This paper has three sections.
Candidates are required to answer all questions in Section A; one question from Section B and two questions from Section C.

SECTION A
Answer all questions in this section.

Question 1 (15 marks)

a) ISA 320 Materiality in Planning and Performing an Audit provides guidance on the concept of materiality in planning and performing an audit.

Define 'materiality' and indicate how the level of materiality can be assessed (5 marks)

b) You are the audit manager of Burnett, Carrington & Robinson, and you are planning the audit of Digiphones, an internet and telephone provider.

(i) Digiphones has offered the members of the audit team the option of buying cell phones at a discount of 50%. This is significantly more than staff members of the company Digiphones are given.

(ii) The CEO of Digiphones was ill for several months; during that time one of the partners of Burnett, Carrington & Robinson was asked to carry out the duties of CEO.

(iii) Burnett, Carrington & Robinson has been auditing the company for the past ten years.
Question 1 (cont’d)

(iv) It was revealed when reviewing the expenses that Digiphones had paid for a cruise for the Vice President of the company and a young member of the audit team. No one in the audit firm had known of the relationship.

(v) Janet Alleyne, the daughter of a retired partner of the audit firm has joined the firm as a recent graduate and is to be assigned to audit Digiphones.

Discuss how each of the situations (if any) could affect the independence of mind and independence in appearance of the audit firm. (10 marks)

Question 2 (10 marks)

Below are the names of accounts which should be confirmed with an outside source. Briefly describe from whom they should be confirmed and the information that should be confirmed. Organise your answer in the following format:

<table>
<thead>
<tr>
<th>Account Name</th>
<th>From Whom confirmed</th>
<th>Information to be confirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Cash at bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Trade accounts receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Share Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Legal fees</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| (v) Interest expense  |                     |                            | (10 marks)
SECTION B

Answer one question from this section.

Question 3 (15 marks)

Your audit firm is the auditor of Speighstown Garden Centre, which operates a large centre that sells plants, garden furniture (e.g. outdoor benches) and garden equipment (e.g. lawn mowers).

The inventory system is up-to-date; the records are well maintained and the year end quantities are used to determine the inventory value. The inventory count instructions are shown below:

(i) The inventory count will be supervised by the Financial Controller and will take place on 31 August 2012. The count will begin at 7am. The centre will be closed on the day of the count, but if any of the large customers like hotels require a rush order, they will be accommodated.

(ii) One member of the Accounts Department will be assigned to each area along with a member of the garden staff. There will be computer produced sheets showing the quantities of each item from the system. The Financial Controller will distribute and collect back the forms at the end of the count. Where the amount observed is different to the amount on the sheet, it will be crossed out and the new amount written in pencil.

(iii) The Financial Controller will then carry out test counts on five items in each area that has been counted. Where an error is found, the area will be re-counted.

(iv) The quantity for any inventory that looks damaged or unsaleable should be crossed out and allotted a quantity of zero.

(v) Once all the sheets have been collected and test counts completed, the Financial Controller will manually update the computerised system to reflect the counted quantities. After the system has been updated, the count sheets are discarded.

Required:

Identify and explain FIVE deficiencies in the inventory counting system that can be highlighted in the instructions from Speighstown Garden Centre. For each deficiency suggest how it could be overcome. (15 marks)
Question 4 (15 marks)

You have been assigned to audit Accounts Receivable of St. David’s Building Materials as at June 30, 2012. On that date there were 200 accounts and the balance totaled $485,570. Forty of the accounts with balances totaling $388,500 were selected for confirmation. All except 5 confirmations were returned without exceptions. The 5 confirmations had the following information and comments:

1. The balance of $6,250 was paid on June 25, 2012.
2. An advance payment of $3,000 made by us in May 2012 should cover the two invoices totaling $1,350 shown on the statement attached.
3. We do not owe you anything as at June 30, 2012 as the goods represented by your invoice dated June 29, 2012, number 54321 in the amount of $10,550 were received on July 5, 2012, on FOB destination terms.
4. Your credit memo dated June 13, 2012 in the amount of $4,350 cancels the balance above.
5. This confirmation was returned as undelivered by the post office.

Required:

(i) Indicate which of the confirmation responses likely represent timing differences. (5 marks)

(ii) For each of the 5 responses indicate the procedures you would perform to determine whether the exception is a misstatement or has been appropriately recorded by the client. (10 marks)
SECTION C
Answer two questions from this section.

Question 5 (20 marks)

(a) Explain why obtaining an understanding of the client's business and its environment is important for the auditor. (4 marks)

(b) ISA 315 *Identifying and assessing the risks of material misstatements through understanding the entity and its environment* sets out matters that should be documented during the planning stage of an audit.

List FOUR matters that should be documented during audit planning. (4 marks)

(c) The following are specific transaction related audit objectives applied to the audit of cash disbursement transactions

(i) Recorded cash disbursement transactions are for the amount of goods or services received and are correctly recorded.

(ii) Cash disbursement transactions are properly included in the accounts payable, master file and are correctly summarized.

(iii) Recorded cash disbursements are for goods and services actually received.

(iv) Cash disbursement transactions are properly classified.

(v) Existing cash disbursement transactions are recorded.

(vi) Cash disbursement transactions are recorded on the correct dates.

<table>
<thead>
<tr>
<th>Management Assertion about Classes of Transactions</th>
<th>General Transaction-Related Audit Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occurrence</td>
<td>Occurrence</td>
</tr>
<tr>
<td>Completeness</td>
<td>Completeness</td>
</tr>
<tr>
<td>Accuracy</td>
<td>Accuracy</td>
</tr>
<tr>
<td>Classification</td>
<td>Posting and Summarisation</td>
</tr>
<tr>
<td>Cutoff</td>
<td>Classification</td>
</tr>
<tr>
<td></td>
<td>Timing</td>
</tr>
</tbody>
</table>

Required:

(i) For each specific transaction-related audit objective, identify the appropriate management assertion (6 marks)

(ii) For each specific transaction-related audit objective, identify the appropriate general transaction-related audit objective (6 marks)

TURN OVER
Question 6 (20 marks)

(i) List three expense accounts that are tested as part of the acquisition and payment cycle or the payroll and personnel cycle. (3 marks)

(ii) List two expense accounts that are not tested as part of the acquisition and payment cycle or the payroll and personnel cycle. (2 marks)

(iii) How will the approach for verifying repair expense differ from that used to audit depreciation expense? Why would the approach be different? (3 marks)

(iv) (i) Distinguish between a client letter of representation and an audit engagement letter and state the purpose of each of each. (6 marks)

(ii) List three items that might be included in each letter. (6 marks)

Question 7 (20 marks)

(a) Explain in your own words, the meaning of the audit terms:

(i) Examine

(ii) Recompute

(iii) Observe

(iv) Trace

(v) Inquire

(5 marks)
Question 7 (cont’d)

(b) For the following independent situations, assume that you are the audit partner on the engagement

(i) Montego Bay Hotel has prepared financial statements but has decided to exclude the Statement of Cash Flows. Management explains that the users find this statement confusing and prefer not to have it included.

(ii) The controller of Workbench Inc. will not allow you to confirm the accounts receivable from two of its large customers. The amounts of the receivables are material in relation to Workbench’s financial statements. You are unable to satisfy yourself as to the collectability of these receivables by alternative procedures.

(iii) You are auditing Triple C Deep Cleaning Services for the first time. Triple C has been in business for several years but over the last two years has struggled to stay afloat given the current economic conditions. Based on your audit work, you have substantial doubt that Triple C will be in business by the end of its next fiscal year.

For each of the situations above, answer the following questions

(i) Identify whether it requires a modification from the standard unqualified report. (1 mark)

(ii) State any additional information you need to make a decision. (2 marks)

(iii) State the type of report you would issue and give the reason for your selection. (2 marks) (15 marks)