

Uol past year paper



**ASSIGN
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Friday, 18 May 2012 : 10. 00am to 1. 00pm Candidates should answer FOUR of the following EIGHT questions: TWO from Section A, ONE from Section B and ONE further question from either section. All questions carry equal marks. © University of London 2012 UL12/0010 D01 PLEASE TURN OVER

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SECTION A Answer TWO questions from this section and not more than one further question. (You are reminded that four questions in total are to be attempted with at least one from Section B.) 1. You have just been approached by the newly-appointed Senior Regulator for the financial services (including accounting and auditing) industry in a country which has previously had little or no regulation on the provision of financial information. The Regulator has said that his first priority is to improve the quality of annual financial statements which the major companies in the country publish.

The Regulator has established working parties to examine improvements in the quality of accounting and financial reporting practices. Another working party has been established to examine the quality of audit field work. The Regulator tells you that he wants your working party to put forward proposals which will improve the quality of audit reporting. He is concerned that present practices allow individual auditors to report in their own way. This has led to confusion, since there are so many different styles of audit

report. The Regulator believes that a standardised approach will reduce this confusion.

He is aware that there are international auditing standards on auditing and asks you to examine the possibility of adopting an approach consistent with the international standards. He asks you to look at the following specific aspects of audit reporting:

- To whom the audit report is addressed
- A reference to the framework of accounting
- A reference to the framework of auditing
- Some discussion of what can be and what cannot be expected from an audit
- The style of opinion on the financial statements, and
- Any other issues you think might be relevant.

Required (a) (b) Draft a report from your working party on the specific issues mentioned above. (15 marks) Draft an appendix to this report setting out the advantages and disadvantages of a standardised approach to audit reporting. (10 marks) UL12/0010 D01 Page 2 of 6 2. You are the audit partner of Lottolife, a leisure establishment which includes a bar and a restaurant open to the general public. The management consists of a senior manager and three assistant managers; all four are paid a salary with a profit-related bonus.

Both the bar and the restaurant are dependent on casual workers who are paid an hourly rate in cash at the end of the week. To record the hours worked, each employee has to 'clock in and clock out' using a clock card inserted into a machine which records the time in and out. There is no other check on the accuracy of the recorded hours. Workers are hired after a short interview by one of the assistant managers who completes a form to

record the details of the successful applicant. The company has a poor reputation as an employer and expects its staff to work long hours.

Consequently employees tend not to stay very long. On resigning, an employee has to sign a form which is endorsed by the assistant manager and is then handed to the Payroll Department so that the employee's last pay packet can be made up and the employee taken off the payroll. There are never enough applicants to fill the vacancies and almost no applicant is rejected. Both pay and staff morale are low. In an attempt to boost the pay and attract more and better staff, one of the assistant managers has suggested paying a weekly bonus from the cash tips left by customers.

The tips would be divided among the workers rather than being banked as part of the takings. There would be no record kept of the tips which would mean that the workers would not be taxed on their 'bonus'. It also has a members-only club which is a licensed casino where various forms of gambling take place. Under the licensing rules only trained staff can be employed and these are reasonably well paid jobs. Occasionally if there is a staff shortage on the catering side in the casino, members of the bar and restaurant staff are brought in, given new uniforms and are instructed to help out.

Technically this is against the gaming rules, but the casino management consider that if the breach is ever discovered by the authorities, the worst thing that might happen would be the casino having to pay a fine. They are aware however that it is possible that the licence could be withdrawn and the casino could be forced to close. Required (a) (b) Identify possible weaknesses in the control environment in Lottolife. (15 marks) Suggest

various audit procedures which might be appropriate in the particular circumstances of Lottolife. (10 marks) UL12/0010 D01 Page 3 of 6 3.

You have just been appointed auditor of Bruton's Ltd, a small family-owned gentlemen's tailors and clothes shop. It is based in the South-West of England where it has six shops in different towns. The clothes it stocks and sells are at the upper end of the price range, appealing to the wealthier customer. The company, like its customers is old-fashioned. In fact, the decor of the shops has not changed since the 1960s. The head of the family and major shareholder, John Bruton, is aged 86 and sees no reason to change what has for fifty years been a winning formula – a top quality service and a premium price.

He dismisses the falling sales and lower profits as simply consequences of the tough economic climate. The three other shareholders are Bruton's sons, the youngest of whom is 53. The sons have tried to get their father to change strategy since they have seen similar companies in other regions increase their market share through the internet and through a radical make-over of their retail outlets. They accept that their plans will cost about ? 10m and they will need a bank loan to finance what is effectively a re-branding exercise.

They believe, though they have not done a detailed analysis, that internet sales over the next three years would bring in enough cash to repay the loan and enough profit to cover loan interest. After that, there would be clear profit for about ten years until the next rebranding was needed. In addition, the leases on the shops are all going to expire in the next five years. These can be renewed but it will be costly as the premises are all in city centre

locations which are highly sought after by companies in the food and drinks industry.

With insufficient cash reserves, Bruton's would need further bank financing to cover the capital cost of renewing these long term leases. The sons are also urging their father to consider buying in cheaper clothes imported from Asia as way of boosting sales and profits. The father who is very patriotic has rejected this suggestion, choosing instead to stay with British-based suppliers who have served him well since he began in business. Bruton's accounting system dates from the 1960s. It is mainly manual with sales staff making out a handwritten receipt for each sale.

Cash is put through a till but there is no reconciliation of receipts and takings through the till. The shops do have credit card facilities but again there is no reconciliation of sales and card receipts. The main element of control is the presence of one of Bruton's sons. Each is responsible for two shops which they attend on alternate days. This close supervision has seemed to work well until, Roger, the eldest son, had a heart attack and was unable to work for six months. During this time, his two brothers supervised the six shops visiting one every three days.

Roger is now back at work though he only works reduced hours at one location. Required (a) (b) Identify the major elements of audit risk in Bruton's Ltd. (15 marks) Explain the steps you would have taken before formally accepting appointment as auditor of Bruton's Ltd. (10 marks) UL12/0010 D01 Page 4 of 6 4. You have just been appointed the Quality Assurance Partner in Raiffes & Co. , Chartered Accountants and Registered Auditors. You are currently reviewing a sample of the audit files of five audit clients.

Your aim is to ensure that the quality of audit work at least matches and, if possible, exceeds the minimum standard required under the international auditing standards and UK legislation. You have made the following list of items which cause you concern:

- In Albany Ltd, the audit team noted that although accurate inventory records had not been kept during the year, the year-end stock count was tightly controlled and a detailed review of gross profit margins suggested little chance of material error. On this basis the audit manager had recommended signing an unmodified opinion.

In Boverton plc, a weakness in internal control had been detected early in the audit. The weakness concerned payroll and may have allowed overpayments to genuine staff and/or payments to fictitious staff. Because payroll is such a sensitive area, the audit team had done nothing more than note the weakness in the audit file, highlighting the issue for partner review. In Chirley plc, the company had failed to comply with the relevant financial reporting standard for pension costs. The matter is one of disclosure rather than measurement.

The Finance Director simply will not accept that the standard is correct and insists that he is right. The recommendation from the audit team is to agree with the Finance Director since the accounting numbers are right and the firm should not risk upsetting a major client. In Dalton, a fraud involving the cashier had been discovered. The amount involved was immaterial to the financial statements. When the Finance Director was told about the fraud, he was unmoved, claiming that he knew about the fraud which had been going on since the man was first employed five years ago.

The Finance Director said that he allowed the cashier to supplement his salary in this way since it was cheaper than giving him a pay rise. In Exeter Ltd, this was the first year of the audit appointment. The fixed asset register had not been maintained for the last five years meaning that it was impossible to assess from the records how long the assets had been in use. Total tangible fixed assets are material to the financial statements. The team had immediately stopped work on fixed assets concluding that the audit report would have to be modified on the grounds of disagreement. • • •

Required (a) Evaluate the situation in each of the five cases and suggest an appropriate course of action in each including if necessary modifying the auditors' report. (15 marks) Suggest steps which the firm should take to ensure that all its audits come up to the appropriate standard. (10 marks)

(b) UL12/0010 D01 Page 5 of 6 SECTION B Answer ONE question from this section and not more than one further question. (You are reminded that four questions in total are to be attempted with at least two from Section A.) 5.

Because audit time is not unlimited, sampling is a key component of any audit strategy. Explain the various factors which auditors consider when setting up their sampling plan. 6. Critically evaluate the purpose of an audit from the point of view of the readers of the auditors' report. 7. You are required to write a general theory of auditing of financial statements. What concepts and assumptions would you include and what purpose would each serve? 8. Critically evaluate the measures taken in the IFAC Code of Ethics to safeguard auditor independence. END OF PAPER UL12/0010 D01 Page 6 of 6