EXAMINATIONS OF DECEMBER 2013.

CODE AND NAME OF COURSE: ACCT3043 – AUDITING I

DATE AND TIME: DURATION: 2 HOURS

INSTRUCTIONS TO CANDIDATES: This paper has 4 pages and 4 questions.

Candidates are required to answer Question 1 and any two (2) other questions

QUESTION 1 (40 marks)

a) Explain briefly the audit terms and indicate the type of evidence each provides:

- Examine
- Compute
- Trace
- Inquire
- Observe

(10 marks)

b) You are an audit manager in Carrington, Lee & Associates, and a firm of Chartered Accountants. You are preparing the engagement letter for the audit of Modern Printery, a public company with a year end June 30, 2013.

Modern Printery has grown over the years and has been your audit client for the past nine years. Their fees represent a significant portion of the audit firm's income. The audit firm provides audit, taxation and some management consultancy services. Owing to the downturn in the economy, 50% of the audit fee for the previous year ended June 30, 2012, has not been paid. The client is satisfied with service provided by the audit firm.

The persons available to work on the audit are almost the same as last year. Mr. Crooke has been audit partner since Modern Printery became an audit client. He has become good friends with the CFO at Modern Printery; their families went on a cruise last August and as a result he has not asked about the outstanding fees.

Sylvia Henry, who has just passed her ACCA final exams, worked in the Accounting Department at Modern Printery for several years. She was recruited by Carrington, Lee and Associates within the past three months. It is considered that she might be a useful addition to the audit team of Modern Printery.

Required
Identify and explain the threats to independence which are in the above scenario and suggest ways in which they can be avoided

(10 marks)

TURN OVER
c) There are five (5) conditions that must be met before an auditor can issue an unqualified report for the audit of Company. List each of these five (5) conditions. 

(5 marks)

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

Required:
List six matters that should be documented during audit planning (3 marks)

e) i) Briefly explain in your own words the meaning of the term "internal control".

(5 marks)

ii) State two reasons why internal controls are evaluated.

(2 marks)

iii) Briefly discuss the inherent limitations of internal control connected with small businesses (5 marks)

QUESTION 2 (30 marks)

The following misstatements are sometimes found in the sales and collection cycle's account balances:

1. The accounts receivable listing does not equal the balance in the general ledger.

2. A shipment made in the subsequent period is recorded as a current period sale.

3. Several accounts receivable are in dispute as a result of claims of defective merchandise.

4. Goods shipped and included in the current period sales were returned in the subsequent period.

5. The allowance for doubtful accounts is inadequate because the client failed to adjust for the current economic depression in the allowance.

6. The use of accounts receivable as collateral for a bank loan is not disclosed in the financial statements.

Required:

i) For each misstatement, identify the balance related audit objective to which it pertains. (6 marks)

ii) For each misstatement, list an internal control that should prevent it (12 marks)

iii) For each misstatement, list one test of details of balances audit procedure that the auditor can use to detect it. (12 marks)

TURN OVER
QUESTION 3 (30 marks)

a) What are the audit objectives of the cash and bank section of the audit? (8 marks)

b) Identify an inherent risk associated with the audit of the cash and bank section (2 marks)

c) Provide five audit procedures which may be used in the audit of "cash on hand and cash at bank" (10 marks)

(d) Larry Blake is employed at H & G Paints, responsible for preparing cheques, recording cash disbursements and preparing bank reconciliations. While reconciling the September bank statement, Blake noticed that five cheques totalling $8,900 had been outstanding for more than a year. He assumes that these cheques will never be presented for payment and taking advantage of his position, he wrote a cheque for $8,900 to himself, forged the financial controller's signature, and cashed the cheque. Blake made no entry in the accounts for this disbursement and attempted to conceal the theft by destroying the forged cheque. He omits the long outstanding cheque from the bank reconciliation for October.

Required
i) Identify four weaknesses in H&G Paints' internal controls. (4 marks)

ii) Explain the audit procedures that might uncover the fraudulent disbursement. (3 marks)

iii) Recommend three controls that might be introduced to prevent this from happening in the future (3 marks)

QUESTION 4 (30 marks)

(a) The minutes of the board of directors of Coconut Grove Hotel for the year ended December 31, 2012 were provided to you. It is presented below:

Minutes of Meeting of July 7, 2013

The meeting of the Board of Directors of Coconut Grove Hotel was called to order by James Richards, Chairman of the Board at 4.15pm. The following directors were in attendance:

Zara Alleyne James Richards Margaret Williams Hyacinth Thomas
Maxine Noel Randolph Springer Brian Williamson

The Board approved the minutes from the meeting of November 15, 2012.

The Board reviewed the financial statements for the financial year ended December 31, 2012. The Board declared an increase in the annual dividend payable to ordinary (common) shareholders from $.50 to $.60 per share. The dividend is payable on September 25, 2013 to shareholders on record as of July 30, 2013.

The Board approved an increased budget of $750,000 to be spent on advertising in the Far East (China and Japan) for the year ended December 31, 2012.
Judith Lambert, CFO updated the Board on discussions with Export Development Bank (EDB) for the financing of a new computerised front desk system. They wished to borrow $1 million and are negotiating for a reduced interest rate. EDB is proposing an interest rate of 10% per annum, with a two year waiver or moratorium on the payment of principal. The Directors have asked the CFO to bring two other proposals for consideration to the next meeting.

Legal counsel has been asked to give an opinion on the likely outcome of a case where an employee who lost two fingers in a freezer door is suing the company for $250,000. The lawyer, Daniel Booker stated that there is every possibility that the company will have to pay as there was apparently no warning that the freezer was malfunctioning.

Bonuses for the year ended December 31, 2012 were to be paid to the following officers on August 30, 2013

Brian Williamson, CEO $27,500
Judith Lambert, CFO $20,500

Required:
Read the minutes of the meeting of July 7, 2013. Use the following format to list and explain information that is relevant for the 2013 audit.

<table>
<thead>
<tr>
<th>Information Relevant to 2013 Audit</th>
<th>Audit Action Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>(15 marks)</td>
</tr>
</tbody>
</table>

b) Towards the end of an audit, it is common for the auditor to seek written representations from the management of the client company. This is usually in the form of a letter from management to the auditors containing all the required written representations.

Required:
(i) Who drafts the letter? (1 mark)
(ii) Explain why auditors seek written representations. (3 marks)
(iii) List three matters commonly included in the letter of representation. (3 marks)

c) In connection with your examination of the financial statements of St Lucy Mattress Company for the year ended 31 March 2013, you are reviewing the plans for a physical inventory count at the company's warehouse. The company assembles mattresses and other household items made with foam. The factory is next door and will continue to make products until 5'o'clock on 31 March 2013. There is also a warehouse in Bridgetown to serve the city merchants.

Required:
(i) List the principal procedures which the auditors should carry out when planning attendance at a company's physical count (4 marks)
(ii) Describe the procedures which St Lucy Mattress Co. should put in place to ensure that all inventory items are counted and that no item is counted twice. (4 marks)

END OF QUESTION PAPER