

**UNIVERSITY OF BOLTON**  
**BOLTON BUSINESS SCHOOL**  
**ACCOUNTANCY PATHWAY**  
**SEMESTER 2 EXAMINATIONS 2008/2009**  
**ADVANCED AUDITING PRACTICE**  
**MODULE NO: ACC3010**

Date: Wednesday 27<sup>th</sup> May 2009

Time: 10:00 – 13:00

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**INSTRUCTIONS TO CANDIDATES:**

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

Answer **ANY FOUR** questions.

This is a closed book examination.

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**Answer ANY FOUR questions.**

**Q1.** You are the engagement partner in charge of the audit of the financial statements of the Bell plc for the year ended 31 May 2009. On 30 April 2009, Bell plc completed the disposal of its only subsidiary, Patel Ltd, which had made substantial losses in the current year due to the loss of a major contract. The Financial Director of Bell plc has prepared a draft income statement for the year ended 31 May 2009, which is set out below, dividing the results between continuing operations (attributable to Bell) and discontinued operations (attributable to Patel).

|                          | Continuing operations<br>£'000 | Discontinued operations<br>£'000 | Total<br>£'000 |
|--------------------------|--------------------------------|----------------------------------|----------------|
| Profit/(Loss) for period | 3,200                          | (2,000)                          | 1,200          |

The loss of £2,000,000 from the discontinued operations comprised trading losses of £1,200,000 and a net loss on the disposal of the assets of Patel Ltd, as follows:

|  |                |
|--|----------------|
|  | £'000          |
| Net assets of Patel at 30 April 2009   | 3,750          |
| Cash proceeds                          | <u>(1,950)</u> |
| Loss arising on disposal of subsidiary | <u>800</u>     |

Patel's results ('discontinued operations' above) have been derived from the former subsidiary's management accounts which have been subject to extensive review by Bell's Group Internal Audit function. Audited accounts of Patel are not available as Patel's new owners have a different year end from Bell and Bell no longer has control over Patel.

In view of the substantial losses of Patel, the Directors of Bell do not want to include the trading results of Patel in the group accounts. They have suggested that the loss on disposal of the subsidiary should be shown as an exceptional item.

You have approached the new owners of Patel, but they have said that they are not prepared to allow you to carry out an audit of their accounts, nor will they answer any questions you might raise on the management accounts to 31 May 2009. Patel's year end has been changed to 31 August, but the new owners do not anticipate any audit work being carried out by the new auditors until some time in 2010, by which date Bell's audit report will need to have been signed off. The Directors of Bell are prepared to give you as much information about the preparation of Patel's accounts as they are able.

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**Question 1 continued**

**Required:**

**(a)** Evaluate the impact that the inability to obtain the audited financial statements of Patel Ltd will have on both the group audit and the group audit report for the year ended 31 May 2009.

**(13 marks)**

**(b)** Justifying your approach, produce an audit programme to cover the disposal of the subsidiary undertaking.

**(12 marks)**

**TOTAL 25 MARKS**

**Q2**

**(a)** You are a senior audit manager, planning the audit for Overseas Traders Ltd, a company which imports goods from around the world via a number of agents. Overseas Traders Ltd has a turnover of approximately £100m, and apart from an Accounts department has a four-person Internal audit team. You have just received an e mail from the Head of Internal audit, Fergus Alexon, advising you that the company is investigating a number of fraudulent transactions, which seem to have involved suspicious journal entries involving four separate branches. Overseas Traders Ltd is obviously very concerned about the serious nature of the situation, but is also extremely keen, at the same time, to minimize the cost of any additional audit work that your firm might reasonably wish to carry out. To that end Fergus has asked you to provide him with a briefing paper advising him of the reliance that your firm might be able to place work on work carried out by the internal audit function in discharging your firm's responsibilities for considering the possibility of fraud, and what specific aspects of the audit related to the possibility of fraud, if any, might they be able to assist with?

**Required:**

Prepare a briefing paper for Fergus Alexon, critically analysing the issue outlined above.

**(13 marks)**

**(b)** The pressures arising from management remuneration, compensation and performance-related incentives have been identified as a significant element to be considered in the identification of potential risks of management fraud.

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**Question 2(b) continued**

**Required:**

You should select a common performance-related incentive scheme typically available to a company's senior management, and critically analyse the potential adverse impact of the abuse of such a scheme on the company, and the steps an auditor should consider taking to give him or her a reasonable chance of detecting any such abuse.

**(12 marks)**

**TOTAL 25 MARKS**

**Q3** You are the manager responsible for the audit of Cook Ltd, which operates 25 motorists' supplies stores in the North West, 6 of which, including the flagship store at the Trafford Centre (which is also 'Head Office') are in Manchester. Head Office provides Cook Ltd's operations with all administrative functions, eg purchases, marketing, HR, pricing and finance being centralized.

The draft financial statements for the year ended 30 April 2009 show the following:

|                   | <b>30 April 2009 £m</b> | <b>30 April 2008 £m</b> |
|-------------------|-------------------------|-------------------------|
| Turnover          | 5.0                     | 4.6                     |
| Profit before tax | 0.4                     | 0.3                     |
| Total Net Assets  | 3.8                     | 3.5                     |

The following issues arising during the final audit have been noted on a schedule of points for your attention, as no provision for any of these items has been made in the draft financial statements

**Required:**

Analyse each set of circumstances below and provide reasoned recommendations as to how each set should be treated in the April 2009 financial statements of Cook Ltd in order that your firm can provide an unmodified audit report.

**(a)** On 1 June 2009, Cook announced its intention to close one of its outlets in Manchester in response to a significant decline in the demand following the opening of a Halfords superstore close by. The shop will close on 1 July 2009. Specialist shop fittings, with little or no resale value, with a current balance sheet value of £240,000 will be scrapped.

**(8 marks)**

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**Question 3 continued**

**(b)** On 1 May 2008 Cook introduced a loyalty scheme for customers. For every £1 spent, a 'point' was eligible to be awarded to a customer's loyalty card on presentation at the till. Accumulated loyalty points can be converted into cash discounts against future purchases on the basis of £1 per 100 points.

**(8 marks)**

**(c)** In October 2008 Cook commenced the development of a site in the Ashworth valley, near Heywood – an area of 'outstanding natural beauty' - on which it plans to build a retail 'megastore', with completion scheduled for late 2009. Planning permission for the development, which was received on 6 May 2009, requires that four rare trees on the site should be preserved, and the restoration of the whole area should be completed by the end of 2010. Additions to Freehold Property during the year include £1.2 million for the estimated cost of site restoration, in accordance with IAS 16 (FRS 15). This estimate includes a provision of £0.2 million for the relocation of the rare trees. In April 2009 the trees were chopped down to allow access for essential steelwork for the frame of the building. On 10 May 2009, Rochdale MBC fined the company £70,000 for chopping down these trees in breach of the planning permission.

**(9 marks)**

**TOTAL 25 MARKS**

**Q4** You are working in the national technical department of a large firm of Chartered Certified Accountants, and you are carrying out a review of some recent audit reports issued by a small two-partner practice which your firm is in the process of taking over.

In each case you are enquired to provide a reasoned answer, with a clear recommendation as to whether the approaches adopted in these audit reports were appropriate, or if not, how they should have been issued.

**(a)** Audit report date 31 May 2009, year-end date 30 April 2009. It is now 5 June 2009. East Ham FC Ltd were doomed to relegation from the English Premiership in March 2009 due to an extremely bad run of results, and as a result, they will suffer a minimum reduction in TV-related income next season of some £25million. The company is already operating at the limit of its own bank facilities, and this brings into question going concern fears over the company's ability to trade successfully in the foreseeable future. East Ham FC Ltd is owned by Niceland plc, a large Scandinavian company, whose credit facilities have been severely hit following the collapse of an

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**Question 4(b) continued**

Icelandic bank. Niceland plc has issued a long term letter of support to East Ham Ltd. In East Ham Ltd's Directors' Report, it acknowledges the problems it faces, and also states that proposals to sell some star players should assist the company's finances and allow it to trade successfully. Details of the letter of support from Niceland plc parent company are included in the notes to the financial statements. The audit report is qualified 'except for'.

**(7 marks)**

**(b)** During the year Tesda plc, a large supermarket chain, changed its accounting policy for inventories from 'First In, First Out, to 'Average Cost'. No disclosure of this change has been given in the financial statements. Working papers suggest that the impact of this change has been that closing stocks are understated by some £5m at the year end compared to what they would have been under the old FIFO basis. This amount was not considered material to the profit, nor the Balance Sheet, and you are in agreement with this fact. The audit report is not qualified, but attention is drawn to the change by way of an emphasis of matter paragraph.

**(7 marks)**

**(c)** In the Directors' Report of Lancsex County Cricket Club Ltd (by guarantee), it was stated that apart from the expected activities related to running a professional cricket team, the club's income from its sports gambling and betting activities form a significant part of its turnover and profits for the year. However, in the financial statements, it is clear that turnover and profits from the sports gambling and betting activities are £200,000 and £35,000 respectively, compared to total turnover and profits of some £24,000,000 and £2,500,000. The auditors are confident as to the accuracy of the figures in the body of the financial statements. The audit report is not qualified and the reasoning contained in the audit file is based on the fact that the audit opinion does not cover the contents of the Directors' Report.

**(5 marks)**

**(d)** The firm of auditors took over responsibility for the audit of David Fence Ltd on 31<sup>st</sup> January 2009. The company's year end was 31 December 2008, and consequently the audit firm did not attend the year end stocktake. The closing stock figure included in the 2008 financial statements is £4.5m, which, given that the net assets of the company were £350,000, and the company made a loss before tax of £25,000, is extremely material to the financial statements. The auditor has been able to obtain sufficient and appropriate audit evidence in relation to the opening balance for stock as at 1 January 2008, and has received a management representation

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**Question 4(d) continued**

letter from the directors relating to the existence of the stock. The audit report is not qualified, but there is an emphasis of matter.

**(6 marks)**

**TOTAL 25 MARKS**

**Q5**

**(a)** Briefly describe and analyse the advantages and disadvantages of using any **TWO** of the following Computer Assisted Audit Techniques ('CAATs')

- Audit Automation
- Audit Software
- Mapping
- Modelling
- On-line Testing

**(8 marks)**

**(b)** Critically evaluate the issues an auditor would need to consider when planning an audit using CAATs:

**(17 marks)**

**TOTAL 25 MARKS**

**END OF QUESTIONS**