

# Implementing Audit Procedures (International Stream)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

MONDAY 12 JUNE 2006

## QUESTION PAPER

Time allowed **3 hours**

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

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Paper T8(INT)



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

- 1** Rose Co, a haulage contractor company with sales of \$7 million and profits of \$1 million for the financial year ended 31 January 2006, recently dismissed its financial director for misappropriating company funds. Following his dismissal, the remaining directors of Rose Co asked your firm to carry out a full review of the company's internal control system with a view to recommending improvements as appropriate to guarantee the effectiveness of the controls.

An audit partner at your firm has written to the directors of Rose Co confirming that the firm will review the various components of the company's internal controls, including control activities employed. He has explained however that any system of internal control can only provide reasonable assurance that the company's financial reporting objectives will be achieved.

The company has over 1,500 customers to whom it sells on credit terms and it employs a manager and five clerks in its sales accounting function. The circumstances of the financial director's dismissal were that in the six month period up to 31 October 2005, he colluded with another senior manager of the company, to misappropriate individual sums totalling \$9,682 received from the company's customers. The directors discovered the fraud following a meeting between one of the customers and the managing director of Rose Co in April 2006, and have subsequently asserted that the auditors of Rose Co were negligent in not having discovered the fraud whilst auditing the company's financial statements for the year ended 31 January 2006. The auditors have stated that the directors are being unreasonable in making this assertion and are confident that an independent review of their audit working papers will confirm that they have not been negligent in their audit work.

**Required:**

- (a) Explain why it is important that the directors of Rose Co should ensure that the company has an effective system of internal control.** (3 marks)
- (b) (i) State FOUR types of control activity; and**
- (ii) For each type of control activity in (i), provide an example of how it may be employed on a day to day basis to control the sales accounting function of Rose Co.** (8 marks)
- (c) Explain why any system of internal control can provide an entity with only reasonable assurance that the entity's financial reporting objectives will be achieved.** (8 marks)
- (d) Briefly comment as to whether the directors of Rose Co would appear to be justified in asserting that the company's auditors were negligent in not detecting the fraud perpetrated by the company's financial director and another senior manager during the year ended 31 January 2006.** (6 marks)

**(25 marks)**

**2 Required:**

- (a) **Identify and explain FOUR matters that an auditor should consider when evaluating the control environment of an entity.** (8 marks)
- (b) Your firm is about to tender for the appointment as auditors to Tulip Co, a company which provides adventure holidays for groups of school children.

Having had an initial meeting with the directors of the company, John White, your firm's audit engagement partner has established that the company has a good control environment.

Your firm has no previous experience of auditing a company engaged in the adventure holiday sector. However, John is confident that by ensuring good audit planning, a thorough understanding of the business and properly directed substantive procedures, the firm will be able to carry out an efficient and effective audit of the financial statements of Tulip Co.

John has had discussions with the audit manager who would be assigned to the Tulip Co audit, and together they have decided that if the tender is successful, the firm will use document flowcharts to record the company's accounting and internal control systems.

**Required:**

- (i) **Identify SIX areas of the business operations of Tulip Co on which your firm should obtain detailed knowledge, in order to obtain an understanding of the business, if it wins the tender for the audit of the company.** (9 marks)
- (ii) **Explain the term 'properly directed substantive procedures' in the context of a risk based audit approach.** (4 marks)
- (iii) **Identify FOUR benefits of using document flowcharts to record a company's accounting and internal control systems.** (4 marks)

**(25 marks)**

- 3** Bluebell Co is an audit client of your firm and has 200 employees. The company purchases land and develops it by building commercial premises, either for sale or for rental. In addition to its land development activity, during the year ending 30 June 2006, Bluebell Co has purchased an office building for its own use at a cost of \$900,000. The purchase was financed by a further issue of ordinary shares in the company for \$600,000 and by a \$300,000 loan from an independent finance company. The loan is secured by a fixed charge over the office building and is repayable over a period of four years.

You have been assigned to the audit of the financial statements of Bluebell Co for the year ending 30 June 2006 and have been instructed to arrange for a bank confirmation letter from the company's bank and also to obtain copies of the minutes of the directors' board meetings for the year. Your audit manager has confirmed that each of these is a good source of evidence as a means of verifying specific matters reflected in the company's financial statements.

**Required:**

- (a) **Identify SIX specific matters with regard to the financial statements of Bluebell Co for the year ending 30 June 2006 which should be confirmed in the confirmation letter from the company's bank.** (9 marks)
- (b) **Identify SIX specific matters in respect of which the minutes of the directors' board meetings of Bluebell Co should provide useful evidence in the audit of the company's financial statements for the year ending 30 June 2006.** (6 marks)
- (c) **State the audit procedures that your firm should carry out to verify the ownership and existence of the office building purchased during the year.** (5 marks)
- (d) **State the audit procedures that your firm should carry out to verify:**
- (i) the amount of the loan from the finance company;
  - (ii) the related interest charges; and
  - (iii) the disclosure of the loan and of the related interest charges;

**in the financial statements of Bluebell Co for the year ending 30 June 2006.** (5 marks)

**(25 marks)**

- 4 (a) When an auditor concludes that the financial statements of a company give a true and fair view, in accordance with the identified financial reporting framework, then he should express an unqualified opinion in his auditor's report on those financial statements.

**Required:**

**Describe the circumstances in which each of the following should be expressed in an auditor's report.**

- (i) **Qualified opinion;** (3 marks)  
(ii) **Disclaimer of opinion;** (3 marks)  
(iii) **Adverse opinion.** (3 marks)

- (b) Auditors often use analytical procedures as substantive procedures to reduce detection risk relating to specific financial statement assertions.

**Required:**

**Explain FOUR factors that determine the extent of reliance that auditors may place on analytical procedures to reduce detection risk.** (10 marks)

- (c) It is standard practice during the course of an audit of a company's financial statements for a letter on internal control (also referred to as a management letter or a letter of weakness) to be issued by the auditors.

**Required:**

**Explain the nature and purpose of a letter on internal control, and state when and to whom it should be issued.** (6 marks)

**(25 marks)**

**End of Question Paper**