

# COMMONWEALTH OF AUSTRALIA

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<b>CHARLES DARWIN UNIVERSITY</b>	Family Name							
	Given Names							
	Student Number							
	Teaching Period		Semester 2, 2016					
<b>FINAL EXAMINATION</b>		<b>DURATION</b>						
<b>ACT504 – Auditing</b>		Reading Time:		10 minutes				
		Writing Time:		180 minutes				

### INSTRUCTIONS TO CANDIDATES

1.1 The examination has 3 sections.

<b>Section A:</b>	<b>Multiple Choice Questions:</b> Answer ALL questions 20 marks
Suggested Time:	40 minutes
<b>Section B:</b>	<b>Short Answer Questions:</b> Answer ALL questions 45 marks
Suggested Time:	90 minutes
<b>Section C:</b>	<b>Short Essay Questions:</b> Answer ALL questions 25 marks
Suggested Time:	50 minutes

Section A must be answered on the Multiple Choice Answer sheet provided in this examination paper and must be handed in with your answer booklet. Please ensure that your name and student number are clearly indicated on your Answer Sheet and at the top of this examination paper.

Section B and Section C are to be answered in the Answer booklet provided.

1.2 Note that questions **ARE NOT** of equal value.

1.3 Read **ALL** questions carefully.

### EXAM CONDITIONS

**You may begin writing from the commencement of the examination session.** The reading time indicated above is provided as a guide only.

This is a RESTRICTED OPEN BOOK examination

No calculators are permitted

No handwritten notes are permitted

Hard copy, unannotated English translation dictionary only

ADDITIONAL AUTHORISED MATERIALS	EXAMINATION MATERIALS TO BE SUPPLIED
Relevant Legislation (Unannotated)	1 x 16 Page Book 1 x 4-Multiple Choice Answer Sheet

**Section A**  
**Multiple Choice Questions**  
**Total No of Marks for this section: 20**

This section should be answered on the Multiple Choice Answer Sheet provided. Please ensure that your name and student number have been written on the Answer sheet and place in the completed answer Booklet.

Each question carries 1 mark. Suggested Time allocation for Section A: 40 mins

**Section B**  
**Short Answer Questions**  
**Total No of Marks for this section: 45**  
**Answer ALL questions**

This section should be answered in the Answer Booklet provided.

Marks for each question are indicated. Suggested Time allocation for Section B: 90 mins

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**Question 1: (10 marks)**

You are a newly qualified accountant who works for the audit firm Harrison Ford & Co. You have been approached by a potential new client, Calista Electronics Pty Ltd, who is looking for an audit firm to carry out an audit on its annual financial report prepared in accordance with the Corporations Act. The managing director, Calista Flockhart, is not sure exactly what an audit involves and what are the responsibilities of the auditor.

***Required:***

**Prepare notes for a meeting with Calista Flockhart which identifies the responsibilities of the auditor and the responsibilities of management.**

The notes should cover the following:

- Distribution of the annual report to shareholders.
- Delivery of the audit report to the entity.
- Obtaining and evaluating evidence concerning the financial report.
- Preparation and presentation of the financial report.
- Maintaining adequate internal controls.
- Testing internal control procedures.
- Expressing an opinion on the financial report.
- Selecting appropriate accounting policies.
- Ensuring the financial report is presented in accordance with standards.
- Performing test of controls.

**(10 marks)**

**Question 2: (13 marks)**

The Fine Arts Ltd is an online retailer of a broad range of art and craft products. You are an audit senior at the firm Star Wars & Co and are planning the financial report audit for the year ended 30 June 2015. The Fine Arts is a new client to your firm and this is the first year end since you were appointed. The following information was obtained from a meeting with the CEO, Katrina Maglanque.

The company has managed to ride a wave of renewed interest by younger people in arts and crafts and the revenue for 2015 is approximately \$3.2 million. This continues a trend that has seen revenue increase by between 20% and 30% consistently for the six years since the company was started by Katrina and her tennis partner Jade Garrard who is the COO. Profits in 2015 are \$0.2 million and have not increased significantly in four years despite the increased turnover. In 2016 there are plans to broaden the range of products sold to include bedding, curtains and household furnishings.

Rapid expansion has put pressure on the company's various systems, not least of which is the online sales order system. The Fine Arts do not have their own in-house IT function relying on Katrina's sister Kristine who is responsible for accounting, IT, HR, payroll and general office management.

You are aware that in previous years errors had been detected at the audit stage, partly due to IT system errors and partly due to Kristine's inexperience as an accountant. Katrina and Kristine are confident that any errors in the financial report will be immaterial and not worth investigating given how busy they are with the growing business.

As part of the growth of the business the company is looking to raise additional bank borrowings to fund more warehouse space and invest in improvements to the IT systems. Katrina has indicated that she needs the audit report signed before 15 September which is when she will be meeting the bank to discuss the details of the loan.

***Required:***

**Based on the above information, identify the issues that give rise to risks for the financial report audit you are about to commence.**

**(13 marks)**

**Question 3: (10 marks)**

Specific auditing procedures for obtaining audit evidence are listed below.

1. Send debtor's confirmation letters to a number of the client's customers.
2. Recalculate depreciation charges.
3. Calculate gross profit rates for the current year and preceding year.
4. Discuss the potential obsolescence of inventory with the management.
5. Examine registration certificates for motor vehicles purchased during the year.
6. Use the computer to scan a file to determine that all documents in a numbered series have been accounted for.
7. Learn about a possible lawsuit in conversation with the financial controller.
8. Obtain a valuation of land held by the company interstate.
9. Observe the year-end inventory count.
10. Select a sample of repairs and maintenance expenses and check whether any should have been capitalised.

***Required***

**Indicate:**

**(a) the type of evidence obtained by each procedure**

**(5 marks)**

**(b) the assertion or assertions to which it relates.**

**(5 marks)**

**Question 4: (12 marks)**

The financial year of Margot Pty Ltd ended on 30 June 2015. Your auditor's report was signed on 25 August and the financial statements were issued on 10 September. Listed below are events that occurred or were discovered after the end of the financial year. Assume that each has a "**material**" effect on the financial statements.

1. 1 August — A lawsuit was filed against Margot for damages that allegedly occurred before 30 June. In the opinion of Margot's lawyers, there is a danger of a significant loss.
2. 15 August — You discovered that Anna, a debtor of Margot went bankrupt on 10 August. The most recent sale had taken place on 25 May and no transactions had occurred since that date.
3. 1 September — You discovered that a legal action commenced against Margot in relation to a faulty product sold in May 2015.
4. 15 September — A fire burnt down one of Margot's warehouses, resulting in a loss of 30% of the inventory that was on hand at that date.
5. 30 September — You discovered that Karen, a debtor of Margot, went bankrupt on 15 July. Sales to Karen were all made before the end of the year.
6. 30 September — You discovered that Nina, a debtor of Margot, went bankrupt on 25 September. The sale had taken place before the end of the year, but the amount had appeared collectable at the date on which the auditor's report was signed.

**Required:**

**(c) Indicate your responsibilities for each of the above events.**

**(6 marks)**

**(d) Indicate the type of disclosure (if any) you would recommend in relation to each of the six events.**

**(6 marks)**



## Section C Case Study Questions

**Total Number of Marks for this section: 25**

This section should be answered in the Answer Booklet provided.

Marks for the question is as indicated. Suggested Time allocation for Section C: 50 mins

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### Question 1: (25 marks)

#### Background

You are a junior auditor working for David Goliath & Co. (the Firm), an international chartered accounting firm.

Your client, Wellness Pty Ltd (Wellness) operates the world-famous Wellness Health Resort, located in the Whitsunday Islands of Northern Queensland.

The following are relevant information in relation to your audit:

- While revenue from accommodation is an important factor in the financial success of Wellness Health Resort, its profits are predominantly driven by the uptake of additional services and facilities by guests during their stay (e.g. use of the spa and holistic health facilities, patronage of the five restaurants and bars within the resort, and partaking in other fee-paying activities).
- Wellness maintains its own website which allows guests to book accommodation at the resort directly. This online booking system is monitored by the reservations team at Wellness which consists of two full-time and three casual staff.
- When a booking is made over the internet, an email is sent to the reservations team informing them that a booking has been made. The resort's booking system is automatically updated at this time. The reservations team is responsible for manually confirming the availability of the accommodation, verifying the guest's credit card details, issuing the guest with an invoice, and passing on the payment receipts to the accounts department. The accounts department then processes the sale into the general ledger.
- On a weekly basis, the junior accounts clerk in the accounts department reconciles the payment receipts, sent by the reservations team, to Wellness's bank statements. The bank statements are emailed to Wellness in PDF form each week.
- Any cancellations received by the reservations team are referred to the accounts department which organises for the guest's payment to be refunded in full (or 50% for cancellations made within seven days of the guest's anticipated arrival date).

- Since the internet booking system is not technically up to date, Wellness intends to engage an IT specialist to completely upgrade the system and eliminate the need for manual checking of details by the reservations staff.
- Based on its discussions with the previous auditors, Wellness changed its revenue-recognition policy prior to the current year audit. Previously, all revenues earned were brought to account when bookings were made (including internet bookings). Now, Wellness recognises:
  - 50% of the accommodation at the time of booking (put to the ‘Deferred revenue: accommodation’ account)
  - 50% of the accommodation seven days prior to the guest arriving (in accordance with Wellness’s cancellation policy) which is immediately recognised as ‘Revenue: accommodation’ since this portion of the revenue is no longer refundable to the guest.

You are currently in the planning stage of the 2015 audit.

Based on the review of the previous year’s audit files and the information gathered by the David Goliath & Co. audit team during the planning stage, the head of the audit team tells you that he intends to adopt a combined audit approach for the 2015 Wellness audit.

His expectation is that all controls at Wellness are operating effectively. He tells you that he intends to place a high level of reliance on the controls at Wellness as he does not expect there will be any deviations.

He has now asked you to assist with the review of the internet booking system at Wellness.

***Required:***

- |   |           |
|---|-----------|
| (a) Identify and explain two (2) key risks to the financial report associated with the internet booking system that may lead to material misstatements being undetected and/or uncorrected. Note: For the purpose of this question, disregard any risks arising from the interface between the internet booking system and the general ledger system. | (4 marks) |
| (b) For each risk identified in (a) above, identify whether it is an inherent risk or a control risk. Explain your answer.  | (4 marks) |
| (c) For each risk identified in (a) above, identify one (1) key account balance at risk of material misstatement as a result of the risk (i.e. two (2) account balances in all).  | (4 marks) |

- (d) For each account balance identified in (c) above, identify and explain one (1) key assertion that may be affected by the risk you identified in (a) above. (4 marks)
- (e) Based on your understanding of the control environment surrounding the internet booking system, describe one (1) key control that you would seek to rely on in the conduct of the 2015 audit of Wellness. (3 mark)
- (f) For the control you identified in (e) above, design an appropriate procedure to test that control. (3 mark)
- (g) For the procedure you described in (f) above, outline the result you would expect if you determined that the control was not reliable. (3 marks)

**(Total marks = 25)**