



Rollno.....

End Semester Examination, December 2024

B.com(H)/BBA(H) – Third Semester

MCSP173- Audit & Assurance

Time: 2.5 hrs.

Max Marks: **50**

Note: *All Questions are compulsory. Marks are indicated against each question.*

PART-A

Q.1.

(a) Which of the following people may act as auditor for a company?

- i. The company's previous finance director who left the company five years ago to join the audit firm
- ii. A director of the company being audited who holds a valid audit certificate
- iii. An employee of the company being audited who holds a valid audit certificate
- iv. The wife of the finance director who works for a reputable audit firm

[CO-2] [L-3] **2**

(b) Define duties of an auditor.

[CO-2] [L-2] **2**

(c) Define objectives of an audit committee.

[CO-3] [L-1] **2**

(d) Which of the following should be included in the annual report regarding the work of the audit committee?

- i. Responsibility for preparing the annual report and financial statements
- ii. Significant issues considered relating to the financial statements
- iii. A description of the principal risks the company faces
- iv. The process used to make appointments to the board

[CO-4] [L-2] **2**

(e) With which of the following activities should the internal audit function NOT be involved?

- i. Monitoring of management's performance
- ii. Reviewing adequacy of management information for decision-making purposes
- iii. Taking responsibility for the implementation of a new sales ledger system
- iv. Assessing compliance with regulation relevant to company.

[CO-1] [L-1] **2**

(f) Define Self-review and advocacy threat.

[CO-4] [L-3] **2**

(g) Elaborate the calculation of materiality.

[CO-2] [L-4] **2**

PART-B

Q.2 You are an audit manager in Swift & Co responsible for the audit of Kingfisher Co, a retail company planning to list on a stock exchange within the next six months. The board of directors currently comprises the chair, chief executive, three executive directors and three non-executive directors. Details of the three non-executive directors is given below.

Teri Toucan

Teri was an employee of Kingfisher until retirement six years ago. On retirement, Teri became a non-executive director. Teri currently receives a pension from Kingfisher Co and a fixed salary for being a non-executive director. Teri does not own shares in Kingfisher Co.

Pat Parrot

Pat was an employee until ten years ago and was also a shareholder in Kingfisher Co as part of Pat's remuneration package included share options which had been exercised. Pat became a non-executive director three and a half years ago and on appointment, Pat left the company's pension scheme and sold all shares in Kingfisher Co.

Linda Lorikeet

Linda is an independent non-executive director of Kingfisher Co. Linda has been a member of the board for eight years and has extensive retail experience from previous employments.

Proposed changes

Kingfisher Co's management has been advised by the audit engagement partner about the need for compliance with corporate governance principles once the company is listed. The board of directors has identified two more potential independent non-executive directors to join Kingfisher Co. Once more directors are appointed, Kingfisher Co plans to establish an audit committee and a remuneration committee.

The two potential directors are:

Frances Finch

Frances is currently the finance director of a listed multi-national banking company and is a non-executive director and audit committee member for another company. Frances is agreeable to being a non-executive director for Kingfisher Co and to be paid a fixed fee which is not related to profits. Frances is being considered for the role of board chair as the current chair is due to retire in six months' time.

Mica Macaw

Mica, the sister of Kingfisher Co's chief executive, is currently a finance director of a small retail company, which does not compete with Kingfisher Co. Mica has expressed an interest in a role at Kingfisher Co provided a contract with a minimum three-year term is offered.

a) Which of the following recommendations is NOT required to be implemented by Kingfisher Co to bring the company in line with corporate governance best practice?

- a) More independent non-executive directors must be appointed to ensure at least half of the board are independent
 - b) The board must appoint a workforce representative
 - c) Linda will need to be replaced as an independent non-executive director next year
 - d) The board chair must be appointed from within the company to ensure they have sufficient knowledge of the company.
- b) In respect of Frances Finch, which of the following statements is TRUE?
- a) Frances could become board chair and sit on the audit committee as the person with recent and relevant financial expertise
 - b) Frances could sit on the remuneration committee but must not be committee chair
 - c) If Frances accepts the role of board chair, remuneration should be related to company performance to align the interests of the chair and the company
 - d) Frances cannot become board chair for Kingfisher Co whilst holding directorships at two other companies.
- c) In respect of Teri Toucan, which of the following will compromise independence?
- a) Teri receives a pension from Kingfisher Co
 - b) Teri does not own shares in Kingfisher Co
 - c) Teri receives a fixed salary from Kingfisher Co
 - d) Teri was an employee of Kingfisher Co six years ago.
- d) Which of the follow are advantages of appointing Mica Macaw as a non-executive director of Kingfisher Co?
1. Mica has close links to Kingfisher Co's chief executive.
 2. Mica's experience in retail will facilitate understanding of the issues faced by Kingfisher Co.
 3. Mica's financial experience will be useful if appointed to the audit committee.
 4. Mica wishes to commit to a three-year contract.
- a) 1, 3 and 4 only
 - b) 2 and 3 only
 - c) 1, 2 and 4 only
 - d) 1, 2, 3 and 4
- e) Which TWO of the following correctly explains corporate governance guidelines in respect of succession and evaluation of directors?
- a) A succession plan should be maintained for the board chair and chief executive
 - b) The annual report should explain the work of the nomination committee including the process for making appointments
 - c) Performance of the board chair, the board, the individual executive and non-executive directors and each committee must be evaluated annually
 - d) All members of the nomination committee must be independent non-executive directors.

[CO-3] [L-3] 10

OR

You are an audit manager in Tigger & Co, a large audit firm which specialises in the car manufacturing industry. Details of three companies operating in this industry are given below.

Winnie Co

Tigger & Co has audited Winnie Co for many years. The audit engagement partner for Winnie Co has been responsible for the audit for six years. The board of directors has asked if Tigger & Co will provide payroll and bookkeeping services, including providing advice on appropriate accounting policies. They have also suggested that the external audit fee should be renegotiated with at least 20% of the fee being based on the company's profit after tax as they feel that this will align the interests of Tigger & Co and Winnie Co.

Eeyore Co

Eeyore Co is a subsidiary of a major global car manufacturer. During the audit, the audit team discovered that Eeyore Co had developed and used a device which gave false readings during

government tests which are required for all cars. The false readings enabled cars to meet government restrictions on carbon emissions which would otherwise have failed and therefore could not have been sold. The audit engagement partner has discussed the matter with senior management of Eeyore Co and advised them to report the matter to the industry regulator. Senior management has refused and reminded the engagement partner that the audit firm has a duty of confidentiality towards the company.

Piglet Co

Piglet Co has recently approached Tigger & Co to act as auditor due to the firm's expertise in the car manufacturing industry. Piglet Co is the main competitor of Winnie Co.

- a. Which TWO of the following statements are TRUE in respect of the conflict of interest between Winnie Co and Piglet Co?
 - a. Tigger & Co must decline the audit engagement of Piglet Co
 - b. Winnie Co and Piglet Co may be concerned that commercially sensitive information may be disclosed by Tigger & Co to their competitor
 - c. Tigger & Co must ask permission of ACCA before accepting the audit of Piglet Co
 - d. Tigger & Co must obtain consent of both clients before continuing with the engagement.
- b. Which of the following is NOT an action that your firm should take to manage the conflict of interest between Winnie Co and Piglet Co?
 - a. Monitoring of safeguards by an engagement quality reviewer
 - b. Require every employee of Tigger & Co to sign a confidentiality agreement
 - c. Use separate engagement teams and engagement partners for each client
 - d. Operate secure data filing of all audit information
- c. Which of the following statements is TRUE in respect of the audit of Winnie Co?
 - a. The audit engagement partner must be rotated
 - b. Providing the additional services for Winnie Co will create a confidentiality threat
 - c. Payroll and bookkeeping services cannot be provided to an external audit client
 - d. Providing advice on accounting policies is acceptable as long as the client is responsible for choosing the specific policies used.
- d. In relation to the proposal that 20% of the audit fee is based on the profit after tax of the company, which of the following statements is TRUE?
 - a. This will lead to fee-dependency which is a self-interest threat. The proposal should be rejected.
 - b. This is a contingent fee arrangement which creates an advocacy threat. The proposal should only be accepted if no more than 15% of the audit fee is based on profit before tax.
 - c. This is a contingent fee arrangement which creates a self-interest threat. The proposal should be rejected.
 - d. This will lead to fee-dependency which is a self-interest threat. The proposal should only be accepted if no more than 15% of the audit fee is based on profit before tax

Q.3 It is 1 July 20X5. You are an audit manager in Owl & Co responsible for the audit of Hawk Co. Hawk Co manufacture kites which it sells via its website directly to customers. You are currently planning the audit for the year ending 31 July 20X5. Two issues have been brought to your attention during a planning meeting with the finance director.

Dismissal of financial controller

The financial controller of Hawk Co, who had been employed by the company for over 20 years, was dismissed in May 20X5. A claim for unfair dismissal has just been received. No replacement has been found for the financial controller as of yet and the tasks are being shared between the finance team until the role is filled.

Payables ledger supervisor

The payables ledger supervisor left in March 20X5 and a replacement has only been appointed in the last week. However, for this period no supplier statement reconciliations or trade payables account reconciliations were performed.

The finance director has also provided you with the most recent management accounts to enable you to perform preliminary analytical procedures and you have calculated the following ratios:

	20X5	20X4
Gross profit margin	17%	26%
Payables payment period	40 days	75 days
Receivables collection period	38 days	29 days

- a) Which of the following are appropriate auditor responses to the increased audit risk created by the finance team being allocated the work of the financial controller?
1. The audit team should be fully briefed and be alert throughout the audit for additional errors
 2. The auditor should appoint an expert to properly assess the risks of misstatement
 3. The finance director should be requested to provide the audit team with assistance for matters that cannot be addressed by the remaining finance function
 4. The auditor should consider resigning from the engagement as audit risk cannot be managed to an acceptable level
- a. 1, 2 and 3
b. 2, 3 and 4
c. 1 and 3 only
d. 1 and 4
- b) Which THREE of the following statements are TRUE in relation to the lack of supplier statement reconciliations?
1. The auditor should perform the supplier statement reconciliations for Hawk Co
 2. There is an increased risk of misstatement of trade payables
 3. Misstatements in the purchase accrual balance may go undetected
 4. The auditor will need to send requests for confirmation of balances to suppliers
 5. Increased substantive testing will need to be performed over purchases and payables.
- c) In respect of the unfair dismissal claim, which of the following audit procedures is NOT appropriate?
1. Review correspondence between the financial controller and the company
 2. Review board meeting minutes
 3. Review correspondence between the company and its lawyer
 4. Discuss the claim with the financial controller
- d) Which of the following are reasons why analytical procedures will be performed during the planning of Hawk Co?
- 1) To help identify areas of potential risk
 - 2) To help obtain an understanding of Hawk Co
 - 3) To help detect material misstatements in the financial statement figures
- a. 1 only

- b. 1 and 2 only
- c. 1, 2 and 3
- d. 2 and 3 only

[CO-3] [L-2] **10**

OR

The directors of Murray Co are interested in being able to report that they comply with best practice corporate governance principles and have asked for your thoughts.

The finance director has provided you with the following information:

The board consists of the chief executive officer, finance director, HR director, production director and sales director. The aunt and uncle of the chief executive officer were appointed as non-executive directors last year. Previously they ran their own small cafe and used a firm of accountants for all financial matters due to their own lack of expertise in that area.

The contracts signed by the non-executive directors state that they are in place until they decide to leave or unless they are found guilty of misconduct. They receive an annual fee and a number of share options in Murray Co as their remuneration.

Since appointment, the two non-executives have formed an audit committee consisting of themselves and the human resources director as it was felt that the finance director would not be an independent member of the committee.

They have also formed a remuneration committee with the finance director and are currently in the process of proposing and approving the salaries for all of the directors for the coming year.

Required:

- i) Explain whether Murray Co is required to comply with a code of corporate governance.
- ii) Explain the strengths of Murray Co's current governance arrangements.?

[CO-1] [L-3] **10**

Q.4 It is 1 July 20X5. You are an audit supervisor in Seagull & Co and you are currently performing the audit of an existing client, Eagle Heating Co (Eagle), for the year ended 31 May 20X5. Eagle manufactures and sells heating and plumbing equipment to a number of home improvement stores across the country. The following information has been obtained during discussions with the finance director.

Albatross Co

Albatross Co, one of Eagle's key customers has been experiencing financial difficulties. Eagle has agreed that Albatross Co can take a six-month payment break, after which payments will resume. The finance director does not believe that any allowance is required against this receivable. Your review of industry journals has identified several articles that suggest Albatross Co may soon cease trading.

Inventory

Eagle has experienced increased competition. In order to maintain its current levels of sales, it has decreased the selling price of its products significantly. Despite the reduction in selling price, inventory levels are significantly higher this year compared to the prior year. In addition to Eagle's inventory, there is inventory stored on behalf of a third party at the year end. Audit staff attended the year-end inventory count of Eagle which was held three days before the year end due to staff availability of Eagle. A reconciliation has been performed to determine the year-end inventory quantities.

Lawsuit

A customer has filed a claim against the company regarding a heating system that Eagle installed two months before the year end. The customer claims the installation was not done properly resulting in an explosion which caused damage to their home. The customer is claiming compensation of \$50,000 which is material to the financial statements. The finance director believes that the claim is not probable to succeed so has not referred to it in the financial statements.

- A) Which of the following substantive procedures will provide the MOST reliable evidence as to the recoverability of the outstanding balance from Albatross Co?
 - Obtain a direct confirmation letter from Albatross Co
 - Review the payment history of Albatross Co to assess the likelihood of payment
 - Review correspondence between Albatross Co and Eagle regarding when payment will be made
 - Review post-year-end cash receipts from Albatross Co.\

- B) Which TWO of the following substantive procedures will provide evidence over the EXISTENCE of Eagle's trade receivables other than the balance owing from Albatross Co?
- Calculate the receivables collection period and compare with prior year
 - Perform a receivables circularisation
 - Review post-year-end cash receipts from customers
 - Recalculate the allowance for irrecoverable receivables
- C) Which TWO of the following factors may indicate overvaluation of inventory at Eagle?
- Increased competition resulting in a decrease in selling price
 - Increased inventory levels
 - Increased inventory turnover ratio
 - Inventory consists of heating and plumbing equipment for home improvement stores
 - Inclusion of the third-party inventory within Eagle's inventory balance
- D) Which of the following are appropriate audit responses to the lawsuit?
1. Ask the finance director to include a provision in the financial statements
 2. Inspect correspondence between the client and their legal advisers
 3. Review board minutes to understand management's view about the claim
 4. Contact the customer to understand the details of the claim
- 2 and 3 only
 - 2, 3 and 4
 - 1, 3 and 4
 - 1 and 4 only

[CO-4] [L-1] 10

OR

It is 1 July 20X5. Your firm, Hercules & Co, has recently won the audit of a new client, Knight Electronics Co, for the year ending 30 September 20X5. Knight Electronics Co sells products enabling 'smart building' systems which allow customers to efficiently control their security, lighting and networking needs. The audit manager held a preliminary meeting with the finance director and has provided you with the following notes:

Planning meeting notes

Since its launch five years ago, Knight Electronics Co has experienced high levels of growth such that the founder and CEO, William Knight, is considering a stock exchange listing next year. Knight Electronics Co has both corporate and domestic customers. On 1 October 20X4 Knight Electronics Co began to offer customers the option to purchase a three-year servicing agreement. This provides three annual services for products purchased. Customers pay for the servicing agreement in full at the start of the agreement.

Component parts are purchased from a number of suppliers. Prices of components have been steadily increasing over the past two years leading to a reduction in the gross profit margin. The forecast financial statements for the year ending 30 September 20X5 show inventory valued at cost. In June 20X5, Knight Electronics Co decided to revalue its premises, which had previously been accounted for using the historic cost model. Properties with a carrying amount under the cost model of \$3.8m were revalued to \$8.4m based on a valuation performed by management. The finance director also carried out an extensive review of non-current asset lives and decided to extend the useful life of plant and equipment from five years to eight years.

In May 20X5, defective equipment used by Knight Electronics Co resulted in a small fire at its premises. The company has commenced legal action against the supplier of the equipment. Knight Electronics Co's lawyers have advised that the legal action is likely to be successful and, as a result, the finance director has included a receivable for the damages likely to be received from the supplier in the forecast financial statements.

During the year the company's credit controller was ill and was absent from work for four months. Due to staff shortages, no replacement credit controller was appointed. The receivables collection period has increased from 45 days to 75 days.

An instance of payroll fraud was also discovered during the year. A payroll clerk had set up a number of fictitious employees and the wages were then paid into the clerk's own bank account. Controls have now been implemented to prevent this from re-occurring and the clerk involved no longer works for the company. However, the audit manager is concerned that additional fraud may have taken place in the payroll department prior to the controls being implemented. William Knight would like the audit to be completed by 31 October 20X5.

Requirements:

- (a) Briefly explain how each of the following sources of information will be used by Hercules & Co to gain an understanding of Knight Electronics Co at the planning stage of the audit: prior year audited financial statements, current year budgets and management accounts, prior year report to management, board meeting minutes and company website.
- (b) Describe FOUR audit risks and explain the auditor's response to each risk in planning the audit of Knight Electronics Co.

[CO- 4] [L-3] 10

Q.5 It is 1 July 20X5. You are an audit supervisor with Morph & Co responsible for planning the final audit of a new client, Hart Co, for the year ending 30 September 20X5. Hart Co specialises in the

design and construction of customised playgrounds. The audit manager recently met with Hart Co's finance director and has provided you with the following notes. **Planning meeting notes**

Hart Co has a forecast profit before tax of \$12.2m (20X4: \$9.8m) and total assets are expected to be \$28.5m (20X4: \$24.3m). The finance director has indicated that the directors are very pleased with the forecast performance for the year as the directors are paid a bonus based on a percentage of profit before tax.

Hart Co is undertaking the construction of playgrounds at 16 sites in various locations across the country. All playgrounds are constructed to specific customer specifications. Customers pay a 25% deposit on signing the contract, with the balance payable when control of the playground is transferred to the customer.

The balance of work-in-progress(WIP) at 30 June 20X5 is \$7.6m in respect of the playgrounds under construction. A WIP count and valuation will be carried out at all sites on 30 September 20X5.

Arrangements have been made for the audit team to attend only five of the WIP counts. Hart Co offers its customers a warranty at no extra cost, which guarantees that the playgrounds will function as expected for a period of three years. The warranty provision for the current year has been calculated as 2% of revenue. In the previous year the warranty was based on 6% of revenue. The finance director has made this change despite no significant difference in construction techniques or the level of claims in the year.

Hart Co has incurred expenditure of \$1.8m relating to the research and development of a new type of environmentally-friendly building material. \$0.6m of the expenditure to date has been written off to the statement of profit or loss. The remaining \$1.2m has been capitalised as an intangible asset. No amortisation has been recognised to date as the material has not yet been brought into use.

In June 20X5, the company contracted to purchase new machinery costing \$2.4m. It paid \$1m on signing the contract to secure the machinery, which was due to be delivered in July 20X5. Due to a supplier problem, the delivery is delayed and is now scheduled to be delivered in October 20X5.

In order to finance the research and development costs and the machinery purchase, Hart Co made a rights issue to existing shareholders at a price of \$0.75 for each \$0.50 share.

Hart Co's payroll function is outsourced to an external service organisation, Chaz Co, which is responsible for all elements of payroll processing and maintenance of payroll records. Hart Co's directors correctly disclosed their remuneration details in the forecast financial statements in line with IFRS Standards, however, local legislation in the country in which Hart Co is based, requires more extensive disclosure. The directors have stated that they consider this onerous and so do not intend to provide the additional information.

Required: ISA 300 Planning an Audit of Financial Statements provides guidance to assist auditors in planning an audit.

(a) Explain the benefits of audit planning.

(b) Describe FOUR audit risks and explain the auditor's response to each risk in planning the audit of Hart Co.

[CO-5] [L-2] 10

OR

It is 1 July 20X5. You are an audit senior with Golden & Co and you are in the process of reviewing the inventory count arrangements for your audit client, Silver Co, in preparation for attendance at the full year-end inventory count on 30 September 20X5. The company manufactures household furniture such as tables, sofas and beds and has a factory and a large warehouse which are located on a single site.

Inventory count arrangements

The company manufactures goods 24 hours a day, seven days a week to meet customers' demands. Production will still be continuing during the inventory count as it is not possible for the company to stop producing goods. Movements of goods in and out of the factory and warehouse will also have to continue for operational reasons.

The count will be undertaken by 20 teams of two counters from the warehouse, and the warehouse supervisor will be overseeing the inventory count. Each team will be given a specific area of the warehouse to count using sequentially numbered inventory sheets which detail the items of inventory together with quantities held at the date of the count as per the inventory system. It has been left to the individuals within each team to decide how to allocate the responsibilities between them.

All goods present in the warehouse on 30 September 20X5 will be allocated into separate warehouse bays (designated areas of the warehouse) in preparation for counting. When a warehouse bay has been counted, it is crossed out on the warehouse map which is held in the office by the warehouse supervisor. The warehouse supervisor is confident that the 20 teams are familiar with the warehouse and the location of the inventory and concluded that that each bay only needs to be counted by one team. One area of the warehouse, which includes a large quantity of spare parts left over from production, will be segregated so that this inventory will not be counted, as the warehouse supervisor has stated that these items are unusable.

A numerical sequence check of the sheets will be carried out by the warehouse supervisor once the count is finished. The inventory sheets will then be passed to a warehouse assistant to update the inventory records to reflect the inventory physically present as per the inventory sheets. Work in progress valuations have previously been carried out by an external inventory valuer. However, the warehouse supervisor has offered to undertake this valuation this year due to being having a detailed knowledge of the company's products. The directors have agreed to this on the basis that it will save costs.

Last week the company agreed to store 30 sofas belonging to a third party in its warehouse for the next four months as the third party's storage facilities became flooded. For convenience, these sofas have been stored alongside similar products which belong to Silver Co.

Requirements: Auditors have a responsibility under ISA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management to communicate significant deficiencies in internal controls to those charged with governance.

- (a) Describe FOUR matters the auditor should consider in determining whether a deficiency in internal controls is significant.
- (b) Identify and explain FOUR deficiencies in Silver Co's inventory count arrangements and provide a control recommendation to address each of these deficiencies.

[CO- 5] [L-2] **10**