Examination Period 3: 2016/17

ACC300517N

Module Title: Audit and Investigations
Level: Six
Time Allowed: Three hours plus 15 minutes reading time. Students must not commence answering the questions until the reading time has ended.

Instructions to students:

- Enter your student number not your name on all answer books.
- During the 15 minutes reading time, students are permitted to make notes on the examination paper but not on the answer book. Students should begin answering the questions after the reading time has ended.
- Answer four questions: three questions from Section A and one question from Section B.
- All questions are equally weighted.
- The use of a non-programmable calculator is permitted.

No. of Pages: 7
No. of Questions: 6

Page 1 of 7
Section A

Answer four out of six questions.

Question 1

a. Discuss four financial statement assertions that you consider important to year end account balances.

   (5 marks)

b. One of your audit clients is Jumbo Supermarket, a medium size stationery supplier primarily based in Northamptonshire. Historically, Jumbo business customers pay for their goods by either cash or credit card, but due to very stiff competition from other suppliers, JUMBO now offers 30 day credit terms to its business customers. This has led to a substantial increase in the receivable balance at the end of the year.

Describe procedures you would perform in order to satisfy yourself that you have obtained sufficient and appropriate audit evidence in relation to JUMBO receivable balances.

   (7 marks)

c. The senior partner of the audit firm where you work has just informed you that an Audit Manager and Audit Partner in charge of an important client (PPP Ltd) left the firm suddenly without any handover or explanatory notes. They were both involved with the client for a number of years.

In a meeting with the senior partner, she made it clear to you that even though PPP is an important client to the firm, it is imperative that you focus on specific risk areas and assess the risk to the firm’s reputation and potential financial liability. She mentioned that PPP has been accused of overstating its revenue and capitalising some large expenses, but the most serious accusation came from a ‘whistle blower’ (a PPP staffer) who accused some senior executives of fraud and misappropriation of company assets. These accusations have led to the departure of the CEO, the CFO and the HR director.

Your task is to understand some of the ‘unconventional’ accounting policies that have been used by PPP and are now considered to be ‘overly creative and unnecessarily complex’ by your firm’s Ethics Committee, but these ‘unconventional’ policies were not questioned by the previous partner.

There is now a class action by some shareholders against your firm. The shareholders claimed to have suffered substantial losses as a result of the firm’s negligence or incompetence about the numbers in the financial statement.

Question 1 continues overleaf
Required:

i. Discuss the main issues in the case above.  
(7 marks)

ii. Determine to what extent the firm is likely to be liable (if at all) or be deemed to have contributed to the loss suffered by the shareholders.  
(6 marks)

(Total: 25 marks)

Question 2

a. What is the essence of ‘value for money’ audit and why do organisations use it?  
(6 marks)

b. Tipton National Health hospital is a leading government funded breast cancer specialist hospital. The hospital offers its services free of charge to everyone within the Tipton area. The hospital has been spending more than its allocated budget over the last few years, but due to the current recession, the government has now installed a new management team to help balance the budget and stop the overspend.

The new Managing Director asked you as the Internal Audit Director is to report back on whether or not the tax payers are getting ‘value for money’ in the purchasing of equipment and services by the hospital.

The hospital has a centralised purchasing department and all purchase requisition forms must be sent to that department. Upon receipt of the forms, the buying team will research the lowest price from an approved list of suppliers and purchase orders (PO’s) are subsequently raised. The PO’s are then passed to the purchasing director, who authorises all orders.

The small buying team receive over 250 forms a day. The human resources department has had difficulties in recruiting suitably trained staff. Overtime rates have been increased to incentivise permanent staff to fill staffing gaps, this has been popular, and reliance on expensive temporary staff has been reduced. Monitoring of staff hours had been difficult but the hospital has implemented a time card ‘clocking in and out’ procedure and these hours are used for overtime payments. The hospital has invested in new surgical equipment, which although very expensive, has allowed for more operations to be performed and patients recover faster. However, there is a shortage of appropriately trained medical staff. A capital expenditure committee has been established, made up of senior managers, and they plan and authorise any significant capital expenditure items.
i. Identify and explain **seven** issues (positive or negative) within the hospital operating environment.

(7 marks)

ii. For each issue identified above, describe how the hospital can make further improvements to provide the best value for money.

(12 marks)

(Total: 25 marks)

**Question 3**

a. Explain what is meant by 'corporate governance' and why it is important.

(6 marks)

b. MURRAY HAMILTON Co (MHC) has been trading for over 20 years and obtained a listing on the London stock exchange five years ago. It provides specialist training for young aspiring sports men and women.

The listing rules of the stock exchange require compliance with corporate governance principles, and the directors are fairly confident that they are following best practice in relation to this. However, they have recently received an email notification from a significant shareholder, who is concerned that the company does not comply with corporate governance principles.

The MHC board is comprised of six directors; there are four executives, Daniel Murray, June Murray, Lee Hamilton and Alan Hamilton who originally set up the company and two non-executive directors who joined MHC just prior to the listing. Each director has a specific area of responsibility, but only the Alan Hamilton (finance director) reviews the financial statements and budgets.

The chief executive officer, Daniel Murray set up the audit committee and sits on the sub-committee along with the finance director and one non-executive director. They want to keep the board small and save costs.

Daniel Murray has recently taken on the role of chairman of the board. It is the finance director and the chairman who make decisions on the appointment and remuneration of the external auditors. Again, to save costs, no internal audit function has been set up to monitor internal controls.

The executive directors’ remuneration is proposed by the finance director and approved by the chairman. They are paid an annual salary as well as a generous annual revenue related bonus.

**Question 3 continues overleaf**
Since the company listed, the directors have remained unchanged and none have been subject to re-election by shareholders.

Required:

Describe six corporate governance weaknesses faced by MURRAY HAMILTON Co and provide recommendation to address each weakness, to ensure compliance with corporate governance principles.

(12 marks)

c. Explain the auditor’s ethical responsibilities with regard to client confidentiality and when they have an:

i. obligatory responsibility; and

(3 marks)

ii. voluntary responsibility to disclose client information.

(4 marks)

(Total: 25 marks)
Section B

Answer one out of three questions.

Question 4

You have been the audit Partner of Pips and Co (a firm of chartered certified accountants) for many years. Your client, Lambs United Ltd, is a listed farm company. The company asked you to put in a bid to act as their internal auditor as well as continue to act as their external auditors. The managing director of Lambs United Ltd emphasised that the main reason for this new contract is to get the synergy between the internal and external audits, which should lead to a substantial reduction in the external audit fees. Alternatively, the director mentioned that they are willing to agree a performance related fee with the firm.

Required:

a. Discuss any ethical threats likely to arise as a result of this new contract.  
(6 marks)

b. Explain how each threat can be minimised.  
(6 marks)

c. Discuss the main differences between internal and external audit.  
(13 marks)

(Total: 25 marks)

Question 5

‘Good audit planning needs to recognise and manage audit risks’.

Required:

a. Critically appraise the above statement. Describe and evaluate audit risks.  
(13 marks)

b. Describe the Key Stages of an External Audit.  
(12 marks)

(Total: 25 marks)
Question 6

a. ISA 300 Planning an Audit of Financial Statements provides guidance to assist auditors in planning an audit.

List and explain the benefits of audit planning.  

b. ISA 530 Audit Sampling provides guidance on methods for selecting a sample of items for testing.

Identify and explain three methods of selecting a sample.  

c. Describe the three types of modified audit opinions.  

d. Describe the audit procedures that you should perform as part of a going concern test of a company you are auditing.  

(Total: 25 marks)