THE UNIVERSITY OF NEW SOUTH WALES

SCIENTIA

MANU ET MENTE

Faculty of Commerce and Economics

School of Accounting

ACCT 3708
AUDITING AND ASSURANCE SERVICES

COURSE OUTLINE

Session 2, 2001

CONTENTS

Workshop Program:

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT3708 AUDITING AND ASSURANCE SERVICES

SESSION 2, 2001

COURSE OUTLINE AND STUDY GUIDE

1. Description of Course:

This course examines the practice of auditing and the concepts which underlie the practice. Although the focus of attention is on audits carried out under the provisions of the Australian Corporations & Securities Legislation, reference is also made to other forms of audit. The course is intended to provide an overview of the audit process as it exists in Australia. Although the auditing course is broken into a number of segments, students should recognise that each segment forms part of the audit process.

2. Course Objectives:

(a) To develop students' understanding of the audit function and of the reasons for an audit.

(b) To familiarise students with the professional, legal, commercial and regulatory constraints within which audits are carried out.

(c) To examine techniques used by auditors including risk analysis, evidence collection and evaluation, and audit reporting.

(d) To familiarise students with current developments in audit practice and research.

3. Prescribed Textbooks, and References:

(a) Prescribed Textbooks:

Australian Society of CPAs and the Institute of Chartered Accountants in Australia, Auditing Handbook, 2001, Vol. 2 of the Accounting and Auditing Handbook, Prentice-Hall.

Gay G., & R. Simnett "Auditing and Assurance Services in Australia" (1st Ed) McGraw-Hill, Sydney 2000.

Trotman K, & P. Roebuck "Case Studies in Auditing" (2nd Ed.) Butterworths, 1998.

(b) Additional References:

Students will find many other auditing textbooks which will provide additional supplementary information. Some of these are available on closed reserve in the main library.

4. Course Arrangements:

Instruction in this course consists of a three-hour workshop each week. It should be emphasised that attendance at classes is a necessary but not sufficient condition for adequate examination preparation. All students should keep up to date with recommended references and participate in workshop discussions. (Note: Workshop solutions will not be made available either on the Web or in open reserved.)

5. Assessment:

Subject to a satisfactory result in the final examination, the weighting of the final (composite) mark will be as follows:

Mid-Session Test	25%
Final Examination	60%
Assignment/Presentation	10%
Workshop Quizes	5%
	100%
	===

NB: Students who do not obtain a satisfactory result in the final examination may still obtain a composite mark in excess of 50 and fail the subject. In such instances a UF grade will be recorded - which means that there has been unsatisfactory performance in an essential component of the course.

Date of Mid-Session

The mid-session test will be held during Week 10 on Thursday 4th October and will cover all material up to and including week 7. Location and timing of the Exam will be finalised during session.

NO SUPPLEMENTARY TESTS WILL BE HELD FOR THE MID-SESSION TEST.

The final examination will cover the whole semester's work.

Except in exceptional circumstances, ***no supplementary examinations*** will be given if requests (for special consideration) are received more than ten days after the final examination in this subject.

Students should note that there will be only one supplementary examination.

6. Staff:

Staff participating in this course are:

	Room	Telephone
Roger Simnett (Honours Co-ordinator)	Quad Room 3084	9385 5825
Peter Roebuck (Lecturer-in-charge)	Quad Room 3095	9385 5845
Wendy Green	Quad Room 3092	9385 5805
Nonna Martinov	Quad Room 3101	9385 5940
Elisabeth Hicks	Quad Room 3116	9385 5833
Fiona Foster		
Louise Luff		

Staff consultation hours will be advised in workshops. Note that consultation in person is the recommended consultation mode. Email consultations **WILL NOT** be provided by staff. Any problems with the course should be directed in the first instance to your workshop leader.

7 CASS star web site:

The following information is provided to you by the Chartered Accountants Students Society (CASS):

> The STAR is the Students and Teachers Accounting Resource created for students and teachers at UNSW to support internet based learning and research. STAR will provide students with course outlines, links to secondary research material, AASB summaries, current accounting news, discussion forums, and information about careers in Chartered Accounting. The STAR is accessible at http://www.cassunsw.org.au - use STAR as your starting point to accounting research.

NOTE: This service is a student initiative. Whilst recommended to students, auditing staff will not be involved with the site other than to provide the auditing course outline and Workshop program details.

8 In addition, a web site for prescribed text book Gay & Simnett "Auditing and Assurance Services in Australia" is available should you wish to use it (this is not mandatory):

The web site is accessible at http://www.mcgraw-hill.com.au/mhhe/acc/gay. The site contains information for students such as an On-line Learning Centre, Weblinks and an Auditing News Centre. Access requires a password, which can be purchased on-line.

ACCT 3708/ACCT3718

AUDITING AND ASSURANCE SERVICES

Provisional Workshop Schedule

Week	Week Beginning		Topic
1	July	23	Introduction to Audit Function, Assurance Framework, Professional Standards and Structure of the Profession.
2	July	30	Introduction to the Audit Process, Risk and Audit Planning.
3	August	6	Control Risk Evaluation and Tests of Controls.
4	August	13	Evaluation of Detection Risk and Substantive Testing.
5	August	20	Analytical Procedures.
6	August	27	Assessment of Materiality and Development of the Audit Strategy.
7	**September**	**3**	**Assignment Presentations**
8	September	10	Using the Work of Others/Internal Audit.
9	September	17	Legal Liability / Ethics.
	September	**24 to 28**	**RECESS**
10	**October**	**1**	**MID-SESSION EXAM**
11	October	8	Auditing in a CIS Environment — Internal Control.
12	October	15	Auditing in a CIS Environment — Substantive Testing
13	October	22	Completing the Audit Process and Audit Reporting.
14	October	29	Public Sector Auditing and Current Issues.

READING GUIDE

WORKSHOP 1: INTRODUCTION TO THE AUDIT FUNCTION, ASSURANCE FRAMEWORK, PROFESSIONAL STANDARDS AND STRUCTURE OF THE PROFESSION.

Textbook Reference:

Gay and Simnett, Chapter 1, Chapter 2 and Chapter 15

Standards:

AUS 202: Objective and General Principles Governing an Audit of a Financial Report.

AUS 210: Irregularities, Including Fraud, Other Illegal Acts and Errors.

WORKSHOP 2: INTRODUCTION TO THE AUDIT PROCESS, RISK AND AUDIT PLANNING

Textbook Reference:

Gay and Simnett, Chapter 5 (pages 150-157, 164-185)
Gay and Simnett, Chapter 6 (pages 200-221)

Standards:

AUS 302: Planning.

AUS 304: Knowledge of the Business.

AUS 402: Risk Assessments and Internal Controls.

WORKSHOP 3: CONTROL RISK EVALUATION AND TESTS OF CONTROLS

Textbook Reference:

Gay and Simnett, Chapter 8 (pages 300-328)
Gay and Simnett, Chapter 9 (pages 368-371)

Trotman and Roebuck, Case 2-8 and Solution

Standards:

AUS 402 Risk Assessments and Internal Controls.

AGS 1006: Expression of an Opinion on Internal Control.

WORKSHOP 4: EVALUATION OF DETECTION RISK AND SUBSTANTIVE TESTING

Textbook Reference:

Gay and Simnett, Chapter 5 (pages 157-164)
Gay and Simnett, Chapter 9 (pages 371-373)
Trotman and Roebuck, Case 3-6 and Solution.

Standards:

AUS 502: Audit Evidence.

WORKSHOP 5: ANALYTICAL REVIEW

Textbook Reference:

Gay and Simnett, Chapter 6 (pages 221-230)
Trotman and Roebuck, Case 1-4 and Solution

Standards:

AUS 512 Analytical Procedures.

WORKSHOP 6: ASSESSMENT OF MATERIALITY AND DEVELOPMENT OF THE AUDIT STRATEGY

Textbook Reference:

Gay and Simnett, Chapter 7

Standards:

AUS 306: Materiality.

AUS 402: Risk Assessments and Internal Controls.

AASB1031: Materiality.

WORKSHOP 7: ASSIGNMENT PRESENTATION
(No prescribed readings)

WORKSHOP 8: USING THE WORK OF OTHERS/INTERNAL AUDIT

Textbook Reference:

Gay and Simnett, Chapter 8 (pages 337-340)
Gay and Simnett, Chapter 16
Trotman and Roebuck, Case 4-12 and Solution.

Standards:

AUS 602: Using the Work of Another Auditor.

AUS 604: Considering the Work of Internal Auditing.

AUS 606: Using the Work of an Expert.

WORKSHOP 9: LEGAL LIABILITY AND ETHICS

Textbook Reference:

Gay and Simnett, Chapter 3 and Chapter 4
Trotman and Roebuck, Case 6-2 and Solution

Standards:

AUS 204 Terms of Audit Engagements.

Joint code of Professional Conduct, Sections A,B,D,F1,F3,F5,F6 and F7.

AUS 206: Quality Control for Audit Work.

APS 4: Statement of Quality Control Standard.

APS 5: Quality Control Policies and Procedures General Guidelines.

WORKSHOP 10 MID-SESSION EXAM

WORKSHOPS 11 AND 12: AUDITING IN A CIS ENVIRONMENT

Textbook Reference:
Gay and Simnett, Chapter 8 (pages 328-337) and Chapter 12
Trotman and Roebuck, Case 4-9 and Solution.

Standards:

AUS 214:	Auditing in a CIS Environment.
AGS 1018	CIS Environments - Stand-alone Microcomputers.
AGS 1020:	CIS Environments - On-line Computer Systems.
AGS 1022:	CIS Environments - Database Systems.

WORKSHOP 13: COMPLETING THE AUDIT PROCESS AND AUDIT REPORTING

Textbook Reference:

Gay and Simnett, Chapter 13
Gay and Simnett, Chapter 14
Trotman and Roebuck, Case 5-9 and Solution.

Standards:

AUS 212:	Other Information in Documents Containing Audited Financial Reports.
AUS 702:	Audit Report on a General Purpose Financial Report.
AUS 706:	Subsequent Events.
AUS 708:	Going Concern.
AUS 802:	The Audit Report on Financial Information Other than a General Purpose Financial Report.
AGS 1006:	Expressions of Opinion on Internal Control.
AGS 1016:	Audit and Review Reports - Half Year Accounts and Consolidated Accounts.
ED 66:	Reporting on the Credibility of Information.

<u>WORKSHOP 14:   PUBLIC SECTOR AUDITING AND CURRENT ISSUES</u>

<u>Textbook Reference</u>:

Gay and Simnett, Chapter 17

<u>Standards</u>:

Introductory Statement of Applicability of Auditing Standards and Statements of Auditing Practice to Auditing in the Public Sector.

ED 30: Audit Exposure Draft, Compliance Auditing.

AUS 806: Performance Auditing.

AUS 808: Planning Performance Audits.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Introduction to the Audit Function, Assurance Framework, Professional Standards and Structure of the Profession

WORKSHOP 1: Week beginning 23 July 2001

1. Describe the objective of an independent audit.

2. Discuss the concept of "assurance" in an audit setting.

3. Distinguish between the management's and the auditor's responsibility for the financial statements being audited.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT3708 AUDITING AND ASSURANCE SERVICES

Introduction to the Audit Process, Risk and Audit Planning

WORKSHOP 2: Week beginning 30 July 2001

1. Trotman & Roebuck
   Chapter 9, Questions 5 and 6.

2. Gay and Simnett
   Questions 6.7 and 6.8 p.235.

3. Identify the types of information in the client's minutes of the board of directors' meetings that are likely to be relevant to the auditor. Explain why it is important to read the minutes early in the engagement.

4. When an auditor has accepted an engagement from a new client who is a manufacturer, it is customary for the auditor to tour the client's plant facilities. Discuss the ways in which the auditor's observation made during the course of the plant tour will be of assistance as he/she plans and conducts the audit.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT3708 AUDITING AND ASSURANCE SERVICES

Control Risk Evaluation and Tests of Controls

WORKSHOP 3: Week beginning 6 August 2001

1. Gay and Simnett 8.15, p.344.

2. The University recently opened a parking station on its lower campus area for the benefit of the students. A guard has been engaged to patrol the lot and to issue parking stickers to University students who submit an application for and show evidence of enrolment. When the sticker is affixed to the car, the student may park in the lot for six hours by placing a dollar in the parking meter. The guard inspects the stickers on all parked cars to determine that only students are parking in the lot and also looks at the time gauges to see that the meter reflects the necessary fee has been paid. The completed application forms are maintained in the guard's office.

   By using the master key, the guard empties the meters weekly and delivers the cash to the University central store department where a clerk opens it, manually counts the coins, puts the cash in a safe, and records the total on a weekly cash report. This report is sent to the University's accounting department. The day following the cash count, the University cashier picks up the cash and manually recounts it, prepares the deposit slip, and makes the deposit at the bank. The deposit slip, authenticated by the bank teller, is sent to the accounting department where it is filed with the weekly cash report.

   Required:

   Describe weaknesses in the existing system. Recommend for each weakness at least one improvement to strengthen the internal accounting control over the parking station cash receipts.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Evaluation of Detection Risk and Substantive Testing

WORKSHOP 4: Week beginning 13 August 2001

1. Gay and Simnett
   Question 5.16, p.189.

2. The auditor should obtain sufficient appropriate audit evidence to enable him/her to draw reasonable conclusions therefrom on which to base his/her opinion on the financial information.

   Required:

   (a) What factors influence the auditor's judgement as to what is sufficient appropriate audit evidence?

   (b) What are the primary methods of obtaining audit evidence?

3. For the following material transactions describe:

   (a) What the transaction represents.
   (b) The financial report assertions contained in the transaction which would be of prime interest to the auditor.
   (c) The evidence the auditor will seek in order to verify these assertions.

   <u>Transaction 1</u>

DR	Accumulated depreciation	10,000	
DR	Cash	250,000	
CR	Buildings		150,000
CR	Extraordinary profit		110,000

   <u>Transaction 2</u>

DR	Investments in unlisted securities	500,000	
CR	Asset revaluation reserve		500,000

4. Several audit procedures are listed below that were performed in the audit of inventory to satisfy specific audit objectives as listed below. The audit procedures assume the auditor has obtained the inventory count sheets that list the client's inventory.

Audit procedures	Financial report assertions (as per AUS 502)
1. Test extend unit prices times quantity on the inventory list, test foot the list and compare the total to the general ledger 2. Trace selected quantities from the inventory list to the physical inventory to make sure it exists and the quantities are the same 5. Question operating personnel about the possibility of obsolete or slow-moving inventory 6. Select a sample of quantities of inventory in the factory warehouse and trace each itemto the inventory count sheets to determine if it has been included and if quantity anddescription are correct 7. Compare the quantities on hand and unit prices on this year's inventory count sheets with those in the preceding year as a test for large differences 8. Examine sales invoices and contracts with customers to determine if any goods are out on consignment with customers. Similarly, examine vendors' invoices and contracts with vendors to determine if any goods on the inventory listing are owned by vendors. 9. Send letters directly to third parties who hold the client's inventory and request they respond directly to us.	Occurrence Existence Rights and Obligations Completeness Valuation Measurement (Cut-off) Disclosure

Required:

Identify the financial report assertion(s) satisfied by each audit procedure.

5. For each of the three (3) key audit risks described below complete the following:

(i) provide a brief **explanation** as to why the situation constitutes an audit risk
(ii) identify the **key** account balance affected
(iii) dentify the **prime** audit assertion to be tested
(iv) for the account balance and the assertion listed in (ii) and (iii) describe in specific terms the **substantive audit procedure** which would best address the risk.

The situations are independent of each other and are to be treated separately in your answers.

(a) Slim and Fit Limited is a manufacturer of sporting equipment. The majority of the merchandise is highly desirable, easily handled and of relatively high dollar value. Pilfering has been an ongoing problem.

(b) Cold and Frosty Limited is a manufacturer of refrigerators. The government has passed environmental legislation to become effective in the next eighteen months which will require Cold and Frosty to substantially modify and replace its current manufacturing process and equipment.

(c) Holford Limited is a manufacturer of cars. Their new range of sports coupe 'EAGLE' has been a great success with huge sales in the last twelve months. However, there has been a great number of customer complaints and a dramatic increase in the servicing and repairs of this model in the last three months. It appears that the material used in the brake linings which is unique to 'EAGLE' is defective after 8,000 kilometres. There is no stock of 'EAGLE' at year end due to a waiting list as a result of the popular demand for the car.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Analytical Procedures

WORKSHOP 5: Week beginning 20 August 2001

1. Trotman and Roebuck
   Question 35, 36 and 38, Chapter 9.

2. Analytical procedures are increasingly being used by the auditing profession as a substantive technique in its own right.

   (a) explain why analytical review procedures are considered to be substantive tests.

   (b) Discuss the criteria which would determine whether an account balance could be substantiated entirely by the use of analytical review procedures.

3. Gay and Simnett
   Question 6.24 and 6.25, p.238.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Assessment of Materiality and Development of the Audit Strategy

WORKSHOP 6: Week beginning 27 August 2001

1. During the course of an audit engagement, an independent auditor must address the concept of materiality. This concept is inherent in the work of the independent auditor and is important for planning, evidence gathering, error evaluation and in the audit opinion forming process.

   Required:

   (i) Briefly describe what is meant by the independent auditor's concept of materiality, and its relevance during the different stages of the audit process.

   (ii) Discuss the process of setting audit materiality.

2. What effect does the assessment of inherent and control risk have on detection risk and the weighting of tests between tests of control, analytical procedures and substantive tests of detail in design of the audit plan (approach)?

3. The following are three situations in which the auditor is required to develop an audit strategy:

   (i) The client has inventory at approximately fifty locations in a three-State region. The inventory is difficult to count and can be observed only by travelling by car. The internal controls over acquisitions, payments and perpetual records are considered effective. This is the fifth year that you have done the audit and audit results in past years have always been excellent.

   (ii) This is the first year of an audit of a medium sized company that is considering selling its business because of severe underfinancing. A review of the purchases and payment cycle indicates that controls over disbursements are excellent, but controls over accounts payable cannot be considered effective. The client lacks receiving reports and a policy as to the proper timing to record purchases. When you review the general ledger, you observe that there are many adjusting entries to correct accounts payable.

   (iii) You are doing the audit of a small loan company with extensive receivables from customers. Controls over granting loans, collections, and loans outstanding are considered effective, and there is extensive follow-up of all outstanding loans weekly. You have recommended a computer system for the past two years, but management believes the cost is too great, given their low profitability. Collections are an on-going problem because many of the customers have severe financial problems. Because of adverse economic conditions, loans receivable have significantly increased and collections are less than normal. In previous years, you have had relatively few adjusting entries.

Required:

For the above situations recommend an evidence mix (i.e. tests of control/substantive testing/analytical procedures for the audit of:

(1) Inventory
(2) Accounts payable
(3) Outstanding loans.

Justify your answer in relation to each situation above.

4. Gay and Simnett
Question 7.14, p.287.
7.19, p.288.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

WORKSHOP 7: Week beginning 3 September 2001

Assignment Presentation

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Using the Work of Others/Internal Audit

WORKSHOP 8: Week beginning 10 September 2001

1. Trotman and Roebuck
   Case 4-13.

2. Your accounting firm has recently acquired a new audit client, which operates a major industrial plant. Coal is the main raw material used to generate power for the plant.

   (a) Consider whether the use of an independent expert will be necessary to determine the quantity of coal held in stockpiles at the plant.

   (b) Assuming such is required, outline the broad procedures that are necessary for you to be able to rely on the expert's work.

3. Gay and Simnett
   Questions 16.4 and 16.5, p.704.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Legal Liability / Ethics

WORKSHOP 9: Week beginning 17 September 2001

1. In his comprehensive judgment in Pacific Acceptance Corporation v Forsyth, Moffit J. set out the duties of the auditor. Briefly outline these duties. Consider also the relationship between these common law duties and the auditing standards.

2. What is the 'proximity test' with regard to auditor's liability to third parties?

3. Describe the implications for auditors of the Esanda High Court ruling.

4. Gay and Simnett
   Question 4.6, p.141.

5. The following each involve a possible violation of the professional bodies ethical rules. For each situation, state any applicable rules of conduct and whether it is a violation.

   (a) John Brown is a chartered accountant, but not a partner, with three years of professional experience with Lyle, and Lyle Chartered Accountants, a one-office firm. He owns 2,500 shares in an audit client of the firm, but he does not take part in the audit of the client and the amount of stock is not material in relation to his total wealth.

   (b) A client requests assistance of J. Bacon, Chartered Accountant, in the installation of a computer system for maintaining production records. Bacon had no experience in this type of work and no knowledge of the client's production records, so he obtained assistance from a computer consultant. The consultant is not in the practice of public accounting, but Bacon is confident of his professional skills. Because of the highly technical nature of the work Bacon is not able to review the consultant's work.

   (c) Five small Sydney public accounting firms have become involved in an information project by taking part in an inter firm working paper review program. Under the program, each firm designates two partners to review the working papers, including the tax returns and the financial statements of another public accounting firm taking part in the program. At the end of each review, the auditors who prepared the working papers and the reviewers have a conference to discuss the strengths and weaknesses of the audit. They do not obtain authorisation from the audit client before the review takes place.

   (d) Bill Wendal, a Chartered Accountant, set up a casualty and fire insurance agency to complement his auditing and tax services. He does not use his own name on anything pertaining to the insurance agency and has a highly competent manager, Sandra Jones, who runs it. Wendal frequently requests

Jones to review the adequacy of a client's insurance with management if it seems underinsured. He feels that he provides a valuable service to clients by informing them when they are underinsured.

6. Many of the 'Big 5' audit firms are undertaking internal audit engagements. For some clients they may also conduct the financial statement audit. Discuss whether or not engaging in such activities impinges on the audit firms' independence both 'in-fact and appearance'. (Your discussion should focus on the latest auditing standards, legislation, and community attitudes).

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

MID-SESSION EXAMINATION

WEEK BEGINNING 1 OCTOBER 2001

A Mid-Session Examination worth 25% will be held during this week. No workshops will be conducted.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Auditing in a CIS Environment

WORKSHOPS 11 and 12: Weeks beginning 8 and 15 October 2001

1. (a) What are the implications of the existence of a computer environment at a client's place of business for an auditor?

   (b) What are the differences between general and application controls in a CIS environment? Identify the major categories of general controls and application controls.

   (c) What controls will be found in a batch processing system which will not be found in an on-line processing system.

   (d) What special problems exist in auditing microcomputer systems.

2. You have been assigned to the audit of a private company which operates a plant nursery with a turnover of $2 million a year. The total number of full-time employees working for the company is 10, together with 3 to 5 casual employees as and when required on weekends. The company is run by a husband and wife team who are the directors and shareholders and a full time accounts clerk, Margaret, who is responsible for all accounting related tasks including debtors, stock, payroll and creditors. All accounting functions are performed on a stand alone 486 machine which runs purchased software from a software house which specialises in the nursery industry. The access to various applications is controlled by passwords. Margaret records passwords to each application in her top drawer. Back up diskettes for all applications are done on a regular basis, appropriately labeled and maintained in a "back-up" case next to the PC.

   As a security measure, the keyboard to the microcomputer has a locking mechanism to control access to the on/off switch. Each night the machine is locked and the key left at reception in case the directors need to access the computer.

   The office of the company is located in a large mobile caravan inside the nursery which is well fenced. The company trades 7 days a week but Margaret only works Mondays to Fridays. The office is also used by various members of the staff to process sales invoices and dispatch documents.

   Instructions on the use of various applications of software are maintained behind the desk on which the PC is located for ease of access by Margaret as she needs to refer to these on a regular basis.

A monthly profit and loss and balance sheet is prepared as part of the roll-forward procedure. Monthly reconciliations are also prepared by Margaret for all balances on the balance sheet, however the directors concentrate their review on the P&L account.

Required:

Identify major weaknesses in the general CIS control environment and suggest remedies for each weakness.

3. You have just been appointed auditor of A Limited (A). As part of the audit planning process you have visited the premises and noted the following issues:

- A's CIS function is under the overall control of the Finance Director. However the day to day operations are the responsibility of the CIS Manager who has had significant CIS experience.
- The key modules of A's Financial Management System (FMS) are currently undergoing significant modification. The Systems Analyst who initially implemented the FMS was recently dismissed as a result of a disagreement with the CIS Manager.
- A few days after the dismissal, the Systems Analyst returned to A's CIS department and made some unauthorised changes to the FMS.
- Subsequent to the dismissal of the Systems Analyst, the FMS development work lost direction. The programmers, who received their detailed instructions from the Systems Analyst, had no written instructions or documented system specifications for the FMS modifications. All such instructions and specifications had been given by the Systems Analyst verbally.
- Only CIS department staff are allowed access to the CIS department. When you visited, however, you were able to enter the department, review existing FMS documentation, and make changes to a FMS program under development via a terminal which was logged on but not attended by a programmer. During this period you were not asked for identification and were left alone for long periods of time.

Required:

(a) From the information above, identify four (4) key general control weaknesses.

(b) For each weakness identified in (a) above, specify your recommendation to overcome these problems

You may wish to present your answer to parts (a) and (b) in your answer book in the form of a table, as indicated below.

Weakness	**Recommendation**

4. Toan & Associates are a firm of solicitors specialising in commercial law. An audit is required under the solicitors' trust regulations. Recent changes in government regulation have deregulated the fees of commercial lawyers, with the result that legal fees have decreased by 20% over the past year. The firm has 4 partners, 90 associates and 6 support staff. All financial records are contained on a personal computer. A general ledger software package that is widely used by legal firms is used by the organisation. The general ledger package also contains an accounts receivable subsidiary ledger, a work-in-progress file (which shows current status of legal cases) and a payroll subsidiary ledger.

All financial records, including all payroll documentation, are maintained by the ledger clerk. The payroll details entered consist of changes to standing data, and transactions. The changes to standing data are additions and deletions of staff to the payroll master file, change of address, variation of approved fortnightly pay, and change to approved overtime rate. Any such changes are contained on a variation of payroll information form which is approved by the personnel partner and one other partner. After being entered into the system, the variation of payroll information form is filed in numerical sequence.

The transaction data is entered each fortnight when the partners and staff complete a pay sheet which assigns their times to jobs. This is entered into the computer package by the ledger clerk and is used to update the work-in-progress file and the payroll file. If any staff work overtime, which must be approved by the partner in charge of the case (evidenced by the partner initialing the pay sheet), this is entered and the overtime is paid at the approved set rate.

The following reports are produced each fortnight and are reviewed and authorised by all partners, at fortnightly partners' meetings:

- Printout of year-to-date payroll master file.
- Payroll transactions file for the last fortnight.
- List of staff who have undertaken overtime in the last fortnight.
- Current status of all cases in progress.
- Cases in progress where additional work has been undertaken over the last fortnight.
- Cases completed and billed over the last fortnight.
- List of accounts receivable master file.

Required:

(a) Evaluate the control risk as low, medium or high in the above payroll system. Justify your evaluation.

(b) Assume that inherent risk and control risk in relation to the payroll expense account have been both evaluated as high for occurrence and measurement assertions. Determine the most appropriate audit strategy for the payroll expense account. Categorise the extent of work to be undertaken under each type of testing (ie tests of control/substantive tests of detail/substantive analytical procedures) as either none, small, medium or extensive. Justify your answer.

(c) The client's software package contains a programmed range check on the payroll file. No associate's fortnightly pay (before overtime) should be outside the range of $2,200-$4,000. Identify and illustrate by example with respect to this control the technique(s) by which the auditor could obtain <u>direct</u> evidence that this programmed control is working.

(d) Some of the reports generated by the client each fortnight are exception reports. Identify which of the reports generated are exception reports. Explain and distinguish between the relevance of the reports to:

(i) the partners of the law firm
(ii) the auditors.

(e) The auditors also use the same exception reports for their audit. Instead of relying on the client-generated exception reports the auditors decide to generate their own. Which computer-assisted audit techniques will aid the auditors in generating these reports. Why would the auditors decide to generate their own reports rather than rely on the client-generated reports?

5. In accordance with your firm's partner rotation policy you have been newly appointed as signing partner of Knocked Down Ltd, a building construction firm with a head office in Sydney. Following an extensive cost review during the year Knocked Down now gets 80% of its timber supplies from a Solomon Islands supplier of low cost rainforest timber. The audit manager has informed you that in previous years significant reliance was placed on the work performed by the client's internal audit staff. The client was required to make significant adjustments last year because your firm detected several errors concerning valuation of inventory. Your initial planning meeting with the client's financial controller has revealed the following information about the purchases and inventory system:

- When goods are received, the goods are counted and inspected and a pre-numbered Goods Received Note (GRN) is prepared. After counting and inspection, the goods are moved directly to a locked storage area. The storeman only releases the goods upon receipt of a materials requisition form signed by an authorised employee.

- The Goods Received Note is sent to the Purchasing Department where it is matched with a supplier's order and then batched and sent to the Computer Information Systems (CIS) Department for input and processing.

- The company has recently purchased a very advanced computer system and purchased software specially for the construction industry which has been developed by Bits'n'Bytes Pty Ltd, a small organisation headed by the General Manager's nephew.

- The CIS Department consists of manager, programmer and two data processing operators. The programmer is not involved in data entry and any programming changes are reviewed and approved by the Manager. A password system restricts the access of the data processing operators to only the applications software that they are using. The CIS department input the batch of transactions and update the Inventory Master File. The Inventory Master File contains inventory number, description, approved suppliers, quantity on hand, invoice price, total cost, sales price, sales year to date and last sale date.

- The updated inventory master file is reconciled to the old master file and the transaction data by the CIS Manager and is sent back to the user department for review. The system automatically produces a number of exception reports which are reviewed by the user department.

- The inventory balance has remained constant over the last year while the accounts payable balance has increased by 40% as the client is suffering from a severe cash shortage brought on by the recession. Many suppliers' accounts have remained unpaid for several months and the client is under pressure from several to pay.

- At the beginning of the year, the client decided to retrench its internal audit department as part of its cost cutting programme.

Required:

(a) From the information provided above, outline factors that would affect your assessment of inherent risk for Knocked Down. Assess this level of risk as Low/Medium/High.

(b) From the information provided above:

  (i) Outline factors that influence your evaluation of general controls for Knocked Down.

  (ii) Identify application controls that exist in the inventory/accounts payable system.

  (iii) Assess the level of control risk for the inventory/accounts payable system. Assess this level of risk as Low/Medium/High.

(c) Determine the most appropriate audit strategy for the inventory/accounts payable system. Categorize the extent of work to be undertaken under each type of testing (i.e., test of controls/substantive tests of details/substantive analytical procedures) as either none, small, medium or extensive. Justify your answer.

(d) Describe three (3) specific tests of control that would be undertaken for application controls identified in (b) (ii) above.

(e) Identify three (3) exception reports that could be generated by audit software that would assist you in the verification of the valuation assertion for inventory.

6. Gay and Simnett
Questions 12.26, p.560.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Completing the Audit Process and Audit Reporting

WORKSHOP 13: Week beginning 22 October 2001

1. Gay and Simnett
   Questions 13.11, p.593.

2. Gay and Simnett
   Questions 13.12, p593.

3. Turbo audited Charge Ltd. For the year ended 30 June 19X8. Turbo is aware that certain events and transactions that took place after 30 June 19X8, but before he issues his report dated 31 August 19X8, may affect the company's financial statements.

   The following material events or transactions have come to his attention:

   (a) On 15 July 19X8, the company settled and paid a personal injury claim to a former employee as the result of an accident that occurred in September 19X7. The company had not previously recorded a liability for the claim.

   (b) On 25 July 19X8, the company agreed to purchase for cash the outstanding shares of Electronic Fuel Injection Ltd. The acquisition is likely to double the sales volume of Charge Ltd.

   (c) On 1 August 19X8, a plant owned by Charge Ltd was damaged by a flood resulting in an uninsured loss of inventory.

   (d) On 5 August 19X8, Charge Ltd. issued and sold to the general public $2 million in convertible notes.

   Required:

   (i) For each of the events or transactions described above, indicate the audit procedures that should have brought the item to the attention of the auditor.

   (ii) Determine the action(s), if any, that the auditor needs to take in relation to each of the above events.

4. The following are independent situations:

   (a) You are the auditor of Codd Ltd. You are about to sign the audit report on the financial statements for the year ended 30 June, 1997 when you become aware that the client has received an amended assessment from the Tax Office. the amendment for $285,000 is a result of tax audit conducted in

March 1997. The amount is material and the company has indicated that it will not appeal against the amendment.

(b) Trade debtors at year end have been verified by audit as $1,500,000, before provision for doubtful debts of $95,000. Just prior to signing the accounts you learn that a major customer was placed into liquidation. On information currently available the likely repayment to unsecured creditors is zero. The customer owed $170,000 at year end and the doubtful debt provision includes a specific provision for 10% of this amount.

Required:

Explain how each of the following situations should be dealt with in financial statements. Justify your decision.

5. Gay and Simnett
   Questions 14.6, p.640.

6. Gay and Simnett
   Questions 14.14, p. 641.

7. Outline and justify the audit opinion that the auditor should issue in each of the following independent situations.

   With the exception of the issues outlined, assume that the auditor is satisfied in all other material respects.

   (i) Your client has intangible assets, being trademarks, which are recorded in the accounts at $4,500,000. the value is the same as in the prior year. During the year, your client commissioned in independent valuation of the trademarks. This valued them at $2,850,000. Management refuses to adjust the financial statements to reflect the revised valuation.

   The materiality for the client has been set at $1,200,000.

   (ii) The client's solicitor's representation letter reveals that there is a possibility of a large legal settlement being made against the client. The client refuses to disclose this fact in the accounts or the notes to the accounts as the cause of the legal action occurred after year end.

   (iii) A company loses most if its accounting records due to a fire in its accounts department. Although it is able to reconstruct its financial statements due to an asset stocktake, third party confirmation procedures and inquiries from creditors, there is no documentation to support transactions for the year.

   (iv) A cut-off error is identified by the auditor which results in an understatement of sales, debtors and profit. The client decides not to adjust the accounts on the basis of this error and the auditor determines that the error is not material to the financial statements.

   (v) A consignment of inventory is incorrectly excluded from inventory and creditors. The client decides not to adjust the accounts on the basis of this error and the auditor determines that the error is material to the financial statements.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

Public Sector Auditing and Current Issues

WORKSHOP 14: Week beginning 29 October 2001

1. Gay and Simnett
   Questions 17.26, p738-739.

2. Explain how the objectives of public sector accounting differ from that of the private sector. What implications do these differences have for auditing the public sector in terms of the application of the risk methodology and the AUSs.

3. (a) The private sector auditor must be "independent and seen to be independent". Is the same true of the public sector auditors?

   (b) Discuss the main independence features prevalent in a public sector audit.

4. You are asked to conduct an operational/performance audit of the purchasing department for a government department.

   (a) List five (5) indicators of performance that you would include in planning the audit.

   (b) What particular problems are associated with measuring performance?

5. Discuss the concept of Corporate Governance. Include in your answer what Corporate Governance is, what its objective is and why it is seen to be important.

THE UNIVERSITY OF NEW SOUTH WALES

SCHOOL OF ACCOUNTING

ACCT 3708 AUDITING AND ASSURANCE SERVICES

ASSIGNMENT

Due Date: Workshop 7 - Week Beginning 3 September 2001

Percentage contribution to final mark: 15% (ie. 15 marks).

Note: This assessment should be completed in groups of four (4)
(NB: Students will be allocated to groups during the first workshop.)

Required:
You are required to obtain the latest copy of an Annual Report for a publicly listed company. You are to consider that your audit firm has recently successfully tendered for the engagement. The manager on the potential engagement has asked you, the audit senior, to commence planning the engagement for the coming period. As this is the first time your firm will be involved with this client, you have no previous work-papers to rely on.

(a) Gather industry data and other information about this client. Compare the client's data to the information obtained.

(b) Undertake analytical procedures for planning purposes (simple comparisons and ratios).

(c) Based on work performed in (a) and (b) detail potential inherent and/or business risks for the audit, explaining why they constitute an audit risk.

Your analysis in (a) should cover:

- the regulatory framework, if applicable surrounding your potential client
- Corporate Governance issues eg. disclosure of audit committees, interlocking directorships
- recent 'press' coverage if appropriate about your potential client
- environmental issues
- any other areas for deem of interest/relevant to understanding the business and assessing risks.

Each group is to present their findings to the workshop. A written submission must also accompany the presentation.

Marks will be awarded based on a presentation and level of depth of analysis.