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Family Name					
Given Name/s					
Student Number					
Teaching Period	Semester 2, 2018				

ACT504 – Auditing	DURATION	
	Reading Time:	10 minutes
	Writing Time:	180 minutes

INSTRUCTIONS TO CANDIDATES

The examination has 3 sections:

Section A: Suggested Time:	Multiple Choice Questions: Answer ALL questions, 20 marks 45 minutes
Section B: Suggested Time:	Short Answer Questions: Answer ALL questions, 40 marks 90 minutes
Section C: Suggested Time:	Case Study Questions: Answer ALL questions, 20 marks 45 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.

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

Any non-programmable calculator is permitted

No handwritten notes are permitted

Hard copy, unannotated English translation dictionary only

ADDITIONAL AUTHORISED MATERIALS	EXAMINATION MATERIALS TO BE SUPPLIED
No additional printed material is permitted	1 x 16 Page Book 1 x 4-Multiple Choice Answer Sheet

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DOUBLE-SIDED.**

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Section B

Short Answer Questions

Total No of Marks for this section: 40

This section should be answered in the Answer Booklet provided.

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

QUESTION 1: (8 Marks)

You are the audit partner of Merit Chartered Accountants (“MCA”), working on the audit of Darwin Tourist Buses (“DTB”) for the 2017 financial year. DTB is a provider of luxury bus trips all around Australia, including both interstate capital city travel and conference and holiday packages.

The net profit before tax of DTB for the 2017 financial year is \$14.5M while net assets total \$232M.

You are reviewing the 2017 audit working papers and note that the assurance services senior has documented a number of situations that may lead to a breach of independence for MCA.

Situation 1

It has been documented that the DTB Financial Controller has gifted the three audit team members with two free luxury holiday packages each. The audit manager has concluded that the key threat to independence in Situation 1 is ‘**self-interest**’.

Situation 2

The audit team has documented that DTB is intending to launch a new customer loyalty program. The CFO of DTB has guaranteed that if the audit team convince MCA and five of its biggest clients to sign an exclusive corporate travel arrangement with DTB, the audit team will receive immediate platinum status (normally requiring a customer to have accumulated one million points), giving them a host of benefits. The audit manager has concluded that the key threat to independence in Situation 2 is ‘**familiarity**’.

Situation 3

The audit team has noted that MCA has put forward a proposal to DTB to provide consulting services. The CFO of DTB has told the audit team that if they do not remove comments in the audit summary review memorandum to be provided to the audit committee about a weakness in the revenue and receivables process, he will not award MCA the consulting work. The audit manager has concluded that the key threat to independence in Situation 3 is ‘**advocacy**’.

REQUIRED:

Explain whether the audit manager has correctly identified the key potential threat to independence for each of Situations 1, 2 and 3 above. Your answer should clearly identify what you believe is the key threat to independence in each situation. (8 marks)

QUESTION 2: (10 Marks)

Toyland Pty Ltd (TPL) is a toy manufacturer. TPL has factories across the country and its customer base includes retailers, as well as individuals, to whom direct sales are made through their website. You are an audit senior at John Nash & Associates and you are currently reviewing documentation of TPL's internal controls in preparation for the interim audit.

You noted the following key points on your audit working papers:

- TPL's website allows individuals to order goods directly and full payment is taken in advance. Currently the website is not integrated into the inventory system and inventory levels are not checked at the time when orders are placed.
- Goods are delivered via local couriers; however, the couriers do not always record customer signatures as proof that the customer has received the goods. Over the past year, there have been customer complaints about the delay between sales orders and receipt of goods. TPL has investigated these complaints and found that, in each case, the sales order had been entered into the sales system correctly, but was not forwarded to the despatch department for fulfilling.
- TPL's retail customers undergo credit checks prior to being accepted and credit limits are set accordingly by sales ledger clerks. Neither the sales area managers nor the sales director are involved with this process. These customers place their orders through one of the sales team, who decides on sales discount levels.
- Raw materials are purchased from a wide range of suppliers. As a result of staff changes in the purchase ledger department, supplier statement reconciliations are no longer performed. Additionally, changes to existing supplier details or inclusion of new supplier details in the purchase ledger master file can be undertaken by purchase ledger clerks, as well as supervisors.
- In the past six months, TPL has changed part of its manufacturing process and as a result some new equipment has been purchased. However, there are now considerable levels of plant and equipment that are now surplus to requirement. Purchase requisitions for all new equipment have been authorised by production supervisors and little has been done to reduce the surplus of old equipment.

REQUIRED:

Identify five (5) deficiencies in the internal controls of TPL. Explain how a business risk arises from each deficiency. (10 marks)

QUESTION 3: (10 Marks)

Listed below are ten substantive procedures:

1. Select a sample of non-current assets and sight them.
2. Review the income statement for unusual differences in the balances recorded for this year and last year.
3. Select a sample of invoices and ensure that they have been properly recorded in the sales ledger.
4. Trace the last inventory received before the year-end to the inventory listing.
5. Review the adequacy of the company's allowance for doubtful debts.
6. Ensure that interest paid on the bank loan is correct by multiplying the interest rate by the outstanding principal for each month of the year.
7. Send a letter to the bank to confirm a loan taken out by the company during the year.
8. Attend the year-end stocktake and perform test counts on a sample of stock items.
9. Review all invoices received for one month after the year-end to ensure that they do not relate to the current year.
10. Calculate the accounts receivable turnover and compare with previous year's turnover.

REQUIRED:

- (a) For each test, indicate what Type of Substantive Audit Procedure to which it relates (*Analytical Review, Tests of details of Balances, or Tests of details of Transactions*). (5 marks)
- (b) Give ONE assertion to which each test relates. (5 marks)

QUESTION 4: (12 Marks)

You are the audit partner of Merit Chartered Accountants (“MCA”), working on the audit of Darwin Tourist Buses (“DTB”) for the 2017 financial year. DTB is a provider of luxury bus trips all around Australia, including both interstate capital city travel and conference and holiday packages.

The net profit before tax of DTB for the 2017 financial year is \$14.5M while net assets total \$232M.

You are due to sign the auditor’s opinion on 22 August 2017. DTB will issue the financial statements on 28 August 2017.

On 16 August 2017, the following situations come to your attention:

Situation 1

Jolly Holidays, one of DTB’s largest wholesale travel agents that purchased travel packages in bulk from DTB, went into liquidation on 3 July 2017. A letter from the liquidator dated 31 July 2017 indicates that creditors are likely to receive \$0.10 in the dollar. As at 30 June 2017, Jolly Holidays owed DTB \$2,301,000.

Situation 2

On 15 August 2017, a bus travelling from Brisbane to Sydney crashed. It is alleged that the bus driver was distracted by a call on his mobile telephone. 5 passengers died and 17 were injured. The passengers had paid their fares during the 2017 financial year. (An account “Unearned Income” was credited in the prior year when monies were received). It is likely that a law suit will be brought against the company due to the driver’s negligence.

REQUIRED:

Assume there are no issues other than those described in Situations 1 and 2, and that going concern is not an issue. Also, assume that in response to each material situation above, management could either adjust the amounts in the financial statements or take no action.

Treating Situations 1 and 2 independently when answering this question:

(a) For Situation 1:

- (i) Identify the appropriate treatment in the financial statements. Justify your answer. (2 marks)
- (ii) Identify the appropriate auditor’s opinion if management adjusts the amounts in the financial statements. Justify your answer. (2 marks)
- (iii) Identify the appropriate auditor’s opinion if management takes no action. Justify your answer. (2 marks)

(b) For Situation 2,:

- (i) Identify the appropriate treatment in the financial statements. Justify your answer. (2 marks)
- (ii) Identify the appropriate auditor’s opinion if management adjusts the amounts in the financial statements. Justify your answer. (2 marks)
- (iii) Identify the appropriate auditor’s opinion if management takes no action. Justify your answer. (2 marks)

You may wish to present your answer in the form of the following table:

Situation	(i) Accounting treatment and justification.	(ii) Auditor's opinion if management adjusts financial statements and justification.	(iii) Auditor's opinion if management takes no action and justification.
1			
2			

Section C

Case Study Questions

Total Number of Marks for this section: 20

This section should be answered in the Answer Booklet provided.

Marks for the question is as indicated. Suggested Time allocation for Section C: 45 mins

SECTION C (20 Marks):

Audit Information

You are the auditor of Ocean Fresh Ltd (OFL) for the year ended 30 June 2018.

OFL is a manufacturer of tinned shellfish products. It purchases fresh shellfish from local suppliers, and frozen shellfish from South East Asia and processes it into tins at its Melbourne factory and then transports it by road to supermarkets around Australia.

You became aware of the following material event:

- On 1 July 2018 a customer at a Perth supermarket purchased a tin of OFL prawns and took it home to have with dinner. That night she became violently ill and was hospitalised. It was discovered that the cause of her illness was the tin of prawns, which was part of a contaminated batch made from a material batch of shellfish imported from South East Asia. The customer suffered severe pain and paralysis that is likely to be permanent. As a result, she lodged a lawsuit against OFL on 15 August 2018 for unspecified damages, due to the serious long-term effects of her injuries.

The financial statements and auditor's report are due to be finalised on 31 August 2018.

The finance director of OFL is also considering establishing an internal audit department and is unsure what factors he should consider when making his decision.

REQUIRED:

- a) List three (3) sources of information that would be of use in gaining an understanding of OFL, and for each source describe what information you would expect to obtain. (6 marks)
- b) Bearing in mind the differences and similarities between the roles of an internal auditor compared to an external auditor, outline two (2) factors the finance director should consider before establishing an internal audit department. (2 Marks)
- c) Explain how the event identified above should be treated by OFL in the financial statements. (6 marks)

- d) Outline the implications for the auditor's report, if any, assuming that this event is appropriately treated as per requirement (c). Justify your answer. (2 marks)
- e) Determine the type of auditor's opinion that you should issue if OFL does not appropriately reflect this event in the financial statements. Justify your answer. (2 marks)
- f) Determine the type of auditor's opinion that you should issue if OFL will not allow you to obtain a solicitor's letter concerning the lawsuit. Justify your answer. (2 marks)

****** End of Exam******