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# Answers

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- 1 (a) The objectives of the internal controls that should be exercised over a wages system are to ensure that:
- (i) wages are paid only to authorised employees of the company.
  - (ii) wages are paid only in respect of work carried out or other authorised criteria.
  - (iii) wages are paid only at authorised rates of pay.
  - (iv) wages deductions are properly accounted for.
  - (v) wages deductions are paid over in full to the appropriate third parties.
  - (vi) wages transactions are recorded completely and accurately in the accounting records.
- (Full marks will be awarded for identifying FOUR of the above or other appropriate objectives.)
- (b) The following control procedures should be adopted:
- (i) employees involved in the actual input and processing of wages data should have 'read only' access to the wages master file.
  - (ii) there should be formal procedures requiring the interviews manager to provide detailed written notification to a responsible official (for example the wages supervisor) of starters and leavers.
  - (iii) the responsible official (above) should maintain an independent record of the cumulative number of authorised employees on file and after preparing appropriate input documentation should update this record to show the revised number of authorised employees that should exist on the master file. The written notification received from the interviews manager should be retained for reference as appropriate (see below).
  - (iv) after updating the wages master file, the responsible official should request a master file update report, and check that:
    - the report number is in line with expectations.
    - the amended details agree with the written notifications from the interviews manager.
    - the number of authorised employees on file agrees with the independent record maintained.Any discrepancies should be investigated immediately.
  - (v) after completion of the foregoing procedures the master file update reports should be filed securely together with input documentation and written notifications from the interviews manager.
  - (vi) at random intervals a more senior responsible official of the company (for example the company accountant), should access the wages master file and check its contents to the manual records maintained, input documentation and notifications from the interviews manager as appropriate.
- (Full marks will be awarded for stating procedures similar to those above.)
- (c) The following control procedures should be adopted:
- (i) the interviews manager should issue standardised time sheets to all interviewers in advance of work to be undertaken. Time sheets should be easily identifiable to individual interviewers.
  - (ii) interviewers should submit their time sheets to the interviews manager on a timely basis for monthly processing. Interviewers should be pursued for time sheets not submitted. Time sheets should be checked and evidenced as such for authenticity and hours worked, by the interviews manager.
  - (iii) pay rates applicable for hours worked and bonus payments due should be either noted on the time sheets by the interviews manager or noted on separate documentation as appropriate, for the attention of the wages clerk (below).
  - (iv) all authorised time sheets and pay rates/bonus documents should be forwarded intact to a wages clerk for the calculation of gross wages by the interviewer (employee).
  - (v) having calculated gross wages, the wages clerk should prepare the data for input by batching and the calculation of a batch input total, using a hash total represented by the total gross wages due.
  - (vi) all data documentation prepared should then be passed to the wages supervisor for checking, and authorisation prior to passing to another wages clerk for computer input and processing following password access.
  - (vii) on completion of processing, the input documentation should then be passed together with the computer produced 'current period payment details' report, to the wages supervisor for cross checking of report totals. Any discrepancies should be noted for re-input.
  - (viii) on satisfactory processing of re-input data and cross checking to a further 'current period payment details' report as required, a request should be made for the computerised production of the interviewers' wage slips.
- (Full marks will be awarded for stating procedures similar to those above.)

**2 (a)** The audit engagement partner (audit partner) should consider the following general matters:

- (i) the reason why the directors of Wizzin Limited wish to appoint new auditors to the company. If it is because they have refused to respond positively to a reasonable request from the existing auditors, resulting in a breakdown of the working relationship with them, then the audit partner of your firm may not be interested in quoting for the appointment.
- (ii) any risk of breaching the independence of the firm. There may be a risk of a threat to the independence or perceived independence of the firm if it is considered that it would become unduly dependent on Wizzin Limited as a consequence of the size of the fee charged to it. ACCA's Rules of Professional Conduct provide detailed guidance notes on this issue. Similarly if any of the firm's partners are connected to Wizzin in any way, then legislation founded in order to maintain auditor independence may prohibit the firm from acting as auditors to it.
- (iii) the ability of the firm to carry out an efficient audit. This will be determined by the reporting deadline set by the company and the audit resources available to the firm. Given the nature, size and spread of locations of the company's activities, the audit partner would need to carefully consider whether the firm could properly service this particular audit assignment. The availability of staff with sufficient technical knowledge and expertise may be dependent on other audit assignments to which the firm is already committed.
- (iv) general commercial considerations. The audit partner would need confidence that the firm could build a successful audit/client working relationship with the company. He would also need to ensure that such a relationship was commercially viable from the firm's perspective. Consequently he would need to consider the integrity and working practices of Wizzin's directors together with the financial strength of the company.

(Full marks will be awarded for describing THREE of the above or other relevant matters.)

**(b)** The following factors would affect the assessment of the inherent risks associated with the audit of the financial statements of Wizzin Limited:

- (i) The company is operating in a competitive market place, has suffered declining profits and has substantial bank borrowings. The directors appear not to be unduly concerned about the company's trading position. However they may be predisposed to misstating the financial statements in order to present a more favourable trading and balance sheet position and to instil greater third party confidence in the company. The assessment of inherent risk would need to take into account these factors, together with the possibilities of potential going concern problems being encountered by the company.
- (ii) The geographical spread of the company's activities over 14 sites would, in isolation, increase the possibility of material misstatement in the company's financial statements. The nature of the company's operation appears to be quite complex, with large volumes of purchases, sales and accounting transactions generally. There would therefore be concern as to the completeness and accuracy of recording of transactions in the company's accounting records and the reflection of the same in the financial statements.
- (iii) The company has incurred substantial costs on repair and refurbishment programmes at all 14 sites around the country. These costs would have a material effect on the company's financial statements and initial concerns would centre around the completeness and accuracy of recording, including the correct categorisation of costs between revenue (repair) and capital (improvement) expenditure in the financial statements.
- (iv) The company has extensive retail operations selling a wide range of products. Sales are predominantly for cash, which is particularly susceptible to loss or misappropriation and this together with the 'collect or delivery' flexibility given to credit sale customers increases the likelihood of unrecorded sales. The nature and mix of sales at each site including the hiring of tools and equipment, would lead to audit concern as to the possibility of unrecorded sales and the incorrect categorisation of sales in the company's accounting records.
- (v) Inventories would represent a significant proportion of the company's assets and there would be initial concern over this area of the company's financial statements. Concerns would centre around the basis of the quantification and valuation of inventories for inclusion in the company's balance sheet. As regards quantification, there may be particular concern as to the measurement of stockpiles of sand and gravel and concerns about valuation may be founded primarily on the values ascribed to inventory lines and individual items of inventory held at each site. Owing to the portability of inventory lines and open access to them, there would also be concern as to the likelihood of loss or misappropriation of inventories.
- (vi) The company's tangible fixed assets include a large volume of high value mobile items. This would cause initial audit concern and would render this area of the company's financial statements being allocated a high inherent risk factor. Any mobile or transportable assets owned by a company are susceptible to loss or misappropriation, but this characteristic is particularly applicable to the fixed assets stated as owned by the company, including the range of tools and equipment available for hire. As well as the issue of existence, the valuation of individual assets may cause concern given the possibility of damage and shortened assets lives brought about as a consequence of the relatively harsh operating environment of the company.
- (vii) The company employs 252 (14 x 18) full-time shop and yard staff supplemented with part-time and temporary employees, in addition to those employed at its head office. Given the likelihood of starters and leavers throughout the year and other payroll complexities including the possibility of overtime and bonus payments, the company will have a large volume of payroll transactions. This would lead to concerns over the completeness and accuracy of recording in this area and the potential of unauthorised payments of salaries and wages.

(Full marks will be awarded for stating and commenting on FIVE of the above or other relevant factors that would affect the initial assessment of inherent risk.)

- 3 (a)** The term 'audit evidence' describes the information obtained by the auditors in arriving at the conclusions on which the audit opinion is based. Audit evidence comprises source documents and accounting records underlying the financial statements (subject to audit) and corroborating information from other sources.
- (b)**
- (1) Inspection
    - (i) Consists of examining records, documents or tangible assets.
    - (ii) Example – the physical inspection of a freehold office building to verify existence of the building.  
Example – the examination of a purchase invoice to vouch the validity of an entry in the trade creditors ledger.
  - (2) Observation
    - (i) Consists of looking at a process or procedure performed by others.
    - (ii) Example – the observation of the counting of stock by an entity's personnel to ensure that they are counted in accordance with procedures authorised by the management of the entity.  
Example – the observation of the opening of the mail of an entity to ensure that at least two employees are present to receive and witness the receipt of monies received by the entity.
  - (3) Computation
    - (i) Consists of checking the arithmetical accuracy of source documents and accounting records or of performing independent calculations.
    - (ii) Example – checking the accuracy of extensions of balance sheet stock calculations to verify the accuracy of the valuation of reported stock.  
Example – checking the depreciation calculations as applied to fixed assets to ensure that depreciation rates are in accordance with the stated policy of the entity.
  - (4) Analytical Procedures
    - (i) Consists of the analysis of significant ratios and trends including the investigations of fluctuations and relationships that are inconsistent with other relevant information or deviate from predicted amounts.
    - (ii) Example – the calculation of the average remuneration (total wages and salaries divided by total employees) paid to the employees of an entity, to assess the reasonableness of the reported wages and salaries costs as compared to a previous equivalent period.  
Example – the calculation of an entity's trade creditors ratio to help assess the reasonableness of bad debt provisions, the effectiveness of credit control and the possibility of under/over statement of reported sales.
- 4 (a) (i)** The objectives and scope of the work of an internal auditor may vary widely and depend on the size and structure of the company and requirements of its management. Ordinarily, internal auditing activities include one or more of the following:
- Review of the accounting and internal control systems.
  - Examination of financial and operating information.
  - Review of the economy, efficiency and effectiveness of operations.
  - Review of compliance with laws, regulations and other external requirements and with management policies and directives and other internal requirements.
- The objective of the work of an external auditor, employed to audit the financial statements of a limited liability company, is to enable the auditors to express an opinion as to whether the financial statements are prepared in all material respects, in accordance with an identified reporting framework. The scope of the work required to meet these objectives is determined by the auditor having regard to any terms of the audit engagement and reporting requirements together with the requirements of Auditing Standards, relevant professional bodies, legislation and regulations.
- (Full marks may be awarded for answers including only some of the above or other relevant points.)
- (ii)** The extent to which an internal auditor should be expected to detect fraud will vary dependent on the tasks he is asked to carry out by management, the scale of any fraudulent activity and the resources with which he is provided to detect fraud. An external auditor should design audit procedures to obtain reasonable assurance that misstatement arising from fraud that is material to a company's financial statements will be detected. However it is often accepted that fraud may not be easy to detect, particularly when carried out by senior managers of a company, since it is ordinarily accompanied by acts specifically designed to conceal its existence. Consequently the extent to which an external auditor should be expected to detect fraudulent activity is dependent on the scale, the degree of concealment and the level of the resultant misstatement in the financial statements.
- (Full marks may be awarded for answers including only some of the above or other relevant points.)
- (b)** External auditors should consider whether:
- (i) the work has been performed by persons having adequate technical training and proficiency as internal auditors and the work of assistants has been properly supervised, reviewed and documented.

- (ii) sufficient appropriate audit evidence has been obtained to afford a reasonable basis for the conclusion reached.
- (iii) conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed.
- (iv) any exceptions or unusual matters disclosed as a consequence of the work have been properly resolved.

**(c)** The fundamental principles of the ACCA's Code of ethics are:

- (i) members should behave with integrity in all professional, business and personal financial relationships. Integrity implies not merely honesty but fair dealing and truthfulness.
- (ii) members should strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other. It presupposes intellectual honesty.
- (iii) members should not accept or perform work which they are not competent to undertake unless they obtain such advice and assistance as will enable them competently to carry out the work.
- (iv) members should carry out their professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of them as members.
- (v) members should behave with courtesy and consideration towards all with whom they come into contact during the course of performing their work.

(Full marks will be awarded for stating any FOUR of the above principles.)

The marking scheme generally indicates that 1 mark or  $1\frac{1}{2}$  marks are awarded for each point. However, consideration should be given to the depth and relevance of points provided by each candidate when answering the question; for example if only a brief explanation is given then it may only be worth  $\frac{1}{2}$  point whilst a detailed discussion could be worth up to a maximum of 2 points.

Marks are not allocated to specific points as the candidate may include a valid point within their answer which is not included in the model answer; the candidate should be given full credit for such points.

The majority of the questions require several points to be included within the answer, so if a candidate concentrates on a few points then they should not be given as much recognition, and their overall mark should be lower than a candidate who provides a range of points.

In conclusion, it is important that the overall standard of the candidate's answer is considered in terms of whether it is above or below a pass grade. After marking each question, the total mark awarded should be evaluated to assess whether it is fair. If it is decided that the total mark is not a proper reflection of the standard of the candidate's answer then the answer should be reviewed again, and the marks adjusted to ensure that the total awarded is fair. If the answer is of a pass standard then it should be awarded a minimum of 40%; if it is below a pass standard then it should be awarded less than 40%.

## **1 Opiniol Limited**

- (a) Stating objectives of the internal controls exercised over a wages system.  
Generally 1 mark per objective up to a maximum of (4 marks)
- (b) Stating the internal control procedures that the company should adopt over the updating of its wages master file with regards to starters and leavers.  
Generally up to  $1\frac{1}{2}$  marks for each stated procedure up to a maximum of (6 x  $1\frac{1}{2}$ ) (9 marks)
- (c) Stating the internal control procedures that the company should adopt over the completion, authorisation and computer processing of interviewers' time sheets.  
Generally up to  $1\frac{1}{2}$  marks for each stated procedure up to a maximum of (8 x  $1\frac{1}{2}$ ) (12 marks)
- (Total 25 marks)**

## **2 Wizzin Limited**

- (a) Describing general matters the audit engagement partner should consider in deciding whether to quote for the audit appointment.  
Generally up to 1 mark per point up to a maximum of 3 marks for each matter with an overall maximum of (3 x 3) (9 marks)
- (b) Stating with reasons factors that would affect the initial assessment of inherent risks associated with the audit of the financial statements.  
Generally up to 1 mark for each point with a maximum of 4 marks for each factor with an overall maximum of (16 marks)
- (Total 25 marks)**

### 3 Audit Evidence

- (a) Explanation of the term 'audit evidence' (1½ marks)  
Statement of what it comprises (1½ marks)
- (b) (i) Explaining what the following procedures involve:
- |                       |            |
|-----------------------|------------|
| Inspection            | (1½ marks) |
| Observation           | (1½ marks) |
| Computation           | (1½ marks) |
| Analytical Procedures | (1½ marks) |
- (ii) Providing TWO examples of the use of each of the procedures.
- |  |           |
|--|-----------|
| Generally up to 1 mark for each example up to a maximum of (4 x 2)     | (8 marks) |
| Explanation of the purpose of the procedure stated in each example.    |           |
| Generally up to 1 mark for each explanation up to a maximum of (4 x 2) | (8 marks) |

**(Total 25 marks)**

### 4 Internal Auditors and External (Registered) Auditors

- (a) (i) Contrasting the objectives and scope of the work of internal auditors and external (registered) auditors.  
Generally 1 mark per point up to a maximum of (4 marks)
- (ii) Commenting on the extent to which each should be expected to detect fraud.  
Generally 1 mark per point up to a maximum of (4 marks)
- (b) Explanation of the matters that the external auditor should consider when evaluating and testing work carried out by internal auditors.  
Generally up to 1 mark per point pertaining to each matter up to a maximum of (4 x 2) (8 marks)
- (c) Stating the fundamental principles of ACCA's Code of ethics.  
Generally up to 2 marks for each principle stated up to a maximum of (4 x 2) (8 marks)

**(Total 25 marks)**