audit of Green Co. The audit is nearing completion and you are performing the going concern review. The auditor's report is due to be signed next week.

Green Co grows crops on a large farm according to strict organic principles that prohibits the use of artificial pesticides and fertilizers. The farm has an organic certification which guarantees its products are to be organic. The certification has increased its sales of flour, potatoes and other products, as customers seek to eat more healthily.

Last year, a neighbouring farm, Black Co started growing genetically modified (GM) crops, the pollen from which blows over Green Co's fields on a regular basis. This is a threat to Green Co's organic status because

organic crops must not be contaminated with GM material. Green Co is considering court action against Black Co for loss of income and to stop Black Co growing GM crops.

The statement of profit or loss of Green Co shows a significant reduction in revenue and profit for the year. The statement of financial position shows an overdraft balance of \$0.2 million.

Q 10. Which of the following indicates a company is not a going concern?

- A. The company is profitable but the directors have decided to cease trading
- B. The company is able to pay its liabilities when they fall due
- C. The company has no intention of ceasing trading
- D. The company is not in financial difficulties

Q 11. 12. 13. 14. Select whether the following are responsibilities of the directors or auditors in relation to going concern.

	Auditors	Directors
Considers implications for the auditor's report		
Prepares forecasts to assess the going concern status		
Selects the basis of preparation for the financial statements		
Evaluates the appropriateness of the basis of preparation		

Q 15. Which of the following audit procedures would provide the auditor with evidence regarding the going concern uncertainties faced by Green Co?

1. Review the cash flow forecasts to assess whether Green Co will have sufficient cash to pay their liabilities when they fall due.
 2. Assess the reasonableness of the forecast for example whether cash inflows have been reduced to reflect the loss of income.
 3. Review correspondence from Green Co's lawyer regarding the expected outcome of the legal action.
 4. Contact Black Co for their comment on the contamination issue.
- A. 1, 2 and 3 only
 - B. 2,3and4only
 - C. 1 and 4 only
 - D. 1,2,3and4

Q 16. The auditor of Green Co believes there is a material uncertainty relating to going concern. How should Green Co reflect this in the financial statements?

- A. The financial statements should be prepared on an alternative basis
- B. Disclosure of the uncertainties should be included in the financial statements
- C. Unless the company is closing down there is no impact to the financial statements

- D. The financial statements should include the cash flow forecast showing the expected impact of the uncertainties

Q 17. 18. The auditor agrees with the client's treatment of the going concern uncertainties. Which TWO of the following best describe the impacts to the auditor's report?

- A. The auditor's report should contain an Other Matter paragraph
- B. The audit opinion should be adverse
- C. The auditor's report should contain a section called Material Uncertainty Relating to Going Concern
- D. The auditor's report should contain an Emphasis of Matter paragraph
- E. The audit opinion should be unmodified

The following scenario relates to questions 19 - 27

Your firm has been contacted by the managing director of Hendricks Co to discuss the possibility of performing an audit of their financial statements. Hendricks Co does not meet the criteria for requiring an audit but forecasts suggest that it will meet the audit threshold within the next two to three years. The managing director has asked you to explain the benefits of having an audit earlier than required. The managing director would also like you to explain what a review of the financial statements would involve as this is being considered as an alternative to having an audit.

If Hendricks Co decides to appoint your firm as auditor you have been requested to appoint Helen Gordon as audit manager as she is the wife of the finance director. Hendricks Co is also interested in using your firm to prepare the financial statements as they believe this would reduce the amount of audit work required due to there being a lower risk of error. They would expect the audit fee to reflect this.

Q 19. 20. Select the level of assurance given and type of conclusion expressed by a review of the financial statements.

Level of assurance
Moderate
Reasonable

Conclusion
Positive
Negative

Q 21. 22. 23. Which of THREE of the following audit procedures will be performed during a review of the financial statements?

- A. Enquiries of management and client staff
- B. Analytical procedures
- C. Tests of controls
- D. Obtain written representations from management
- E. Obtain external confirmations from receivables

Q 24. Which of the following is NOT a benefit of Hendricks Co having an audit?

- A. The financial statements will be independently scrutinized increasing the reliability of the information
- B. The accuracy of the financial statements will be confirmed
- C. Fraud may be detected
- D. Internal control deficiencies may be highlighted and reported to management

Q 25. 26. Which TWO of the following threats to objectivity would be created if Helen Gordon is appointed as audit manager for the audit of Hendricks Co?

- A. Familiarity
- B. Self-review
- C. Self-interest
- D. Advocacy
- E. Intimidation

Q 27. Which of the following statements is true in respect of the preparation of the financial statements of Hendricks Co?

- A. Financial statements should not be prepared by the accountancy firm
- B. The audit fee will be lower if the firm prepares the financial statements and audits them
- C. The same person who prepared the financial statements should be assigned to the audit team to reduce the time needed to perform the audit
- D. The auditor should take care not to assume management responsibilities such as deciding on the company's accounting policies

Q 28. Which of the following audit procedures may be performed remotely under International Standards on auditing standards?

- A. Fraud inquiry.
- B. Internal control walk-throughs.
- C. Inventory observation.
- D. All of the above.

Q 29. The COVID-19 pandemic has caused the financial position of many organizations to deteriorate. When substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists, which of the following is true?

- A. Disclosure in the financial statements is required regardless of whether substantial doubt is alleviated by management's plans.
- B. If the auditor concludes substantial doubt is alleviated by management's plans, an emphasis-of-matter paragraph is required.
- C. If the auditor concludes the going concern basis of accounting is appropriate but substantial doubt remains, an adverse opinion should be issued.
- D. If the auditor concludes the going concern basis of accounting is not appropriate, a disclaimer of opinion should be issued

Q 30. Auditors are required to include an emphasis-of-matter (EOM) paragraph in their audit opinion when:

- A. Subsequent event disclosures relative to the COVID-19 pandemic will be included in the financial statement footnotes.
- B. The client's fiscal year end falls after the World Health Organization announced a global health emergency (on Jan. 30, 2020).

- C. The auditor is unable to obtain sufficient appropriate audit evidence due to a scope limitation, and the possible effects on the financial statements of undetected misstatements are material but not pervasive.
- D. None of the above.

Q 31. You are auditing the financial statements of a company for the year ended 31 December 2019, which of the following is true with respect to subsequent events?

- A. Decreases in investment valuations resulting from COVID-19 are likely to require recognition in financial statements.
- B. Bad debts resulting from COVID-19 are likely to require recognition in the financial statements.
- C. Subsequent events relative to COVID-19 may require disclosure but are unlikely to be recognized in the financial statements.
- D. Inventory spoilage and obsolescence resulting from COVID-19 are likely to require recognition in the financial statements.

Q 32. Management should disclose risks and uncertainties that could significantly affect (1) amounts reported in the financial statements in the near term, or (2) the near-term functioning of the entity. Risks and uncertainties that require disclosure can stem from:

- A. Activities in which the entity has not yet engaged.
- B. Concentrations in a market or geographic area.
- C. Use of market prices to value marketable securities.
- D. Significant estimates that are expected to remain consistent near term.

Exercise # 1 (30%)

Lily Window Glass Co (Lily) is a glass manufacturer, which operates from a large production facility, where it undertakes continuous production 24 hours a day, seven days a week. Also on this site are two warehouses, where the company's raw materials and finished goods are stored. Lily's year-end is 31 December.

Lily is finalizing the arrangements for the year-end inventory count, which is to be undertaken on 31 December 20X2. The finished windows are stored within 20 aisles of the first warehouse. The second warehouse is for large piles of raw materials, such as sand, used in the manufacture of glass. The following arrangements have been made for the inventory count:

The warehouse manager will supervise the count as he is most familiar with the inventory. There will be ten teams of counters and each team will contain two members of staff, one from the finance and one from the manufacturing department. None of the warehouse staff, other than the manager, will be involved in the count.

Each team will count an aisle of finished goods by counting up and then down each aisle. As this process is systematic, it is not felt that the team will need to flag areas once counted.

Once the team has finished counting an aisle, they will hand in their sheets and be given a set for another aisle of the warehouse. In addition to the above, to assist with the inventory counting, there will be two teams of counters from the internal audit department and they will perform inventory counts.

The count sheets are sequentially numbered, and the product codes and descriptions are printed on them but no quantities. If the counters identify any inventory which is not on their sheets, then they are to enter the item on a separate sheet, which is not numbered.

Once all counting is complete, the sequence of the sheets is checked and any additional sheets are also handed in at this stage. All sheets are completed in ink.

Any damaged goods identified by the counters will be too heavy to move to a central location, hence they are to be left where they are but the counter is to make a note on the inventory sheets detailing the level of damage.

As Lily undertakes continuous production, there will continue to be movements of raw materials and finished goods in and out of the warehouse during the count. These will be kept to a minimum where possible.

The level of work-in-progress in the manufacturing plant is to be assessed by the warehouse manager. It is likely that this will be an immaterial balance. In addition, the raw materials quantities are to be approximated by measuring the height and width of the raw material piles. In the past this task has been undertaken by a specialist; however, the warehouse manager feels confident that he can perform this task.

Required:

(a) For the inventory count arrangements of Lily Window Glass Co:

(i) Identify and explain SIX deficiencies; and

(ii) Provide a recommendation to address each deficiency.

Note: Prepare your answer using two columns headed Deficiency and Recommendation respectively.

You are the audit senior of Daffodil & Co and are responsible for the audit of inventory for Lily. You will be attending the year-end inventory count on 31 December 20X2.

In addition, your manager wishes to utilize computer-assisted audit techniques for the first time for controls and substantive testing in auditing Lily Window Glass Co's inventory.

Required:

(b) Describe the procedures to be undertaken by the auditor DURING the inventory count of Lily Window Glass Co in order to gain sufficient appropriate audit evidence.

(c) For the audit of the inventory cycle and year-end inventory balance of Lily Window Glass Co:

(i) Describe FOUR audit procedures that could be carried out using computer assisted audit techniques (CAATS)

(ii) Explain the potential advantages of using CAATs, including data analytics.

(iii) Explain the potential disadvantages of using CAATs and data analytics.

Exercise # 2 (20%)

In November 2017, the head office of XYZ was damaged by a fire. Many of the company's accounting records were destroyed before the audit for the year ended on December 31, 2017 took place. The company's financial accountant has prepared financial statements for the year ended 31 December 2017 on the basis of estimates and the information he has been able to recover. You have completed the audit of these financial statements but have not been able to obtain sufficient audit evidence in all areas.

Required:

(a) Draft, for inclusion in the auditor's report, wording appropriate to XYZ.

Note: You are not required to reproduce the auditor's report in full. Only the differences for an unmodified report were required.

(b) Explain and distinguish between the following forms of modified report.

- (i) Emphasis of matter;
- (ii) qualified opinion;
- (iii) disclaimer of opinion;
- (iv) adverse opinion.

Exercise # 3 (20%)

You are auditing the financial statements of XYZ SAL, a Lebanese listed company, for the year ended 31 December 2020. XYZ SAL's cash and cash equivalents consists of the following bank balances in one of the biggest Lebanese banks:

- Bank account 1: In US Dollars: 1,051,235 \$
- Bank account 2: In Lebanese Pounds: 523,475,000 LBP

The Company's operations are only in Lebanon that has been witnessing, since October 2019, severe events that have set off an interconnected fiscal, monetary and economic crisis and as well as deep recession that have reached unprecedented levels. Sovereign credit ratings have witnessed a series of downgrades by all major rating agencies and reached the level of default on March 2020.

The difficulty in accessing foreign currencies lead to the emergence of a parallel market to the peg whereby the price to access foreign currencies has been increasing constantly, deviating significantly from the peg of 1,507.50 USD/LBP. This has resulted in an uncontrolled rise in prices and the incessant de facto depreciation of the Lebanese Pound, impacting intensely the purchasing power of the Lebanese citizens, driving a currency crisis, high inflation and rise in the consumer price index.

Throughout this sequence of events, banks have imposed unofficial capital controls, restricted transfers of foreign currencies outside Lebanon, significantly reduced credit lines to companies and withdrawals of cash to private depositors, all of which added to the disruption the country's economic activity. Accordingly, XYZ SAL's access to the bank accounts has been restricted and the company can only use the balances to pay by

Cheques, an undesired mean of payment by most of the company's suppliers. In addition, most of those suppliers are not accepting payments by Cheques in USD so that the company can only use those funds by converting the equivalent of 1,000 USD per month to LBP as per the circular 151 issued by the Banque du Liban (according to which the conversion rate of 3,900.00 USD/LBP can be applied).

The company prepares its financial statements in accordance with International Financial Reporting Standards. You have determined that the balances of cash and cash equivalents are material based on the materiality levels set out in the overall strategy.

However, the company's management has decided not to adjust the value of the cash and cash equivalents balances in accordance with IFRS 9 – Financial Instruments in light of the recent events.

Required:

- 1. Using the information above, comment on the matters to be considered when planning for the audit and explain the audit procedures you are likely to perform to audit the cash and cash equivalents.**
- 2. Discuss the effects of the matters described above on the audit report and draft, if any, the additional paragraphs to be added to the report in accordance with International Standards on Auditing**

Good Work!!