# Implementing Audit Procedures

(International Stream)

Paper T8(INT)

**ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION**

**ADVANCED LEVEL**

**MONDAY 14 JUNE 2004**

**QUESTION PAPER**

Time allowed **3 hours**

ALL FOUR questions are compulsory and MUST be answered

**The Association of Chartered Certified Accountants**

**ALL FOUR questions are compulsory and MUST be attempted**

**1** M, a large manufacturing company limited by liability, has all of its production, stores and head office buildings situated on a single site. The buying and accounts departments are located in the head office building.

Following a recent take-over of the company, the new directors have been informed that there is an inadequate level of internal controls over the Purchases and Trade Payables system. Weaknesses include an absence of control procedures and adequate documentation. Similarly there has been no attempt to use supplier statements to supplement other controls within the system.

A 'batch entry batch processing system' is used throughout the company's accounting system, which incorporates fully integrated payables and general ledgers.

**Required:**

**(a) State FOUR objectives of having internal controls in a Purchases and Trade Payables system.** (4 marks)

**(b) Identify the internal controls that should exist in M over the following:**

**(i) Requisitioning and authorisation of purchases;**

**(ii) Acknowledgement of the receipt of goods and the return of goods to suppliers;**

**(iii) Checking and authorisation of purchase invoices prior to batching for processing through the computerised accounting system.** (15 marks)

**(c) Explain how supplier statements should be used to supplement other controls in the Purchases and Trade Payables system of M.** (3 marks)

**(d) State the meaning of the term 'batch entry batch processing system' and explain the use of control totals in such a system.** (3 marks)

**(25 marks)**

**2** J.J. is a small limited liability company which sells mineral water dispensing machines and bottles of mineral water.

The company's only shareholders, directors and employees are brothers Joe, Jim and Josh Alsage. The company's manual accounting system is simple in design and includes a sales day book, a cash book and trade receivables and general ledgers. Josh maintains the books of prime entry but not the trade receivables and general ledgers. These ledgers are written up by an independent qualified bookkeeper.

J.J. focuses on achieving bulk order high value sales to multi-site corporate customers. Consequently during the year ended 31 May 2004 there were only 48 sales invoice transactions. All sales are made on credit terms and invoices are priced from a standard product price list authorised by the directors. The control procedures employed over sales include the use of pre-numbered multi-part despatch notes and sales invoice stationery.

You have been assigned to the audit of the financial statements of J.J. for the year ended 31 May 2004. Your audit manager has explained why a direct verification (vouching) approach to the audit will be adopted as opposed to a systems based approach, and your first task will be to work on the area of sales. You are not required to verify entries in the company's trade receivables ledger or general ledger.

**Required:**

**(a) (i) Summarise what is meant by a 'systems based' approach to an audit. Your answer should refer to the stages of such an approach.** (10 marks)

**and**

**(ii) Summarise what is meant by a 'direct verification (vouching)' approach to an audit, explaining why the approach is often more appropriate when auditing the financial statements of a small limited liability company.** (8 marks)

**(b) State TWO main common objectives of vouching despatch notes, sales invoices and the sales day book, when auditing the sales of J.J.** (4 marks)

**(c) State THREE checks you would carry out to verify the completeness of processing of individual invoices, and THREE checks you would carry out to verify the accuracy of processing of individual invoices when vouching the sales invoices of J.J.** (3 marks)

**(25 marks)**

**3** An analysis of the trade receivables of Zais, a limited liability company, as at 31 May 2004 reveals the following:

| Balance Level | Number of Balances | Value |
|---|---|---|
| Over $15,000 | 3 | $94,107 |
| $10,001 to $15,000 | 10 | $139,406 |
| $7,501 to $10,000 | 19 | $165,100 |
| $2,501 to $7,500 | 51 | $174,842 |
| $0 to $2,500 | 146 | $130,975 |
| Credit Balances | 7 | ($621) |
| Total | 236 | $703,809 |

Janice, your audit supervisor, has instructed you to obtain direct confirmation of trade receivables using a sample size of 70 trade receivables balances. You are to use the positive confirmation method. In the course of her conversation with you, Janice mentioned that it is not always appropriate to adopt a sampling approach when testing various populations during the course of an audit.

**Required:**

**(a) State FOUR circumstances during the course of an audit when it would not be appropriate to adopt a sampling approach to testing.** (6 marks)

**(b) (i) Explain the difference between the 'positive' and 'negative' methods of obtaining direct confirmation of trade receivables balances and describe the circumstances in which the latter should be used.** (5 marks)

**(ii) Explain why none of the employees of Zais should have any influence on the selection of trade receivables balances to be confirmed.** (2 marks)

**(c) Explain the significance of including:**

**(i) All accounts with balances in excess of $7,500;**
**(ii) Some accounts with zero balances;**

**in the sample of trade receivables balances of Zais to be confirmed.** (6 marks)

**(d) Describe the other types of account in addition to those stated in (c) above, which would require special attention and would need to be represented in the sample of trade receivable balances to be confirmed.** (6 marks)

**(25 marks)**

**4 (a)** Provided an auditor possesses professional objectivity, he does not have to be *seen* to be independent.

**Required:**

**Comment on the above statement ensuring that you include an explanation of the term 'professional objectivity' and include commentary on the validity of the statement.** (10 marks)

**(b)** ACCA's Rules of Professional Conduct describe various situations and relationships, which if existing, could pose a threat to auditor independence. The guidance notes provide examples of appropriate actions that can be taken to safeguard against the loss of independence where such situations and relationships exist.

At a recent training seminar, the following scenarios were presented for discussion:

– On 20 May 2004, the audit engagement partner of Poynt and Co visited the offices of Geeclubs, a limited liability company, to plan the final audit procedures for the year ending 31 July 2004. A week later, each of the five partners of Poynt and Co received an unsolicited letter from the Managing Director of Geeclubs offering one year's free membership at one of the company's golf and country clubs with effect from 1 August 2004. Individual annual membership normally costs $3,000 and the offer was not made to anyone else.

– The wife of one of the audit managers at Pebury and Company – a large audit firm and auditors of Adlin, a limited liability company, has recently been appointed as the Financial Director of Adlin. Immediately prior to her appointment she had been employed by one of Adlin's competitors. Each of the directors of Adlin is entitled to an annual bonus based on the reported profit of the company.

– Bollies, a long established firm, audit the financial statements of two private limited liability companies owned by Thomas Arn, an entrepreneur with a very dominant personality. The annual total fee income of Bollies is $830,000 and the combined audit fees attributable to the two companies is $72,000. Thomas Arn has recently approached Bollies with a view to appointing them as auditors to a third limited liability company under his control. The projected annual fee attributable to the third company is $80,000.

**Required:**

**For each of the above scenarios:**

**(i) comment on any concerns you may have regarding the threat to auditor independence and objectivity.**

**(ii) recommend the appropriate action to be taken by the audit firm to safeguard against any threat identified.** (15 marks)

**(25 marks)**

**End of Question Paper**