

UNIVERSITY OF BOLTON

OFF CAMPUS DIVISION

WESTERN INTERNATIONAL COLLEGE

BA (HONS) ACCOUNTANCY

SEMESTER TWO EXAMINATION 2021/2022

ADVANCED AUDITING PRACTICE

MODULE NO: ACC6006

Date: Thursday 19 May 2022

Time: 1:00 – 4:00PM

INSTRUCTIONS TO CANDIDATES:

There are **FIVE** questions on this paper.

SECTION A consists of **TWO** questions, answer **ALL** questions.

SECTION B consists of **THREE** questions, answer **ONLY TWO** questions.

This is a closed book exam.

You must hand in the exam paper with your answer booklet.

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SECTION A (Answer ALL Questions)

QUESTION 1

The following information relates to part (a) and (b):

You currently work as a Senior Audit Manager for William & Co which is large national accountancy and audit firm which has specialisms in many areas including auditing fast fashion clothing companies.

Martin Ltd has requested your firm to act as external auditors. Martin Ltd is in the fast fashion clothing industry. Your firm currently also audits Brian Ltd which is another fast fashion retailer and competitor of Martin Ltd.

If the audit engagement is accepted for Martin Ltd you will act as Senior Audit Manager throughout the audit engagement. In the past you worked for Martin Ltd as a Financial Controller and hence owned some shares in Martin Ltd.

The engagement partner for Martin Ltd will be Dean Harris who has acted as engagement partner for Brian Ltd for almost 10 years. It should also be noted that the Audit Supervisor for the audit of Martin Ltd will be Tom as his brother is Finance Director at Martin Ltd and it is believed he will know the business well. Additionally, Martin Ltd has offered to give all staff at William & Co free clothes if they accept the role of as auditors.

Martin Ltd would want your firm to provide some additional non-audit services such as tax and accounting advice. Additionally, management of Martin Ltd have said they wish for William & Co to prepare the financial statements and also to defend the company at a tax tribunal against HMRC.

Finally, in relation to Brian Ltd it should be noted the company has not paid the fee for the prior year audit and you have been asked by Dean Harris to assess the issue.

Required:

(a) Critically evaluate the steps that William & Co should take to manage the conflict of interest arising from performing the audit of Martin Ltd and Brian Ltd.

(6 marks)

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Question 1 continued

(b) Critically evaluate **seven** ethical threats which may affect the independence of William & Co in respect of the audit of Martin Ltd and Brian Ltd, and for each threat identify ways in which the threat might be reduced. You should prepare your answer using two columns headed Ethical threat and Possible safeguard respectively.

(14 marks)

The following information relates to part (c):

In your role as Senior Audit Manager you are responsible for the training and development of trainees within William & Co. Currently you are running an internal training course for audit juniors in relation to the importance of quality control in auditing.

Required:

(c) Critically evaluate why quality control policies and procedures are necessary, the areas that should be covered by quality control policies and outline procedures that would be required to ensure that the policies are met.

(10 marks)

Total 30 marks

End of question 1

Please turn the page

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Question 2

You work for Khan & Co as an Audit Manager and are responsible for a portfolio of audit clients for which the audit work is nearing completion. The following matters have been brought to your attention:

- (i) Arnold Ltd operates a perpetual (continuous) inventory system. No year-end count is performed. You have reviewed the level of adjustments made each month after each perpetual count and concluded that due to the significance of the adjustments, the inventory system is not reliable.

You have requested that a full year-end count is performed but management has refused saying it would be too disruptive. The inventory balance is £8 million. Sales revenue is £100 million and profit for the year is £30 million.

(6 marks)

- (ii) Bolu Ltd has not made allowance for an irrecoverable debt of £100,000 in respect of a customer declared bankrupt just after the year-end. Profit for the year is £1,000,000.

(6 marks)

- (iii) Simon Ltd is being sued by a competitor for the theft of intellectual property. The amount of the claim is material and the case could go either way, hence there is uncertainty in relation to the outcome. The claim is not mentioned anywhere in the financial statements.

(6 marks)

- (iv) The directors of Clermont Ltd have decided not to present the statement of profit and loss as they don't want to show poor performance in the year. The directors have argued with the auditor that they wish to omit the statement of profit or loss for this year only.

(6 marks)

- (v) Peter Ltd is involved in a major court case as several customers are suing the company as a result of injury caused by faulty products. The level of the legal claims could bankrupt the company if the legal case is lost. The directors assess and disclose the case as a contingent liability in the accounts. The auditor agrees with the treatment and disclosure.

(6 marks)

Question 2 continued over the page

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Question 2 continued

Required:

For each of the above situations critically evaluate the implications for the independent auditor's report.

Total 30 marks

End of question 2

END OF SECTION A

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SECTION B: TWO Questions ONLY to be attempted

Question 3

In recent times there has been increased scrutiny of the audit profession and the role of the auditors especially in relation to major corporate scandals and failure of companies. Pressure groups and stakeholders have lost trust in the audit profession as a result of this increased criticism. There has been an increased focus on the issue of professional scepticism exercised by auditors during the audit process.

Required:

Critically evaluate the meaning of professional scepticism and pressure to exercise increased levels of professional scepticism throughout the audit process. You should use examples to illustrate your answer.

Total 20 marks

End of question 3

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Question 4

Marek Co is a manufacturing organization which operates in the UK and Internationally and has a year end of 31 December 2020. You should note the following important matters:

Shortly after the year end on 6 January 2021, Gold Star, a major key customer of Marek Co, went into administration and had a balance of £422,000 due to Marek Co.

Due to cash shortage in the business Marek Co is struggling to pay most of its suppliers and its key suppliers are threatening to stop providing goods on credit if payments are not made on time going forward.

On 7 January 2021, the sales director left the company and has yet to be replaced. The sales director is suing Marek Co for constructive dismissal due to an ongoing dispute with the board of directors of Marek Co. The board are struggling to find a replacement sales director to join the board.

On 8 January 2021 there was a major flood at the premises of the third-party warehouse provider, which destroyed all inventory held there. Approximately one half of Marek Co's total inventory was stored in the premises of the third party.

The factory assembly line was refurbished during the year at a cost of £2 million. An additional £3 million loan facility provided to Marek Co during the year is secured, in part, on the refurbished assembly line. The assembly line broke down during January 2021 and 4 weeks later is still not working which has had a significant impact on business operations.

The company is seeking new funding through an initial public offering of shares in the company in order to become listed on a stock exchange. In the event that the initial public offering does not proceed, this will require Marek Co's existing banking arrangements to be renegotiated and additional funding to be raised from either existing or new investors.

The financial statements of Marek Co show an overdraft at 31 December 2020 of £360,000 (2019: £240,000). The overdraft limit is £400,000. Additionally, the cash flow forecast shows negative monthly cash flows for the next twelve months.

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Question 4 continued

Required:

Critically evaluate the potential indicators that Marek Co is not a going concern using the information provided above.

Total 20 marks

Question 5

The following information is relevant to part (a):

Smith Enterprises Co (Smith Co) has been in business for 25 years in the fast food industry and has recently become a listed company. As Smith Co is listed on a stock exchange it is required to comply with certain corporate governance principles.

Barry is both the chairman and chief executive officer of Smith Co as he has said he wants full control of the board. Barry is unsure if Smith Co needs more non-executive directors as there are currently four non-executive directors and six executive directors which make up the board of directors. Barry wants to appoint his brother as a non-executive director. Barry's brother is a retired chief executive of a luxury national supermarket chain.

The chief financial officer, Jane sets the remuneration to be paid to all executive directors. At present the majority of remuneration is awarded to directors by way of a bonus based on profit before tax for the year. Jane is also considering offering non-executives bonuses as she believes this will motivate them.

Additionally, Jane is considering setting up an audit committee as she believes that this will be useful for the company, however she hasn't had the time to set this up yet as she is too busy.

Finally, a new marketing director was appointed 6 months ago, however she has yet to undertake her board training as Barry hasn't had the time to deal with this due to having a busy workload at present.

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Question 5 continued

Required:

- (a) Critically evaluate **FIVE** corporate governance deficiencies faced by Smith Enterprises Co and provide a recommendation to address each deficiency to ensure compliance with corporate governance principles. You may wish to use a two-column format in your answer.

(10 marks)

The following information is relevant to part (b):

You work as an audit manager in a firm of chartered certified accountants and part of your role is taking on responsibility for training of audit juniors within your department. The audit juniors are unsure about what constitutes fraud and who is responsible for the detection and prevention of fraud.

Required:

- (b) Critically evaluate the types of fraud which can take place in organizations. You should use examples to illustrate your answer and prepare notes of the responsibilities of fraud for both the directors and auditors.

(10 marks)

Total 20 marks

END OF QUESTIONS