

Certified Accounting Technician Examination  
Advanced Level

# Implementing Audit Procedures (UK Stream)

Monday 10 December 2007

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

The Association of Chartered Certified Accountants



# Paper T8 (UK)

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

- 1** Starling Limited manufactures a range of vacuum cleaners, operates from large factory premises and prepares its annual financial statements to 31 January. It has a stores area from which raw materials and parts are issued to production, and a finished goods store. In recent months the company has encountered severe difficulties in controlling its stock resulting in losses, stopped production due to the shortage of parts and incorrect valuation of stock.

The company has been using a system of continuous stock checking (also known as a 'perpetual stock system') as a means of control, but the directors recognise that the system has failed during the current year. Consequently they have agreed that company employees will carry out a physical stock count as at 31 January 2008, as a basis for valuing stock for inclusion in the company's annual financial statements. The directors have also agreed to seek advice from your audit firm in connection with the introduction of a satisfactory system of continuous stock checking to be introduced from February 2008 and also in connection with the valuation of stock.

**Required:**

- (a) **State FIVE objectives of the internal controls that should be exercised over stock, including stock records.** (5 marks)
- (b) **State FIVE procedures that Starling Limited will need to incorporate in its revised continuous stock checking system, if it is to be relied upon by the company's auditors.** (5 marks)
- (c) **Describe SIX matters that should be covered by the physical stock count instructions to facilitate an efficient and reliable count as at 31 January 2008.** (9 marks)
- (d) (i) **Define the term 'cost' as applied to stock;** (2 marks)  
(ii) **Define the term 'net realisable value' as applied to stock;** (2 marks)  
(iii) **State how Starling Limited should value its stock as at 31 January 2008 in accordance with SSAP 9 *Stocks and long-term contracts*.** (2 marks)

**(25 marks)**

- 2 Finch Limited operates eight hotels in various locations around the country. The following information relates to the company's operations during the year ended 30 November 2007.
- (1) Following career moves by the ex-managing director and the ex-financial director, two replacement directors were appointed in February 2007. The new managing director has extensive experience of working in the hotel sector and adopts an aggressive management style whilst the new financial director is an unqualified accountant with only limited experience in the hotel sector.
  - (2) The company's directors, central administration and accounts department are located at its head office premises and wages payments to all employees together with all company supplier payments are made from there. Accounts staff at each hotel deposit hotel takings into the company's bank account at their local branch of the bank.
  - (3) The company's accounting system, which comprises fully integrated nominal, trade creditors and trade debtors ledgers, relies on daily sales and accounting information being input into remote terminals at each hotel, for transfer to a secure central computer based in the head office accounts department. The new financial director has changed some of the general controls of the system including those relating to the use of the remote terminals.
  - (4) The company operates a cash or bank card payment policy for non-corporate customers with credit terms being offered only to corporate customers.
  - (5) The remuneration package of each of the company's directors provides for the payment of a bonus based on the profits of the company. Similarly, the remuneration package of each hotel general manager provides for a bonus based on the profits of their hotel.
  - (6) Independent contractors were employed to construct a new hotel on land already owned by the company. Work commenced in January 2007 and the new hotel began trading in November 2007.
  - (7) Each hotel offers restaurant, gym, conference and meeting facilities. The company owns all of the hotels' land and buildings. During the year, two of the hotels were extended substantially to create additional restaurant space, whilst a swimming pool was constructed at another.
  - (8) In keeping with the company policy, all hotels are furnished and equipped similarly with ongoing repairs, maintenance and replacement programmes for furnishings and equipment.
  - (9) In September 2007, food poisoning at one of the company's largest hotels resulted in hospital admission for eight of the hotel's customers. The directors of Finch Limited have received legal advice confirming that the company is likely to have to pay compensation to settle the legal claims that have been lodged against it in this regard.

**Required:**

- (a) **Explain the meaning of the term 'inherent risk'.** (2 marks)
- (b) **State with reasons FIVE factors that would affect the initial assessment of the inherent risk associated with the audit of the financial statements of Finch Limited for the year ended 30 November 2007.** (15 marks)
- (c) **Explain what is meant by the term 'general controls' as applied to a computer-based accounting system and state the objectives of such controls.** (4 marks)
- (d) **State FOUR general controls that should exist to prevent unauthorised access to Finch Limited's computer system from the remote terminals located at each hotel.** (4 marks)

**(25 marks)**

**3** Your firm is the auditor of Owl Limited, a small precision engineering company which makes parts for car engines. The company maintains a nominal ledger, together with trade debtors and trade creditors ledgers. It also maintains a fixed assets register.

You have been assigned to the audit of the company's financial statements for the year ended 30 November 2007 and are aware that:

- (1) In May 2007 the company disposed of a large lathe machine for £30,000 and replaced it by purchasing two small but costly machines.
- (2) The company's trade debtors ledger included several customers, with large credit balances on their accounts as at 30 November 2007.
- (3) Throughout the year the company's cashier has been responsible for bank payments, the receipt and banking of trade debtors monies and the recording of all bank transactions in the company's accounting records. As the cashier is a very trusted employee the company's directors expect your firm to restrict its audit procedures in this area.
- (4) Your firm's audit procedures will include checking a sample of Owl Limited's year-end supplier statement balances.

**Required:**

- (a) (i) **Describe THREE audit tests your firm should carry out with regard to the disposal of the lathe machine;**  
(ii) **Describe THREE audit tests that should be carried out with regard to the purchase of the two additional machines.** (9 marks)
- (b) **State FOUR possible causes as to why the credit balances could have arisen on customer accounts within the trade debtors ledger of Owl Limited as at 30 November 2007.** (6 marks)
- (c) **Explain the extent of the substantive procedures your firm should carry out in the bank area of Owl Limited.** (5 marks)
- (d) **Comment on the reliability of supplier statements as a source of audit evidence and state FOUR audit objectives of your firm checking a sample of Owl Limited's year-end supplier statement balances.** (5 marks)

**(25 marks)**

- 4 (a) At a recent seminar on audit independence, an auditor and ACCA member explained that his sister owned all of the share capital in Eagle Limited and asked whether he should accept the appointment as auditor of the company. He is also the auditor of Robin Limited, a company which rents out holiday cottages. The company has offered him free use of a cottage for a two-week period, which would normally cost £1,000 and the auditor is unsure whether to accept the offer.

**Required:**

- (i) **State with reasons whether the auditor should accept the appointment as auditor to Eagle Limited;** (4 marks)
- (ii) **State with reasons whether the auditor should accept the offer of free holiday accommodation from Robin Limited.** (4 marks)

- (b) When carrying out audit sampling auditors need to consider whether to use statistical sampling.

**Required:**

- (i) **Define the term 'audit sampling';** (2 marks)
- (ii) **State FOUR advantages of using statistical sampling rather than non-statistical sampling (judgemental sampling).** (6 marks)

- (c) For recurring audits it is advisable to split working papers between permanent and current audit files, and in many firms working papers on the current audit file are automated.

**Required:**

- (i) **List SIX examples of the working papers ordinarily contained in a current audit file;** (6 marks)
- (ii) **State THREE advantages of using automated working papers.** (3 marks)

**(25 marks)**

**End of Question Paper**