

**UNIVERSITY OF BOLTON**  
**BUSINESS AND CREATIVE TECHNOLOGIES**  
**ACCOUNTANCY PATHWAY**  
**SEMESTER 2 EXAMINATIONS 2010/2011**  
**AUDITING**  
**MODULE NO: ACC2503**

Date: 1<sup>st</sup> June 2011

Time: 10:00am – 1:00pm

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**INSTRUCTIONS TO CANDIDATES:** There are **FOUR** questions.

Answer **ALL** of the questions.

No additional materials are permitted  
in this exam.

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### Q1

Morris Ltd assembles domestic appliances from parts procured from a large number of suppliers. As part of the interim audit work two weeks prior to the company year-end, you are testing the procurement and purchases systems and attending the inventory count.

#### Procurement and purchases system

Parts inventory is monitored by the stores manager. When the quantity of a particular part falls below re-order level, an e-mail is sent to the procurement department detailing the part required and the quantity to order. A copy of the e-mail is filed on the store manager's computer.

Staff in the procurement department check the e-mail, allocate the order to an authorised supplier and send the order to that supplier using Electronic Data Interchange (EDI). A copy of the EDI order is filed in the order database by the computer system. The order is identified by a unique order number.

When goods are received at Morris Ltd, the stores clerk confirms that the inventory agrees to the delivery note and checks the order database to ensure that the inventory were in fact ordered by Morris Ltd. (Delivery is refused where goods do not have a delivery note.)

The order in the order database is updated to confirm receipt of goods, and the perpetual inventory system updated to show the receipt of inventory. The physical goods are added to the parts store and the paper delivery note is stamped with the order number and is filed in the goods inwards department.

The supplier sends a purchase invoice to Morris using EDI; invoices are automatically routed to the accounts department. On receipt of the invoice, the accounts clerk checks the order database, matches the invoice details with the database and updates the database to confirm receipt of invoice.

The invoice is added to the purchases database, where the purchase day book (PDB) and suppliers individual account in the payables ledger are automatically updated.

#### **Required:**

(a) Identify six audit procedures that an auditor would normally carry out on the purchases system at Morris Ltd with reasons for each procedure.

**(12 marks)**

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**Question 1 continued....**

(b) Identify four audit procedures that an auditor will normally perform prior to attending the client's premises on the day of the inventory count.

**(2 marks)**

(c) On the day of the inventory count, you attended the Birmingham depot at Morris Ltd. You observed the following activities:

1. Pre-numbered count sheets were being issued to client's staff carrying out the count. The count sheets showed the inventory ledger balances for checking against physical inventory.
2. All count staff were drawn from the inventory warehouse and were counting in teams of two.
3. Three counting teams were allocated to each area of the stores to count, although the teams were allowed to decide which pair of staff counted which inventory within each area. Staff were warned that they had to remember which inventory had been counted.
4. Information was recorded on the count sheets in pencil so amendments could be made easily as required.
5. Any inventory not located on the pre-numbered inventory sheets was recorded on separate inventory sheets – which were numbered by staff as they were used.
6. At the end of the count, all count sheets were collected and the numeric sequence of the sheets checked; the sheets were not signed.

**Required:**

(i) Identify the weaknesses in the control system for counting inventory at the Birmingham depot.

**(3 marks)**

(ii) For each weakness, explain why it is a weakness and state how that weakness can be overcome.

**(8 marks)**

**Total 25 marks**

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**Q2**

- a) ISA 505, *External confirmations*, states that ‘the auditor should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level.

**Required**

- i) List four examples of external confirmations **(4 marks)**  
ii) For each example in (i) above explain:

One audit assertion that the external confirmation supports, and  
One audit assertion that the external confirmation does **NOT** support.

**(8 marks)**

- b) Julie Ltd has a significant number of cash transactions and recent non-current asset purchases have been financed by a loan. This loan is repayable in equal annual instalments over the next five years.

**Required**

- i) Explain the procedures to obtain a bank report for audit purposes from Julie Ltd’s bank and the substantive procedures that should be carried out on that report. **(7 marks)**
- ii) List further substantive procedures that should be carried out on the bank balances in Julie Ltd’s financial statements. **(6 marks)**

**Total 25 marks**

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**Q3**

a) ISA 210 *Terms of audit engagements* explains the content and use of engagement letters.

**Required**

State eight items that could be included in an engagement letter **(8 Marks)**

b) ISA 500 *Audit evidence* explains types of audit evidence that the auditor can obtain.

**Required**

State and briefly explain four types of audit evidence that can be obtained by the auditor.

**(4 marks)**

c) ISA 700 *The auditor's report on financial statements* explains the form and content of audit reports.

**Required**

State, giving examples of 3 ways in which an auditor's report may be modified and briefly explain the use of each modification. **(3 marks)**

d) Below is an extract from an audit report produced by an audit junior:

**Basis of opinion**

'We conducted our audit in accordance with Auditing Standards. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.'

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**Question 3 continued....**

'We planned and performed our audit so as to obtain as much information and explanation as possible given the time available for the audit. We confirm that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. The directors however are wholly responsible for the accuracy of the financial statements and no liability for errors can be accepted by the auditor. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the company's annual report.'

**Required**

Without redrafting the above report identify and explain the errors in the above extract.

**(10 Marks)**

**Total 25 marks**

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**Q4**

- a) Explain the meaning of audit risk in the context of the audit risk model. **(4 marks)**
- b) ISA 315 *Obtaining an understanding of the entity and its environment and assessing the risk of material misstatement* sets out matters that should be documented during the planning stage of an audit.

**Required:**

List six matters that should be documented during the audit planning. **(6 marks)**

- c) ISA 230 *Audit documentation* provides guidance to auditors in respect of working papers.

**Required:**

- i) List six factors which affect the form and content of working papers **(3 marks)**
- ii) List the purpose of working papers **(3 marks)**
- d) You have been promoted to the role of audit senior in the audit firm of TIFI & Co. As part of your new responsibilities you have been given the responsibility for a long existing audit client DGY Ltd. DGY Ltd import and export DVD movies and computer software. The company operates out of eight branches throughout the UK.

**Required:**

List the documentation that should assist you in familiarising yourself with DGY Ltd. Describe the information that you should expect to obtain from each document.

**(9 marks)**

**Total 25 marks**

**END OF QUESTIONS**