

UNIVERSITY OF BOLTON

OFF CAMPUS DIVISION

WESTERN INTERNATIONAL COLLEGE

BA (HONS) ACCOUNTANCY

SEMESTER 2 EXAMINATIONS 2021/2022

AUDITING AND ASSURANCE

MODULE NO: ACC5004

Date: Monday 16 May 2022

Time: 1:00pm – 4:00pm

INSTRUCTIONS TO CANDIDATES:

There are 5 questions on this paper.

Answer BOTH questions from section A and TWO questions from section B.

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

Section A Answer Both Questions

QUESTION 1

Your firm has recently been appointed as auditor for Johnson Co, a small car manufacturer. The audit partner has recently attended a planning meeting with Anthony Isherwood, the Finance Director and has left the following notes to assist with your audit planning.

The draft results show revenue of £396m (2020: £400m), gross profit of £142m (2020: £142m) and profit before tax of £80m (2020: £92m). Performance in the first half of the year was stronger than in the same period in 2020. However, due to a series of safety issues with some cars (see below), sales in the second half were not as strong, resulting in an overall reduction in revenue compared with the prior year. All cars are sold with a 5-year warranty, enabling customers who experience problems with their vehicle that are not due to normal usage and wear and tear to take the car to an approved mechanic for repair or replacement free of charge.

During the year, 50 customers experienced severe safety issues with their car and, as a result, are suing Johnson Co. The matter has not yet been brought to court. Given the circumstances of the safety issues, Johnson's lawyers believe an out of court settlement will be less costly and less risky than allowing the matter to be settled by the court.

The company replaced a significant part of its production line during the year to improve production quality following the safety issues. As a result of the disposal of the old equipment, there is a significant loss on disposal recognised in the income statement. The company also revalued its factory premises 3 months before the year-end to a value of £10m. This valuation figure is used in the financial statements.

To finance the replacement of the production line, Johnson took out a 5-year loan for £6m, which is repayable in quarterly instalments.

**Question 1 continues over the page
Please turn the page**

University of Bolton
 Off Campus Division – Western International College
 BA (Hons) Accountancy
 Semester 2 Examination 2021/2022
 Auditing and Assurance
 Module No. ACC5004

Question 1 continued

Extracts from the statement of financial position are shown below.

	2020	2021
	£m	£m
Inventory	22	16
Trade Receivables	44	34
Cash	1.8	2.8
Trade Payables	26	20
Other Current Liabilities	18	18

Required:

- (a) Calculate FIVE ratios for both years which could assist when planning the audit.
(5 marks)
- (b) Using the information provided and the ratios calculated, summarise FIVE audit risks and explain the auditor's response to each risk when planning the audit of Johnson Co.
(10 marks)
- (c) Explain FIVE items that should be included on every working paper.
(5 marks)

(Total: 20 marks)

End of question 1
Questions continue over the page
Please turn the page

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

QUESTION 2

Introduction

LBT Co assembles specialist motor vehicles such as lorries, buses, and trucks. The company owns four assembly plants to which parts are delivered and assembled into motor vehicles. The factory workers usually work a standard eight-hour day, although this is supplemented by overtime regularly as LBT has a full order book. There is one shift per day; mass production and around the clock working are impossible due to the specialist nature of the assembled motor vehicles.

Wages system – shift workers

Shift-workers arrive for work at about 7.00 am and clock in using an electronic identification card. The card is scanned by the time recording system, and each production shift-workers identification number is read from their card by the scanner. The worker is then logged in as being at work. Shift-workers are paid from the time of logging in. The logging in process is not monitored as it is assumed that shift workers would not work without first logging in on the time recording system. At least 400 vehicles must be manufactured each day by each workgroup. If necessary, overtime is performed to complete the day's quota of cars. The shift foreman is not required to monitor the extent of any overtime work. However, the foreman ensures workers are not taking unnecessary or prolonged breaks, which would automatically increase the amount of overtime.

Payment of wages

Details of hours worked each week are sent electronically to the payroll department, where hours worked are allocated by the computerised wages system to each employee's wages records. Staff in the payroll department compare hours worked from the time recording system to the computerised wages system and enter a code word to confirm transfer accuracy. The code word also acts as authorisation to calculate net wages. The codeword is the name of a domestic cat belonging to the department head and is generally known around the department.

Each employee's net pay is recorded, and a list is sent over LBT Co's internal network to the accounts department. An accounts clerk ensures that employee bank details are on file in the accounts department. The clerk then authorises and makes payments to those employees using LBT Co's online banking system. The financial accountant reviews the total amount of wages made every few weeks to ensure that the management accounts are accurate.

**Question 2 continues over the page
Please turn the page**

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

Question 2 continued

Termination of employees

When employees leave LBT Co, the personnel department sends an e-mail to the payroll department detailing the employee's termination date and any unclaimed holiday pay. The receipt of the e-mail by the payroll department is not monitored by the personnel department.

Required:

(a) Explain FOUR control objectives of a payroll system. **(4 marks)**

(b) In respect of the wages recording and payment system of LBT Co:

(i) Criticise FIVE deficiencies in that system

(ii) Recommend a control to overcome each deficiency

(iii) Examine the test of controls the auditor would perform to assess if each of these controls is operating effectively.

Note: Prepare your answer using three columns headed Control deficiency, Control recommendation and Test of control, respectively.

(15 marks)

(c) Assess the substantive procedures the auditor should perform to confirm LBT Co's payroll figure.

(6 marks)

LBT is considering outsourcing its payroll department to an external payroll service provider to reduce costs.

(d) Examine the impact outsourcing the payroll function will have on the external audit of LBT Co.

(5 marks)

(Total: 30 marks)

End of question 2
Questions continue over the page
Please turn the page

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

Section B - Answer TWO questions only from this section

Question 3

A small bowling club (SBC) owns ten bowling greens. These bowling greens can be used in any weather conditions as there is a mechanical roof that can cover each green and electronic lighting that can be used as and when required. The club had 420 members from the start of the financial year to 30 April 2022. Each member is required to pay an annual membership fee of £115 per annum.

You are the auditor of SBC and have been provided with the following additional information:

It has been noted that approximately 10% of members do not renew their memberships when they fall due. New members are only required to pay half of the annual membership fee. 38 new members joined during the financial year just ended, and members are not required to pay their fees in advance.

When a bowling green is hired, non-members can do this at the rate of £8.50 per hour and sign a log sheet showing the greens hired. All cash is collected and placed in a cash tin in the clubhouse. It is collected and banked by the SBC secretary regularly. The secretary prepares a paying-in slip which they then pass to the treasurer. This slip analysis shows the relationship between green hire and membership fees. The secretary also provides the treasurer with a list of those members who have paid their fees. These amounts are then recorded in the cash book.

SBC also incurs expenses related to the running of the club, including the maintenance of the bowling greens, electricity for the mechanical roof, and lights on each green. The club also hosts championship bowling competitions. It supplies the bowls for the competitors to ensure there is no possibility for the bowls to be tampered with to gain a competitive advantage. Each competition uses 16 bowls.

All expenses are paid for by the treasurer who uses the club debit card. The receipts for these expenses are filed in chronological order. The treasurer is also responsible for preparing the annual financial statements, which are subsequently audited by an independent auditor as required by the club rules.

**Question 3 continues over the page
Please turn the page**

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

Question 3 continued

Required:

- a) Assess the audit work required to ensure the completeness of income for SBC bowling club.
(10 marks)
- b) Explain the audit procedures you should perform to check the completeness and accuracy of expenditure at the club.
(10 marks)
- c) Compose a coherent argument as to why the testing of internal controls would not assist you in your audit work for the annual audit of SBC.
(5 marks)

(Total 25 marks)

**End of question 3
Questions continue over the page
Please turn the page**

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

Question 4

Sand & Glass Co manufactures glassware. Its year-end was 31 July 2021, and the draft revenue is £74 million and the draft profit before tax is £18.4 million. You are the audit supervisor, and the year-end audit is due to commence shortly. The following matters have been brought to your attention.

Sand & Glass Co pays a bonus to its sales staff if a specified sales target is achieved. The finance director is concerned that the sales staff have recorded fictitious sales in the final month of the financial year to increase their bonus.

All sales are made on credit, and the sales staff are responsible for performing credit checks on all new customers; however, you discovered that this rarely happened during your tests of controls. The value of receivables over 6 months old is £1,560,000. Standard credit terms offered to customers are 30 days.

Required:

- (a) Examine the auditor's responsibilities in relation to fraud and error
(5 marks)
- (b) Demonstrate the substantive procedures that should be performed to obtain sufficient, appropriate audit evidence in relation to:
- (i) Revenue (5 marks)
 - (ii) Receivables (6 marks)
 - (iii) Sales related bonus (4 marks)

The audit is nearly complete, and the auditor's report will be issued next week. Your revenue testing identified that a material value of fictitious sales had been recorded, and management adjusted the financial statements accordingly. Your testing of receivables concluded that the debts over 6 months old are likely to result in irrecoverable debts and should be written down. Management has agreed to make an allowance of £780,000.

- (c) Explain the implications for the auditor's report because of the above information.
(5 marks)

(Total: 25 marks)

End of question 4
Questions continue over the page
Please turn the page

University of Bolton
Off Campus Division – Western International College
BA (Hons) Accountancy
Semester 2 Examination 2021/2022
Auditing and Assurance
Module No. ACC5004

Question 5

a) Examine the following statements and explain the extent to which you agree with them:

(i) Audit risk is the risk that control systems will not detect material misstatements in the financial statements subject to audit.

(5 marks)

(ii) The letter of engagement is of little value, as most clients will not understand what it means.

(5 marks)

b) Cumulative client knowledge enables the auditor to be more efficient and aids effectiveness in the audit process. Explain what you understand by cumulative client knowledge. What information about an organisation would be helpful to you permanently?

(5 marks)

c) Explain the validity of the following statement: 'It is very easy to apply the audit risk model. All you have to do is multiply figures together to determine the amount of testing you have to do.'

(10 marks)

(Total 25 Marks)

End of question 5

End of questions